1. In the sticky-price model, if no firms have flexible prices, the short-run aggregate supply schedule will:
   A) be vertical.          B) be steeper than it would be if some firms had flexible prices.
   C) slope upward to the right.       D) be horizontal.

2. Assume that an economy has the Phillips curve \( \pi = \pi_{-1} - 0.5(u - 0.06) \). Then the natural rate of unemployment is:
   A) 0.5.  B) 0.12.  C) 0.06.  D) 0.03.

3. Assume that an economy has the Phillips curve \( \pi = \pi_{-1} - 0.5(u - 0.06) \). How many percentage point-years of cyclical unemployment are needed to reduce inflation by 5 percentage points?
   A) 20  B) 10  C) 5  D) 2.5

4. The government can lower inflation with a low sacrifice ratio if the:
   A) money supply is reduced slowly.          B) public has adaptive expectations.
   C) short-run aggregate supply schedule is relatively flat.       D) public believes that policymakers are committed to reducing inflation.

5. If only unanticipated changes in the money supply affect real GDP, the public has rational expectations, and everyone has the same information about the state of the economy, then:
   A) monetary policy can be used to systematically stabilize output.
   B) monetary policy cannot be used to systematically stabilize output.
   C) a policy of keeping the money supply constant is optimal.
   D) a policy of adjusting the money supply in response to the state of the economy is optimal.
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6. Assume that an economy has the usual type of Phillips curve except that the natural rate of unemployment in an economy is given by an average of the unemployment rates in the last two years. Then, there is:
A) a long-run tradeoff between inflation and unemployment.
B) no long-run tradeoff between inflation and unemployment.
C) no short-run tradeoff between inflation and unemployment.
D) a sacrifice ratio that is large but not infinite.

7. Assume that the Democrats always had a policy of high money growth whereas the Republicans followed a policy of low money growth, and the economy had a standard Phillips curve. Then, if the two parties took regular terms in office:
A) there would be no political business cycle, but inflation would be higher under the Democrats.
B) there would be no political business cycle, but inflation would be higher under the Republicans.
C) unemployment would be lower under the Democrats but inflation would be higher.
D) both unemployment and inflation would be higher under the Democrats.

8. If a city passes laws limiting rents on apartments, but promises to exempt buildings not yet built:
A) construction of new buildings will not be discouraged.
B) construction of new buildings may be discouraged.
C) builders will not expect the city to renege on its promise.
D) the city will have no incentive to renege on its promise.
6. Assume that an economy has the usual type of Phillips curve except that the natural rate of unemployment in an economy is given by an average of the unemployment rates in the last two years. Then, there is:

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12. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern but are not altruistically linked:
A) both the young and the old will consume more.
B) there will be a net increase in overall consumption.
C) there will be a net decrease in overall consumption.
D) there will be no change in overall consumption.

13. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern and are altruistically linked:
A) both the young and the old will consume more.
B) there will be a net increase in overall consumption.
C) there will be a net decrease in overall consumption.
D) there will be no change in overall consumption.

15. If a consumer is a borrower in period one and the interest rate rises, the:
A) income and substitution effects both tend to make consumption higher in the first period.
B) income and substitution effects both tend to make consumption lower in the first period.
C) income effect tends to make consumption higher in the first period and the substitution effect tends to make it lower.
D) substitution effect tends to make consumption higher in the first period and the income effect tends to make it lower.

16. In the dynamic model of aggregate demand and aggregate supply, if the central bank chooses a large value of $\Theta_{p}$, the responsiveness of nominal interest rates to inflation, and a small value of $\Theta_{y}$, the responsiveness of nominal interest rates to output, then the DAD curve will be relatively _______ and supply shocks will have relatively _______ impacts on inflation than output.
A) flat; larger B) flat; smaller C) steep; larger D) steep; smaller
12. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern but are not altruistically linked:
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16. In the dynamic model of aggregate demand and aggregate supply, if the central bank chooses a large value of $\Theta_\pi$, the responsiveness of nominal interest rates to inflation, and a small value of $\Theta_\pi$, the responsiveness of nominal interest rates to output, then the DAD curve will be relatively _______ and supply shocks will have relatively _______ impacts on inflation than output.
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16. In the dynamic model of aggregate demand and aggregate supply, if the central bank chooses a large value of $\Theta_\pi$, the responsiveness of nominal interest rates to inflation, and a small value of $\Theta_y$, the responsiveness of nominal interest rates to output, then the DAD curve will be relatively ______ and supply shocks will have relatively ______ impacts on inflation than output.
A) flat; larger        B) flat; smaller        C) steep; larger        D) steep; smaller
12. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern but are not altruistically linked:
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16. In the dynamic model of aggregate demand and aggregate supply, if the central bank chooses a large value of Θπ, the responsiveness of nominal interest rates to inflation, and a small value of Θy, the responsiveness of nominal interest rates to output, then the DAD curve will be relatively _____ and supply shocks will have relatively _____ impacts on inflation than output.
A) flat; larger              B) flat; smaller            C) steep; larger              D) steep; smaller
17. A central bank that chooses a small value of $\Theta_\pi$, the responsiveness of nominal interest rates to inflation, and a large value of $\Theta_\gamma$, the responsiveness of nominal interest rates to output, is choosing to obtain less ______ at the expense of more ______.
A) inflation; output  B) output; inflation
C) inflation variability; output variability  D) output variability; inflation variability

18. A central bank that chooses a large value of $\Theta_\pi$, the responsiveness of nominal interest rates to inflation, and a small value of $\Theta_\gamma$, the responsiveness of nominal interest rates to output, is choosing to obtain less ______ at the expense of more ______.
A) inflation; output  B) output; inflation
C) inflation variability; output variability  D) output variability; inflation variability

19. Beginning at long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, if the central bank permanently reduces its inflation target, then in the initial period the DAS curve ______ and the DAD curve ______.
A) shifts upward; shifts rightward  B) does not shift; shifts leftward
C) does not shift; does not shift  D) shifts downward; shifts leftward

20. Beginning at long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, if the central bank permanently reduces its inflation target, then in the initial period of the change, output ______ and inflation ______.
A) increases; increases  B) increases; decreases
C) decreases; decreases  D) decreases; increases
17. A central bank that chooses a small value of $\Theta_{\pi}$, the responsiveness of nominal interest rates to inflation, and a large value of $\Theta_{y}$ the responsiveness of nominal interest rates to output, is choosing to obtain less ______ at the expense of more ______.
A) inflation; output         B) output; inflation
C) inflation variability; output variability  D) output variability; inflation variability

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A) inflation; output         B) output; inflation
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A) increases; increases         B) increases; decreases
C) decreases; decreases        D) decreases; increases
17. A central bank that chooses a small value of $\theta_r$, the responsiveness of nominal interest rates to inflation, and a large value of $\theta_y$, the responsiveness of nominal interest rates to output, is choosing to obtain less _____ at the expense of more _____.
A) inflation; output  B) output; inflation
C) inflation variability; output variability  D) output variability; inflation variability

18. A central bank that chooses a large value of $\theta_r$, the responsiveness of nominal interest rates to inflation, and a small value of $\theta_y$, the responsiveness of nominal interest rates to output, is choosing to obtain less _____ at the expense of more _____.
A) inflation; output  B) output; inflation
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A) inflation; output  B) output; inflation
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A) inflation; output          B) output; inflation
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A) increases; increases          B) increases; decreases
C) decreases; decreases          D) decreases; increases
21. Beginning at long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, in the periods after a permanent reduction in the central bank's inflation target, the DAS shifts downward because:
A) the natural level of output increases in response to the lower rates of inflation.
B) the deviation of output from the natural level of output increases as a result of lower rates of inflation.
C) lower rates of inflation generate negative supply shocks.
D) expectations of inflation decrease as a result of lower inflation in previous periods.

22. Starting from long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, a permanent reduction in the central bank's inflation target causes the nominal interest rate to:
A) decline continuously until reaching a lower level in the long run.
B) increase initially and then decline until reaching a lower level in the long run.
C) decline immediately to a lower level in the long run.
D) fall below and then rise continuously to a long-run level below the initial level.

23. A binding borrowing constraint will ______ the potency of an announced future tax cut to influence aggregate demand but will ______ the potency of a temporary tax cut.
A) not affect; increase
B) increase; not affect
C) decrease; increase
D) increase; decrease
21. Beginning at long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, in the periods after a permanent reduction in the central bank's inflation target, the DAS shifts downward because:
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23. A binding borrowing constraint will ______ the potency of an announced future tax cut to influence aggregate demand but will ______ the potency of a temporary tax cut.
A) not affect; increase
B) increase; not affect
C) decrease; increase
D) increase; decrease
24. If consumers want consumption to be as constant as possible over their life cycles and income rises gradually over their periods of employment, then if borrowing constraints prevent their wealth from falling below zero:
A) they can achieve constant consumption by borrowing.
B) their consumption in retirement will be higher than it was in earlier parts of the life cycle.
C) their consumption during their younger years will be lower than it will be in later parts of the life cycle.
D) their consumption during their later working years will be higher than it was or will be in other parts of the life cycle.

25. The life-cycle model predicts that if the proportion of the population that is elderly increases over the next 20 years, then the national saving rate ______ over the next 20 years.
A) will increase
B) will remain unchanged
C) will decrease
D) may first increase and then decrease
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