Sample Multiple-Choice Questions

Circle the letter of each correct answer.

1. Which of the following monetary and fiscal policy combinations would definitely cause a decrease in aggregate demand in the short run?

	Discount Rate	Government Spending	Open Market Operations
(A)	Decrease	Decrease	Buy bonds
(B)	Decrease	Increase	Buy bonds
(C)	Decrease	Increase	Sell bonds
(D)	Increase	Decrease	Sell bonds
(E)	Increase	Decrease	Buy bonds

2. Which of the following monetary and fiscal policy combinations would definitely cause an increase in aggregate demand?

	Reserve Requirements	Taxes	Government Spending
(A)	Decrease	Decrease	Decrease
(B)	Decrease	Decrease	Increase
(C)	Increase	Decrease	Increase
(D)	Increase	Increase	Decrease
(E)	Increase	Decrease	Decrease

3. Assume that the economy has a low unemployment rate and a high rate of inflation. Which of the following sets of monetary and fiscal policies would be consistent and designed to reduce the rate of inflation?

	Discount Rate	Government Spending	Open Market Operations
(A)	Increase	Increase	Buy bonds
(B)	Increase	Increase	Sell bonds
(C)	Increase	Decrease	Sell bonds
(D)	Increase	Decrease	Buy bonds
(E)	Decrease	Decrease	Buy bonds

4. To counter the crowding-out effect on interest rates caused by the government's deficit spending, the Federal Reserve can
   (A) cut tax rates.
   (B) increase tax rates.
   (C) increase the discount rate.
   (D) increase the reserve requirement.
   (E) buy bonds through open market operations.

5. Which of the following would best portray long-run economic growth?
   (A) A leftward shift of the aggregate demand curve
   (B) A rightward shift of the aggregate demand curve
   (C) A leftward shift of the production possibilities curve
   (D) A leftward shift of the long-run aggregate supply curve
   (E) A rightward shift of the long-run aggregate supply curve

6. An increase in which of the following would be most likely to increase long-run economic growth?
   (A) Taxes
   (B) Interest rates
   (C) Consumer spending
   (D) Productivity
   (E) Value of domestic currency

7. An expansionary fiscal policy will result in an increase in the interest rate unless which of the following occurs?
   (A) Taxes are cut instead of government expenditures being increased.
   (B) The money supply is increased.
   (C) Wage and price controls are imposed.
   (D) The exchange rate is fixed.
   (E) The Federal Reserve sells government bonds.

8. An expansionary monetary policy may promote long-run growth if it leads to
   (A) an increase in consumption.
   (B) an increase in investment.
   (C) an increase in government spending.
   (D) a constant level of government spending.
   (E) a decrease in net exports.

9. If the government increases spending without a tax increase and simultaneously no monetary-policy changes are made, which of the following would most likely occur?
   (A) Income would not rise at all because no new money is available for increased consumer spending.
   (B) The rise in income may be greater than the multiplier would predict because the higher interest rates will stimulate investment spending.
   (C) The rise in income may be smaller than the multiplier would predict because the higher interest rates will crowd-out private investment spending.
   (D) Income will go up by exactly the amount of the new government spending since this acts as a direct injection to the income stream.
   (E) Income will not go up unless taxes are cut as well.

10. If Congress and the Federal Reserve both wished to encourage growth of productive capacity in an economy already close to full employment, it would be most appropriate to
   (A) increase interest rates by buying bonds on the open market.
   (B) use a tight money policy to decrease government spending.
   (C) reduce taxes on consumption, increase income taxes and increase government transfer payments.
   (D) reduce interest rates by engaging in open-market operations and raise taxes on personal income.
   (E) increase capital gains taxes and decrease the money supply.

11. "Sales of durable goods last month were surprisingly high. Recent price increases have pushed the CPI to more than a 7 percent increase for the past year. On average, the producer price index has gained 1 percent each month during the last year. Wage rates have increased throughout the economy, but productivity gains are minimal. The unemployment rate, however, is steady at 6 percent." Which of the following changes in the tax rate, government spending and the federal funds rate are most appropriate given the state of the economy?

	Tax Rate	Government Spending	Federal Funds Rate
(A)	Increase	Increase	Increase
(B)	Increase	Decrease	Increase
(C)	Increase	Decrease	Decrease
(D)	Decrease	Increase	Decrease
(E)	Decrease	Decrease	Decrease

12. When the unemployment rate is 10 percent and the CPI is rising at 2 percent, the federal government cuts taxes and increases government spending. If the Federal Reserve buys bonds on the open market, interest rates, investment, real gross domestic product (GDP) and the price level are most likely to change in which of the following ways?

	Interest Rates	Investment	Real GDP	Price Level
(A)	Decrease	Decrease	Increase	Increase
(B)	Decrease	Increase	Increase	Increase
(C)	Increase	Decrease	Decrease	Decrease
(D)	Increase	Decrease	Increase	Increase
(E)	Increase	Increase	Increase	Increase

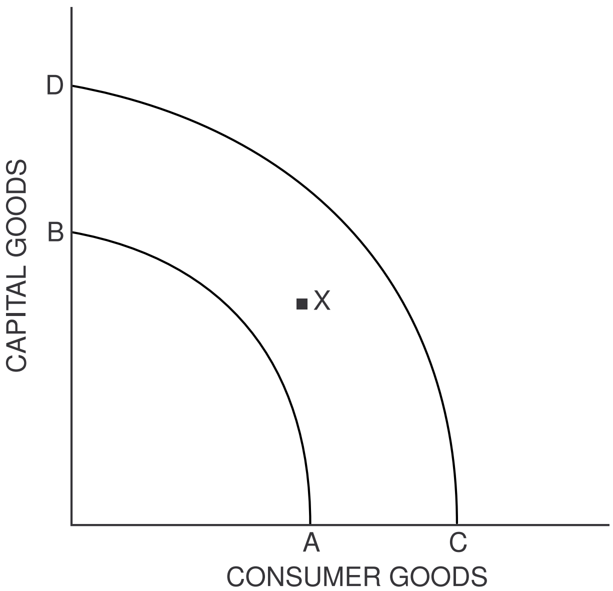
13. When the unemployment rate is 4.5 percent and the CPI is rising at a 12 percent rate, the federal government raises taxes and cuts government spending. If the Federal Reserve sells bonds on the open market, interest rates, investment, real gross domestic product (GDP) and the price level are most likely to change in which of the following ways?

	Interest Rates	Investment	Real GDP	Price Level
(A)	Decrease	Decrease	Increase	Increase
(B)	Increase	Decrease	Increase	Increase
(C)	Increase	Decrease	Decrease	Decrease
(D)	Decrease	Increase	Increase	Increase
(E)	Decrease	Decrease	Increase	Increase

14. The statement that "the cost of reducing the rate of inflation is that people must lose their jobs" indicates that the speaker believes in a relationship that is usually depicted by which of the following?
(A) The short-run Phillips curve
(B) The liquidity trap
(C) The production function
(D) The quantity theory of money
(E) The spending multiplier

15. In the short run, combining an expansionary fiscal policy with a tight money policy is most likely to cause
(A) real GDP to increase.
(B) real GDP to decrease.
(C) interest rates to fall.
(D) interest rates to rise.
(E) the federal budget deficit to decrease.

Use the following graph to answer questions 16 and 17.



16. If the production possibilities curve of an economy shifts from AB to CD, it most likely is caused by
    (A) full employment of resources.
    (B) technology advances.
    (C) allocative efficiency.
    (D) a decrease in the price level.
    (E) productive efficiency.

17. If the production possibilities curve of an economy is CD and the economy is producing at Point X, which of the following is true?
    (A) Technology advances changed industrial production.
    (B) The quality and quantity of productive resources increased.
    (C) Improvements in productivity led to increased output.
    (D) Resources are not fully employed.
    (E) Aggregate demand decreased.

18. The theory of rational expectations implies which of the following?
    (A) Unemployment and the rate of inflation are directly related.
    (B) An increase in the money supply will have no effect on price level.
    (C) Attempts to decrease unemployment below the natural rate lead to depression.
    (D) Attempts to decrease unemployment through government policy will be thwarted by people's reactions.
    (E) Government policies work only if the money supply increases by 10 percent.

19. The Phillips curve shows the relationship between
    (A) unemployment and economic growth.
    (B) unemployment and full employment.
    (C) inflation and unemployment.
    (D) inflation and investment.
    (E) inflation and real interest rates.

20. Which of the following explains why inflation can increase?
    I. Increase in aggregate demand
    II. Decrease in aggregate supply
    III. Increase in rate of money supply growth
    (A) I only
    (B) II only
    (C) III only
    (D) I and II only
    (E) I, II and III