12.1 Unemployment and Inflation: Is There a Trade-off?

2) Phillips’s research looked at British data on
   A) unemployment and inflation.
   B) unemployment and nominal wage growth.
   C) inflation and nominal wage growth.
   D) unemployment and output.
Answer: B
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

3) The negative relationship between unemployment and inflation is known as the
   A) aggregate supply curve.
   B) aggregate demand curve.
   C) Phillips curve.
   D) efficiency wage line.
Answer: C
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

4) The Phillips curve appeared to fit the data well for the United States in the
   A) 1960s.
   B) 1970s.
   C) 1980s.
   D) 1990s.
Answer: A
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

6) Milton Friedman and Edmund Phelps questioned
   A) the use of expectations in the Phillips curve.
   B) the stability of the relationship between inflation and unemployment.
   C) the existence of a natural rate of unemployment.
   D) the existence of a full-employment level of output.
Answer: B
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

7) In the extended classical model, an anticipated decrease in the money supply would cause output to
   _______ and the price level to _______ in the short run.
   A) increase; decrease
   B) increase; remain unchanged
   C) remain unchanged; increase
   D) remain unchanged; decrease
Answer: D
9) In the extended classical model, an unexpected decrease in aggregate demand would cause unanticipated inflation to be ________ and cyclical unemployment to be ________.
   A) positive; negative
   B) positive; positive
   C) negative; negative
   D) negative; positive
   Answer: D

13) In the expectations-augmented Phillips curve, \( \pi = \pi^e - 3(u - 0.06) \). When \( \pi = 0.06 \) and \( \pi^e = 0.03 \), the unemployment rate is
   A) 0.04.
   B) 0.05.
   C) 0.06.
   D) 0.07.
   Answer: B

16) The Phillips curve is the relation between inflation and unemployment that holds for a given natural rate of unemployment and a
   A) given rate of inflation.
   B) given expected rate of inflation.
   C) given level of unemployment.
   D) given expected level of unemployment.
   Answer: B

17) Suppose most people had anticipated that inflation would be 3% in the coming year because the Fed would increase the money supply by 3%. Instead, the Fed increases the money supply by 5%. In the short run, this would cause actual output to be ________ full-employment output and prices to increase by ________ 3%.
   A) above; more than
   B) above; less than
   C) below; more than
   D) below; less than
   Answer: A

18) An increase in the expected rate of inflation would
   A) shift the Phillips curve upward.
   B) shift the Phillips curve downward.
   C) shift the long-run Phillips curve to the right.
   D) shift the long-run Phillips curve to the left.
Answer: A
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

20) If the expected rate of inflation rose at the same time the natural rate of unemployment rose, the Phillips curve
   A) would shift down.
   B) would shift up.
   C) would not move.
   D) might shift up or down or not move, depending on which effect was larger.
Answer: B
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

21) A beneficial supply shock would cause
   A) a movement up the short-run Phillips curve.
   B) a movement down the short-run Phillips curve.
   C) the short-run Phillips curve to shift upward and to the right.
   D) the short-run Phillips curve to shift downward and to the left.
Answer: D
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

22) Classicalists argue that an adverse supply shock would
   A) raise neither the natural rate of unemployment nor the actual rate of unemployment.
   B) raise the actual rate of unemployment, but not the natural rate of unemployment.
   C) raise the natural rate of unemployment, but not the actual rate of unemployment.
   D) raise both the natural rate of unemployment and the actual rate of unemployment.
Answer: D
Diff: 2
Topic: Section 12.1
Question Status: Previous Edition

24) The Friedman–Phelps analysis shows that a negative relationship between inflation and unemployment holds
   A) even when expected inflation changes.
   B) even when the natural rate of unemployment changes.
   C) even if both the expected inflation rate and the natural rate of unemployment change.
   D) as long as the expected inflation rate and the natural rate of unemployment are approximately constant.
Answer: D
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

25) The Phillips curve shifted during the 1970s primarily because of
A) the two large oil price shocks.
B) the changing demographics of the population.
C) tight monetary policy.
D) easy fiscal policy.
Answer: A
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

26) Examining data on cyclical unemployment plotted against unanticipated inflation shows
   A) a positive relationship.
   B) a negative relationship.
   C) no significant relationship.
   D) a relationship only during the 1960s.
Answer: B
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

28) An analysis of the American economy since 1960 shows that there is a stable relationship between inflation and unemployment
   A) only in the short run.
   B) only in the long run.
   C) in neither the short run nor the long run.
   D) in both the short run and the long run.
Answer: A
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

29) Both classicals and Keynesians agree that policymakers
   A) can exploit the Phillips curve in the short run.
   B) cannot exploit the Phillips curve in the short run.
   C) can keep the unemployment rate permanently below the natural rate by permanently running a high rate of inflation.
   D) cannot keep the unemployment rate permanently below the natural rate by permanently running a high rate of inflation.
Answer: D
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

32) The long-run Phillips curve is
   A) vertical.
   B) horizontal.
   C) upward sloping.
   D) downward sloping.
Answer: A
Diff: 1
Topic: Section 12.1
Question Status: Previous Edition

33) The fact that the long-run Phillips curve is vertical implies that
   A) monetary policy can’t affect unemployment.
B) money is neutral in the long run.
C) there is a natural rate of inflation.
D) money can't affect inflation in the long run.
Answer: B

12.2 The Problem of Unemployment

1) When the economy goes into a recession, there's an increase in
   A) frictional unemployment.
   B) structural unemployment.
   C) cyclical unemployment.
   D) voluntary unemployment.
Answer: C

2) According to Okun's law, if full-employment output is $5000 billion, then each percentage point of unemployment sustained for one year reduces output by
   A) $50 billion.
   B) $100 billion.
   C) $150 billion.
   D) $200 billion.
Answer: B

   A) fell; rose
   B) fell; fell
   C) rose; fell
   D) rose; rose
Answer: C

5) One reason for the fall in the natural rate of unemployment since 1980 is
   A) changes in the demographic composition of the work force.
   B) the decline in inflation.
   C) increased competition from foreign workers.
   D) the depreciation of the dollar relative to foreign currencies.
Answer: A
6) The bulk of the decline in the natural rate of unemployment since 1980 is because of
   A) a decline in the inflation rate.
   B) a decline in the share of young workers in the labor force.
   C) increased competition from foreign workers.
   D) the depreciation of the dollar relative to foreign currencies.
   Answer: B
   Diff: 1
   Topic: Section 12.2
   Question Status: New

7) A difficulty faced by policymakers who wish to use the unemployment rate as a guide to whether the economy is weak or strong is that
   A) the natural rate of unemployment is hard to measure.
   B) the natural rate of unemployment almost never changes.
   C) policymakers must use data on output to tell whether the unemployment rate is too high or too low.
   D) the impact of policy on the economy is subject to long and variable lags.
   Answer: A
   Diff: 1
   Topic: Section 12.2
   Question Status: New

12.3 The Problem of Inflation

1) One cost of a perfectly anticipated inflation is that it
   A) transfers wealth from lenders to borrowers.
   B) transfers wealth from borrowers to lenders.
   C) increases menu costs.
   D) damages the role of prices as signals in the economy.
   Answer: C
   Diff: 1
   Topic: Section 12.3
   Question Status: New

2) The costs in time and effort incurred by people and firms who are trying to minimize their holdings of cash because of inflation are called
   A) menu costs.
   B) shoe leather costs.
   C) transactions costs.
   D) imperfect competition costs.
   Answer: B
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

3) Shoe leather costs are
   A) the costs in time and effort incurred by people and firms who are trying to minimize their holdings of cash because of inflation.
   B) the costs of changing prices, such as printing and mailing catalogues.
   C) the costs of the redistribution of wealth between lenders and borrowers.
   D) the costs associated with the confusion of prices as signals.
   Answer: A
   Diff: 1
   Topic: Section 12.3
5) One cost of an unanticipated inflation is that it
   A) transfers wealth from lenders to borrowers.
   B) transfers wealth from borrowers to lenders.
   C) decreases menu costs.
   D) increases the purchasing power of money.
   Answer: A
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

6) A COLA is
   A) a center of labor activity.
   B) a cost of living adjustment.
   C) a contract on long-term assets.
   D) a crisis of labor analysis.
   Answer: B
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

7) Hyperinflation occurs when
   A) the inflation rate rises.
   B) the inflation rate declines.
   C) the inflation rate is extremely high.
   D) the inflation rate is extremely low.
   Answer: C
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

8) The reduction of the inflation rate is called
   A) deflation.
   B) disinflation.
   C) unflation.
   D) reflation.
   Answer: B
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

10) A rapid and decisive reduction in the rate of growth of the money supply for the purpose of disinflation is called
   A) a salt water policy.
   B) a cold shower policy.
   C) gradualism.
   D) a cold turkey policy.
   Answer: D
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition
11) Keynesians prefer a disinflation policy of
   A) cold turkey.
   B) stabilization.
   C) gradualism.
   D) aggregate demand management.
   Answer: C
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

12) The sacrifice ratio is
   A) the amount of output lost when the inflation rate is reduced by one percentage point.
   B) the percentage reduction in inflation when output falls one percentage point below potential.
   C) the percentage change in employment when output declines by one percentage point.
   D) the number of percentage points that the unemployment rate rises when output declines by one percentage point.
   Answer: A
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

13) The amount of output lost when the inflation rate is reduced by one percentage point is called
   A) Okun's law.
   B) the sacrifice ratio.
   C) the Solow residual.
   D) Planck's constant.
   Answer: B
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

17) Countries in which wages adjust slowly to changes in the supply of and demand for labor are likely to have ______ sacrifice ratio.
   A) an infinite
   B) a high
   C) a low
   D) a zero
   Answer: B
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

19) Countries in which the government does not regulate the labor market are likely to have ______ sacrifice ratio.
   A) an infinite
   B) a high
   C) a low
   D) a negative
   Answer: C
   Diff: 1
   Topic: Section 12.3
   Question Status: Previous Edition

21) If a rapid disinflation has a lower sacrifice ratio than a slow disinflation, then reducing inflation is best
accomplished by

A) gradualism.
B) increasing money growth.
C) reducing interest rates.
D) a cold-turkey approach.

Answer: D

Diff: 1
Topic: Section 12.3
Question Status: Previous Edition

22) The main determinant of how quickly expected inflation adjusts to changes in monetary policy is

A) the slope of the Phillips curve.
B) the slope of the short-run aggregate supply curve.
C) the credibility of the central bank.
D) the degree of indexation in the economy.

Answer: C

Diff: 1
Topic: Section 12.3
Question Status: Previous Edition