Don’t forget to download a copy of the Homework Cover Sheet. Mark the location where you handed in your work.

Homework #7; Chapter 5. This homework has three parts (A, B, C). Each part will be separately graded.

Part A, HW #7, Ch #5.

Go to technical problems, page 110. Do the following problems. Show your work.

1a.
1b.

Part B, HW#7, Ch #5.

Go to empirical problems, page 110. Do the following problems. Show your work.

1.
2a; 2b; 2c (optional)

Part C, HW#7, Ch#5.

MC Quiz, 25 questions, use red score sheet handed out in class or available outside Heady 281 or Heady 67.

We will use the following grading scale.

A = 20+
B = 19, 18, 17
C = 16, 15, 14
D = 13, 12, 11
F = < 11

1. The level of GDP that corresponds to full employment in the labor market is called
   A) potential GDP
   B) real GDP
   C) nominal GDP
   D) natural GDP
   E) structural GDP

2. Most economists prior to Keynes thought
   A) unemployment could be eliminated by an active fiscal policy
   B) the economy always adjusted to full employment
   C) the economy always adjusted to a natural rate of inflation
   D) monetary policy could eliminate the business cycle
   E) government intervention was needed to avoid persistent unemployment
3. The Keynesian AS-curve differs from the classical AS-curve, since Keynes
A) thought that labor markets worked smoothly to always establish full employment
B) thought that nominal wages were flexible even when there was unemployment
C) thought that nominal wages were rigid even when there was unemployment
D) described the AS-curve as completely vertical
E) assumed that firms tried to exploit the work force by paying them substandard wages

4. The Keynesian aggregate supply curve implies that
A) the economy is always at the full-employment level of output
B) the price level is unaffected by current levels of GDP
C) wages are perfectly flexible
D) real money balances decrease as the AD-curve shifts to the right
E) an increase in nominal money supply will not affect the level of real GDP

5. The AS-curve is horizontal or very flat if
A) additional resources (especially labor) can be hired to produce additional output with little or no increase in existing prices
B) wages fall rapidly with an increase in unemployment, reducing spending and income to restore equilibrium
C) firms lower prices not only to stimulate sales during a recession but also to avoid a loss in profit, thus flattening out the AS-curve
D) the nominal wage adjustment occurs fairly rapidly
E) nominal wages and prices always change proportionally, leaving the real wage rate unchanged

6. Given the Keynesian AS-curve, expansionary monetary policy will
A) increase the level of output but leave the price level unchanged
B) increase the price level but leave the level of output unchanged
C) increase both the level of output and the price level
D) leave the level of output and the price level unchanged
E) increase the level of output but decrease the price level

7. The AD-AS diagram used in this chapter
A) is unrelated to the demand and supply diagram used in microeconomics
B) uses the cost of a basket of all goods and services we buy as the "price"
C) uses an AS-curve that is relatively more price elastic in the medium run than in the long run
D) uses an AS-curve that is vertical in the long run and horizontal in the very short run
E) all of the above

8. Which of the following is NOT reflected in a shift of the AD-curve?
A) a change in real money balances due to a change in the price level
B) a change in real money balances due to a change in nominal money supply
C) a change in government transfer payments
D) a change in the confidence of consumers and businesses
E) all of the above will shift the AD-curve
9. The natural rate of unemployment is
   A) always zero
   B) the unemployment rate that exists when inflation is zero
   C) the unemployment rate that exists when output is assumed to be at its full-employment level
   D) the unemployment rate that exists above frictional unemployment
   E) none of the above

10. Frictional unemployment is defined as
    A) all unemployment above the natural rate
    B) unemployment that is cyclical in nature
    C) the natural unemployment rate minus cyclical unemployment
    D) unemployment resulting from people shifting between jobs and looking for new jobs
    E) any unemployment that is below 4%

11. A shift of the AD-curve to the left can be caused by
    A) a decrease in taxes
    B) an increase in business and consumer confidence
    C) an increase in nominal money supply
    D) a decrease in government transfer payments
    E) a decrease in money demand

12. The AD-curve has a negative slope since
    A) firms only produce more if it is cheaper to do so
    B) a price decrease increases real money balances, leading to lower interest rates and increased spending
    C) lower prices mean higher real wages so consumers can afford to buy more goods and services
    D) lower prices drive up the demand for goods since buyers fear future market shortages
    E) lower prices increase consumer confidence, which encourages spending

13. An increase in aggregate demand can be caused by
    A) an increase in government expenditures
    B) an increase in nominal money supply
    C) a decrease in taxes
    D) an increase in business and consumer confidence
    E) all of the above

14. In the medium run, if government purchases are increased and nominal money supply is decreased, we can expect that
    A) aggregate demand and prices will increase but interest rates will not change
    B) aggregate demand, prices, and the interest rate will all decrease
    C) aggregate demand and interest rates will decrease but prices will increase
    D) the AD-curve will shift to the right and the AS-curve will shift to the left
    E) the interest rate will increase while aggregate demand and prices may increase, decrease, or remain the same
15. To maintain a fixed level of aggregate demand, the Fed would have to respond to a tax increase by
A) increasing reserve requirements
B) increasing the discount rate
C) buying bonds in the open market
D) selling bonds in the open market
E) urging banks to ration credit

16. In a normal AD-AS diagram with an upward-sloping AS-curve, if a tax decrease is combined with money expansion,
A) output will remain relatively unaffected but interest rates will decrease
B) output will remain relatively unaffected but interest rates will definitely increase
C) aggregate demand, the price level, and output will all decrease
D) aggregate demand, the price level, and output will all increase
E) the price level will increase but we can't say what will happen to output or interest rates

17. Expansionary monetary policy will increase nominal GDP
A) in the Keynesian case
B) in the classical case
C) in the medium run
D) all of the above
E) only A) and C)

18. In the classical supply curve case, monetary expansion will
A) increase P, lower i, and leave Y unchanged
B) increase Y, lower i, and leave P unchanged
C) leave Y and i unchanged but increase P
D) leave Y, i, and P unchanged
E) increase Y, i, and P

19. Assume investment is very interest sensitive and wages always adjust immediately to maintain an equilibrium in the labor market. Which of the following would be most effective in significantly increasing the level of output?
A) expansionary fiscal policy
B) expansionary monetary policy
C) increased government spending accompanied by monetary expansion
D) an increase in government transfer payments
E) none of the above policies would succeed in significantly increasing the level of output

20. Fiscal policy will affect prices and interest rates but not the level of output if
A) the AD-curve is vertical
B) the AS-curve is vertical
C) the AD-curve is horizontal
D) the AS-curve is horizontal
E) both A) or D)
21. In the AD-AS model, fiscal or monetary policy cannot affect the level of output in
   A) the medium run and the long run
   B) the medium run and the short run
   C) the short run only
   D) the medium run only
   E) the long run only

22. According to the quantity theory of money, velocity can be expressed as
   A) \( V = \frac{M}{PY} \)
   B) \( V = \frac{MY}{P} \)
   C) \( V = \frac{PY}{M} \)
   D) \( V = MY \)
   E) none of the above

23. If nominal GDP is $10,400 billion and nominal money supply is $5,200 billion, then
   the income velocity of money is
   A) \( V = 5,200 \)
   B) \( V = 0.5 \)
   C) \( V = 2 \)
   D) \( V \) can only be determined if the price level is known
   E) none of the above

24. If restrictive monetary policy leads to a lower price level but leaves output, employment, and interest rates unchanged, then
   A) real money balances must be unchanged
   B) it must have been accompanied by expansionary fiscal policy
   C) it must have been accompanied by restrictive fiscal policy
   D) money is said to be neutral
   E) both A) and D)

25. A decrease in the income tax rate will cause
   A) a fairly large increase in aggregate demand
   B) a fairly small increase in aggregate supply
   C) an increase in the price level
   D) all of the above
   E) none of the above