Study guide 2

The most important determinant of consumer spending is:

> the level of income.

With a marginal propensity to save of .4, the marginal propensity to consume will be:

> 1.0 minus .4.

As disposable income goes up, the:

> average propensity to consume falls.

The relationship between consumption and disposable income is such that:

> a direct and relatively stable relationship exists between consumption and income.

If the MPC is .8 and disposable income is $200, then:

> consumption and saving cannot be determined from the information given.

John Maynard Keynes created the aggregate expenditures model based primarily on what historical event?

> Great Depression.

The aggregate expenditures model is built upon which of the following assumptions?

> Prices are fixed.

In the aggregate expenditures model, it is assumed that investment:

> does not change when real GDP changes.

All else equal, a large decline in the real interest rate will shift the:

> investment schedule upward.

Refer to the diagrams. Curve A

> is an investment demand curve and curve B is an investment schedule.

Other things equal, the slope of the aggregate expenditures schedule will increase as a result of:

> an increase in the MPC.

Study guide 2 (cont)

In a private closed economy, when aggregate expenditures exceed GDP:

> business inventories will fall.

The aggregate demand curve:

> shows the amount of real output that will be purchased at each possible price level.

The interest-rate effect suggests that:

> an increase in the price level will increase the demand for money, increase interest rates, and decrease consumption and investment spending.

The real-balances effect indicates that:

> a higher price level will decrease the real value of many financial assets and therefore reduce spending.

The foreign purchases effect suggests that a decrease in the U.S. price level relative to other countries will:

> increase U.S. exports and decrease U.S. imports.

If the price level increases in the United States relative to foreign countries, then American consumers will purchase more foreign goods and fewer U.S. goods. This statement describes:

> the foreign purchases effect.

Which of the following is incorrect?

> When the price level increases, real balances increase and businesses and households find themselves wealthier and therefore increase their spending.

The group of three economists appointed by the president to provide fiscal policy recommendations is the:

> Council of Economic Advisers.

Countercyclical discretionary fiscal policy calls for:

> inflation

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Study guide

Fiscal policy refers to the:

> deliberate changes in government spending and taxes to stabilize domestic output, employment, and the price level.

Discretionary fiscal policy is so named because it:

> involves specific changes in T and G undertaken expressly for stabilization at the option of Congress.

An economist who favors smaller government would recommend:

> tax cuts during recession and reductions in government spending during inflation.

Discretionary fiscal policy will stabilize the economy most when:

> deficits are incurred during recessions and surpluses during inflations.

An appropriate fiscal policy for a severe recession is:

> a decrease in tax rates.

An appropriate fiscal policy for severe demand-pull inflation is:

> a tax rate increase.

In an aggregate demand-aggregate supply diagram, equal decreases in government spending and taxes will:

> shift the AD curve to the left.

Which of the following represents the most expansionary fiscal policy?

> A $10 billion increase in government spending.

A contractionary fiscal policy is shown as a:

> leftward shift in the economy's aggregate demand curve.

A tax reduction of a specific amount will be more expansionary the:

> larger is the economy's MPC.

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Study guide (cont)

Money functions as:

> all of these.

If you are estimating your total expenses for school next semester, you are using money primarily as:

> a unit of account.

If you write a check on a bank to purchase a used Honda Civic, you are using money primarily as:

> a medium of exchange.

Purchasing common stock by writing a check best exemplifies money serving as a:

> medium of exchange.

When economists say that money serves as a unit of account, they mean that it is:

> a monetary unit for measuring and comparing the relative values of goods.

The paper money used in the United States is:

> Federal Reserve Notes.

In the United States, the money supply (M1) is comprised of:

> coins, paper currency, and checkable deposits.

Checkable deposits are classified as money because:

> they can be readily used in purchasing goods and paying debts.

To say that coins are "token money" means that:

> their face value is greater than their intrinsic value.

In defining money as M1, economists exclude time deposits because:

> they are not directly or immediately a medium of exchange.

Currency in circulation is part of:

> both M1 and M2.

The amount of money reported as M2:

> is larger than the amount reported as M1.

Study guide (cont)

Paper money (currency) in the United States is issued by the:

> Federal Reserve Banks.

"Near-monies" are included in:

> M2 only.

Most modern banking systems are based on:

> fractional reserves.

A fractional reserve banking system:

> is susceptible to bank "panics" or "runs."

Bank panics:

> are a risk of fractional reserve banking but are unlikely when banks are highly regulated and lend prudently.

The claims of the owners of a firm against the firm's assets are called:

> net worth.

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Study guid

What are the three basic functions of money? Describe how rapid inflation can undermine money's ability to perform each of the three functions.

> a) Money is a medium of exchange, a unit of account, and a store of value. b) People will only accept money in exchange for the goods and services for the work they perform. Rapid inflation decreases the value of money and makes it impossible to adjust prices instantaneously. As a store of value and using the rule of 70, one can estimate how long it takes a dollar savings to lose half the purchasing power.

Study guid (cont)

What “backs” the money supply in the United States? What determines the value (domestic purchasing power) of money? How does the purchasing power of money relate to the price level? Who in the United States is responsible for maintaining money's purchasing power?

> a) Nothing backs the money supply, except for the people's trust in the government. b) Money has value only because people use it as a medium of exchange. c) The value of money is inversely related to price levels. d) The Board of Governors is responsible

Does leverage increase the total size of the gain or loss from an investment, or just the percentage rate of return on the part of the investment amount that was not borrowed? How would lowering leverage make the financial system more stable?

> a) Leverage increases the total gain or loss from investment. Lowering leverage lowers the risk.

What is the basic objective of monetary policy? What are the major strengths of monetary policy? Why is monetary policy easier to conduct than fiscal policy?

> a) The basic objective is to assist the economy is achieving a full employment, non-inflationary level of output. b) Monetary policy takes affect much quicker than fiscal.

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Study guid (cont)

Explain the links between changes in the nation’s money supply, the interest rate, investment spending, aggregate demand, real GDP, and the price level.

> a) Money supply has an inverse relationship with interest rates. If the Feds pursue an anti –inflationary policy than it would decrease the money supply and increase interest rates. High interest rates decrease spending which moderates aggregate spending and inflationary pressure. Feds would need to put in an expansionary policy to increase money supply to stimulate the economy. The lower the prices the higher the aggregate demand, which is a function of GDP. This all affects the consumers reaction to spending or saving.

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