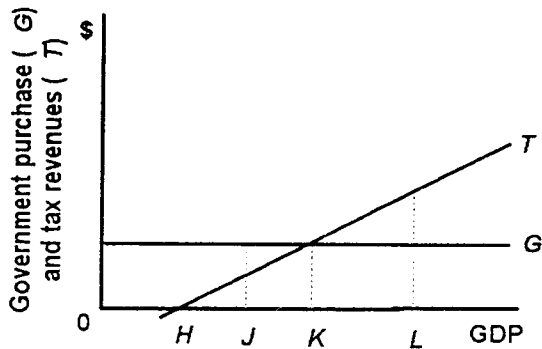


EXAM 2
FALL 1999

Use the following to answer question 13:



- ___ 13. Refer to the above diagram. Automatic stability in this economy could be decreased by:
- shifting the government expenditure line upward but parallel to its current position.
 - changing the tax system so that the tax line is shifted upward but parallel to its present position.
 - changing the government expenditures line so that it has a negative slope.
 - changing the tax system so that the tax line has a flatter slope.
- ___ 14. A strict balanced-budget amendment that would require the Federal government to balance its budget during a recession would be:
- expansionary and worsen the effects of the recession.
 - contractionary and worsen the effects of the recession.
 - contractionary and counter the effects of the recession.
 - expansionary and counter the effects of the recession.
- ___ 15. Proponents of the notion of a "political business cycle" suggest that:
- the full-employment budget is a better indicator of the state of the economy than the actual budget.
 - cyclical swings in the economy are produced by the inherent instability found in capitalist economies.
 - a possible cause of economic fluctuations is due to the use of fiscal policy for political purposes.
 - there is a tradeoff among goals that tends to make the economic policies of state and local governments procyclical.
- ___ 16. Which definition(s) of the money supply include(s) only items which are directly and immediately usable as a medium of exchange?
- $M1$
 - $M2$
 - $M3$
 - $M1$ and $M2$

13. D

14. B

15. C

16. A

Multiple Choice (3 Points each):

- _____ 1. The transactions demand for money will shift to the:
- A) right when the interest rate increases.
 - B) left when nominal GDP decreases.
 - C) right when nominal GDP decreases.
 - D) left when nominal GDP increases.
- _____ 2. The interest rate will fall when the:
- A) quantity of money demanded exceeds the quantity of money supplied.
 - B) supply of money decreases.
 - C) quantity of money supplied exceeds the quantity of money demanded.
 - D) demand for money increases.
- _____ 3. Which group is responsible for the policy of the Federal Reserve on purchasing and selling government securities?
- A) Thrift Advisory Council
 - B) Federal Open Market Committee
 - C) Federal Advisory Council
 - D) Office of Management and Budget
- _____ 4. A wealthy executive is holding money for a good time to invest in the stock market. This action would be an example of the:
- A) transactions demand for money.
 - B) asset demand for money.
 - C) use of money as a medium of exchange.
 - D) creation of fiat money.
- _____ 5. The multiple by which the commercial banking system can expand the supply of money is equal to:
- A) its excess reserves.
 - B) the ratio of fixed to liquid assets.
 - C) the reciprocal of the discount rate.
 - D) the reciprocal of the reserve ratio.
- _____ 6. If borrowers request that part of their loans be paid in currency, this would:
- A) increase the excess reserves of banks.
 - B) increase the maximum demand-deposit creation of the banking system.
 - C) decrease the reserve ratio of the banking system.
 - D) decrease the lending potential of the banking system.

- ___ 7. The price of a bond with no expiration date is originally \$5,000 and it pays an annual interest payment of \$500. If the price of the bond falls to \$4,000, then the effective interest rate yield to a new buyer of the bond is:
- A) 12.5 percent.
 - B) 11.0 percent.
 - C) 9.0 percent.
 - D) 14.4 percent.
- ___ 8. The commercial banking system can lend by a multiple of its excess reserves primarily because:
- A) its reserves are highly liquid assets.
 - B) its reserves are fractional.
 - C) it loses reserves when it extends credit.
 - D) its reserves are on deposit with the Federal Reserve Banks.
- ___ 9. Monetary policy will be most powerful when the investment-demand curve is relatively:
- A) steep, and the demand for money curve is also relatively steep.
 - B) flat, and the demand for money curve is relatively steep.
 - C) flat, and the demand for money curve is also relatively flat.
 - D) steep, and the demand for money curve is relatively flat.
- ___ 10. Which is considered a *strength* of monetary policy compared to fiscal policy?
- A) the flatness of the money demand curve
 - B) its cyclical asymmetry
 - C) the steepness of the investment demand curve
 - D) its protection from political pressure
- ___ 11. When the Federal Reserve takes action to stimulate the economy by lowering interest rates, the direction of its policy tends to be:
- A) partly offset because it decreases the income of those who hold interest-bearing accounts at banks and other financial institutions.
 - B) reinforced because it increases the net export effect.
 - C) partly offset because of increases in the Federal budget deficit.
 - D) reinforced because it increases the income of those who hold interest-bearing accounts at banks and other financial institutions.

1. B 2. C 3. B 4. B 5. D
 6. D 7. A 8. B 9. B 10. D
 11. A or B

