Cycle Patterns, Impulses, and Mechanisms

Topic: Business Cycle Patterns
Skill: Recognition
1) A business cycle is
A) the downward trend in real GDP.
B) an irregular fluctuation in real GDP about its trend.
C) the trend increase in real GDP.
D) a periodic and predictable fluctuation in real GDP about its trend.
Answer: B

Topic: Business Cycle Patterns
Skill: Recognition
2) The precise dating of expansions, recessions and turning points in the business cycle is done by the
A) Bureau of Economic Activity.
B) National Bureau of Economic Research.
C) Conference Board.
D) Federal Reserve Board.
Answer: B

Topic: Business Cycle Patterns
Skill: Recognition
3) Since 1920, the average length of a recession has been about ____ and the average length of an expansion has been about ____.
A) 1 month; 4 years
B) 6 months; 3 years
C) 1 year; 4 years
D) 18 months; 3 years
Answer: C

Topic: Business Cycle Patterns
Skill: Recognition
4) According to the National Bureau of Economic Research, since 1920 the average length of recessions has been approximately
A) one year.
B) a year and a half.
C) two years.
D) four years.
Answer: A

Topic: Business Cycle Patterns
Skill: Recognition
5) Which of the following statements regarding business cycles is correct?
A) Expansions and recessions are about equal in length
B) The average length of a recession is just over one year
C) Between 1920 and 2003 there have been 10 recessions
D) In recent years, business cycle expansions have been getting shorter in duration
Answer: B

Topic: Business Cycle Patterns
Skill: Recognition
6) Measured by duration, the longest business cycle expansion occurred during the
A) 1930s.
B) 1960s.
C) 1980s.
D) 1990s.
Answer: D

* This is Chapter 30 in Economics.
7) Which one of the following statements concerning business cycles is NOT correct?
A) Between 1920 and 2003 there have been more than 10 business cycle expansions.
B) The longest business cycle expansion occurred after 1980.
C) Between 1920 and 2003 there have been more than 10 business cycle recessions.
D) The three longest business cycle recessions have all occurred since 1960.
Answer: D

8) The average length of recessions has been ____, while the average length of expansions has been ____.
A) 2 years; 2 years
B) 4 years; 1 year
C) 1 year; 4 years
D) 4 years; 4 years
Answer: C

9) Which of the following are true regarding business cycles?
I. The National Bureau of Economic Research (NBER) officially identifies phases of the business cycle.
II. Expansions last, on average, four years.
III. Recessions, on average, last for no more than six months.
A) I only.
B) I and II.
C) II and III.
D) I, II and III.
Answer: B

10) Since 1920, the average peak to trough decline in real GDP during a recession has been about
A) 1 percent.
B) 6 percent.
C) 10 percent.
D) 20 percent.
Answer: B

11) According to the National Bureau of Economic Research, since 1920 the average drop in real GDP during recessions has been approximately
A) 2 percent.
B) 6 percent.
C) 10 percent.
D) 13 percent.
Answer: B

12) During the Great Depression, real GDP fell by
A) 50 percent.
B) 33 percent.
C) 20 percent.
D) 13 percent.
Answer: B

13) Which of the following periods has shown the greatest variation of real GDP across recessions and expansions, that is, in which period were the business cycles the most severe?
A) 1910s-1920s.
B) 1930s-1940s.
C) 1950s-1960s.
Answer: B

14) A business cycle impulse is the
A) economic event that ends a business cycle fluctuation.
B) economic event that begins a business cycle fluctuation.
C) mechanism that causes a cycle to continue.
D) policy response to the actions of the public that start a business cycle.
Answer: B

15) A business cycle mechanism
A) ends business cycle fluctuations.
B) starts business cycle fluctuations.
C) eliminates the effects of economic shocks.
D) transmits economic shocks to the economy.
Answer: D
Topic: Role of Investment and Capital  
Skill: Recognition  
16) Which of the following correctly describes recessions?  
  I. Recessions, on average, last one year.  
  II. Declines in investment in new capital trigger recessions.  
  III. Recessions are easily predictable.  
A) I only.  
B) III only.  
C) I and II.  
D) II and III.  
Answer: C  

Topic: Role of Investment and Capital  
Skill: Recognition  
17) When shocks hit the economy, the variable they tend to affect the most is  
A) consumption expenditure.  
B) investment.  
C) government purchases of goods and services.  
D) net exports.  
Answer: B  

Topic: Role of Investment and Capital  
Skill: Recognition  
18) The various business cycle theories agree that the crucial variable affected by shocks to the economy is  
A) consumption expenditure.  
B) government expenditure.  
C) investment expenditure.  
D) net exports.  
Answer: C  

Topic: Role of Investment and Capital  
Skill: Recognition  
19) Which of the following describes economists’ abilities to forecast or explain the business cycle?  
A) Economists are very successful in forecasting when recessions will start.  
B) Economists are very successful in forecasting when recessions will end.  
C) Economists agree that consumption plays an important role in predicting recessions.  
D) Economists agree that increases in investment precede an economic expansion.  
Answer: D  

Topic: Role of Investment and Capital  
Skill: Recognition  
20) Economists generally agree that  
A) consumption expenditure, but not capital accumulation, drives business cycles.  
B) increasing returns to capital plays an important role in new capital investment.  
C) capital and investment play an important role in driving the business cycle.  
D) investment usually increases at the beginning of a recession.  
Answer: C  

Topic: Role of Investment and Capital  
Skill: Recognition  
21) As the capital stock increases, the profit rate falls because of the  
A) law of demand.  
B) laws of the market.  
C) law of diminishing returns.  
D) laws of production.  
Answer: C  

Topic: Role of Investment and Capital  
Skill: Recognition  
22) Which component of expenditure plays a central role in the business cycle?  
A) Consumption expenditure  
B) Government purchases  
C) Investment  
D) Net Exports  
Answer: C  

Topic: Role of Investment and Capital  
Skill: Conceptual  
23) The capital stock and the profit rate are related because of the ___.  
A) negatively; law of production  
B) negatively; law of diminishing returns  
C) positively; law of production  
D) positively; law of diminishing returns  
Answer: B  

Topic: Role of Investment and Capital  
Skill: Recognition  
24) At the start of a recession, investment typically  
A) decreases because of low profits.  
B) decreases because of low interest rates.  
C) increases because prices decrease.  
D) increases to take advantage of “down time.”  
Answer: A
**Topic: Role of Investment and Capital**  
**Skill: Recognition**  
25) During a recession, investment is  
A) high and the capital stock grows rapidly.  
B) low and the capital stock grows rapidly.  
C) high and the capital stock grows slowly.  
D) low and the capital stock grows slowly.  
**Answer: D**  

**Topic: Role of Investment and Capital**  
**Skill: Conceptual**  
26) In a recession,  
A) investment is low and the capital stock grows quickly.  
B) investment is low and the capital stock grows slowly.  
C) investment is high and consumption is low.  
D) consumption is high and government spending is low.  
**Answer: B**  

**Topic: Role of Investment and Capital**  
**Skill: Recognition**  
27) During an expansion investment is  
A) high and the capital stock grows rapidly.  
B) low and the capital stock grows rapidly.  
C) high and the capital stock grows slowly.  
D) low and the capital stock grows slowly.  
**Answer: A**  

**Topic: Aggregate Demand Theories of the Business Cycle**  
**Skill: Recognition**  
29) The _____ theory is considered a(n) ____ theory of the business cycle?  
A) Monetarist; real business cycle  
B) Keynesian; aggregate demand  
C) Rational expectations; supply side  
D) New Keynesian; supply side  
**Answer: B**  

**Topic: Aggregate Demand Theories of the Business Cycle**  
**Skill: Recognition**  
30) According to ____ the business cycle is the result of shifts in the economy’s AD curve.  
A) the Keynesian theory only  
B) only the Keynesian and monetarist theories  
C) the Keynesian, monetarist, and real business cycle theories  
D) the Keynesian, monetarist, and rational expectations theories  
**Answer: D**  

**Topic: Aggregate Demand Theories of the Business Cycle**  
**Skill: Recognition**  
31) Which of the following is a theory that economists use to describe the business cycle?  
A) Contractionary/expansionary model.  
B) Keynesian model.  
C) Circular flow model.  
D) Impulse model.  
**Answer: B**  

**Topic: Aggregate Demand Theories of the Business Cycle**  
**Skill: Recognition**  
32) Business cycle events that arise solely from aggregate demand shifts are emphasized by the  
A) Keynesian and real business cycle theories.  
B) monetarist and real business cycle theories.  
C) Keynesian and monetarist theories.  
D) none of the major theories.  
**Answer: C**
Topic: Aggregate Demand Theories of the Business Cycle
Skill: Recognition
33) Which of the following is NOT an aggregate demand theory of the business cycle?
   A) Keynesian theory
   B) Monetarist theory
   C) Rational expectations theory
   D) Real business cycle theory
Answer: D

Topic: Keynesian Theory
Skill: Conceptual
34) In the Keynesian business cycle theory, business cycles begin with changes in
   A) inflation expectations.
   B) consumer sentiment.
   C) business expectations about sales and profits.
   D) the public’s expectations about Fed policies.
Answer: C

Topic: Keynesian Theory
Skill: Conceptual
35) In the Keynesian business cycle theory, business cycle impulses are
   A) expectations about government policy.
   B) firms’ expectations about sales and profits.
   C) consumers’ expectations about future income.
   D) the public’s expectations about Fed policies.
Answer: B

Topic: Keynesian Theory
Skill: Recognition
36) Keynes used the term “animal spirits” to refer to the
   A) animalistic behavior of investors.
   B) irrational behavior of financial markets.
   C) business leaders’ volatility of expected sales and profits.
   D) all of the above.
Answer: C

Topic: Keynesian Theory
Skill: Recognition
37) Which theory emphasizes frequent changes in investment because of “animal spirits” as the main source of economic fluctuations?
   A) Real business cycle theory.
   B) Rational expectations theory.
   C) Keynesian theory.
   D) Monetarist theory.
Answer: C

Topic: Keynesian Theory
Skill: Recognition
38) The impulse in the Keynesian theory of the business cycle is
   A) the growth rate of the quantity of money.
   B) changes in government spending.
   C) the real interest rate.
   D) expected future sales and profits.
Answer: D

Topic: Keynesian Theory
Skill: Conceptual
39) One model of the business cycle claims that volatile expectations about future sales and profits are the primary impulse in starting a business cycle. This model is the
   A) real business cycle model.
   B) Keynesian theory.
   C) aggregate supply model.
   D) circular flow model.
Answer: B

Topic: Keynesian Theory
Skill: Conceptual
40) Which theory maintains that the main impulse of a business cycle is expectations of future sales and profits?
   A) Keynesian theory
   B) Monetarist theory
   C) Rational expectations theory, both new classical and new Keynesian
   D) Real business cycle theory
Answer: A

Topic: Keynesian Theory
Skill: Recognition
41) The impulse that leads to business cycle events within Keynesian theory is
   A) the growth rate in labor productivity.
   B) the growth rate in the quantity of money.
   C) adverse shocks to international trade.
   D) expected future sales and profits of firms.
Answer: D
42) Which theory assumes that business cycles occur because of changes in expected future sales and profits?
A) Monetarist theory.
B) Rational expectations theory.
C) New classical theory.
D) Keynesian theory.
Answer: D

43) Suppose that managers forecasted a large decline in expected sales and profits. According to the _____, this forecast is an impulse that may start a business cycle.
A) Keynesian model
B) circular flow model
C) real business cycle model
D) aggregate supply model
Answer: A

44) In the Keynesian business cycle theory, the short-run aggregate supply curve is assumed to
A) be vertical.
B) be horizontal.
C) have a positive slope.
D) have a negative slope.
Answer: B

45) Because the Keynesian business cycle theory proposes a(n) _____ short-run aggregate supply curve, a decrease in aggregate demand results in _____.
A) horizontal; the price level rising
B) vertical; the price level rising
C) horizontal; no change in the price level
D) upward sloping; the price level falling
Answer: C
49) According to the Keynesian theory of the business cycle, an increase in ____ will trigger a business cycle by creating ____.
A) forecasted profits; a leftward shift in the aggregate supply curve
B) growth rate of the quantity of money; a leftward shift in the aggregate supply curve
C) forecasted sales; a rightward shift in the aggregate demand curve
D) expectations of future sales; rightward shift in the long-run aggregate supply curve
Answer: C

50) According to the Keynesian business cycle theory, which component of aggregate demand is most volatile and hence the primary source of the business cycle?
A) Consumption spending
B) Investment spending
C) Government spending
D) Net exports
Answer: B

51) Evidence indicates that a recession occurs at about the same time as a decrease in investment. According to the Keynesian theory, a decrease in investment is attributable to
A) a fall in animal spirits.
B) a decline in the growth rate of productivity.
C) a decline in the growth rate of the quantity of money.
D) intertemporal substitution in working decisions.
Answer: A

52) According to the Keynesian theory of the business cycle, a(n)
A) decrease in profit expectations will decrease investment only and will not change real GDP or consumption expenditure.
B) decrease in profit expectations will decrease investment, real GDP and consumption expenditures.
C) increase in profit expectations will increase investment only and will not change real GDP or consumption expenditure.
D) decrease in sales expectations will affect the price level and not real GDP.
Answer: B

53) Which of the following business cycle theories stress the “multiplier effect?”
I. The Real Business Cycle model.
II. The Monetarist Model
III. The Keynesian Model
A) I only.
B) III only.
C) I and II.
D) I and III.
Answer: B

54) In Keynesian business cycle theory, the business cycle mechanism is the multiplier and a
A) vertical aggregate demand curve.
B) vertical short-run aggregate supply curve.
C) horizontal short-run aggregate supply curve.
D) horizontal aggregate demand curve.
Answer: C
In Keynesian business cycle theory, the money wage rate
A) never changes.
B) rises when unemployment is less than the natural rate but does not change if unemployment exceeds the natural rate.
C) rises when unemployment is less than the natural rate and falls if unemployment exceeds the natural rate.
D) does not change if unemployment is less than the natural rate but falls if unemployment exceeds the natural rate.
Answer: B

Using the Keynesian model to describe the business cycle, the model predicts the
A) money wage rate increases during a recession.
B) money wage rate increases during an expansion.
C) the price level decreases during an expansion.
D) money wage rate decreases during an expansion.
Answer: B

In Keynesian business cycle theory, money wage rates____ when aggregate demand decreases so that GDP is less than potential GDP and money wage rates____ when aggregate demand increases so that GDP exceeds potential GDP.
A) do not fall; rise
B) fall; rise
C) fall; do not change
D) rise; fall
Answer: A

According to Keynes, the economy can get stuck in a recession because
A) investors are animalistic.
B) wages and prices are flexible.
C) wages are sticky downwards.
D) fiscal policy is ineffective.
Answer: C

Which theory maintains that asymmetric changes in money wage rates lead to recessions that don’t self-correct and expansions that cause inflation?
A) Keynesian theory
B) Monetarist theory
C) Rational expectations theory
D) Real business cycle theory
Answer: A

In Keynesian business cycle theory, the money wage rate is____ in the downward direction and____ in the upward direction.
A) rigid; flexible
B) market-determined; flexible
C) flexible; market-determined
D) flexible; rigid
Answer: A

According to the Keynesian model of the business cycle, the money wage rate is
A) sticky in the upward direction.
B) flexible in the upward direction.
C) sticky in the downward direction.
D) Both answers B and C are correct.
Answer: D
**Topic: Keynesian Theory**  
**Skill: Recognition**

64) In the Keynesian theory of the business cycle, the response of the money wage rate to changes in aggregate demand is
   A) symmetrical so that wages are sticky on the upside and the downside.
   B) symmetrical so that wages are flexible on the upside and the downside.
   C) asymmetrical so that wages are sticky on the upside and flexible on the downside.
   D) asymmetrical so that wages are flexible on the upside and sticky on the downside.

**Answer: D**

**Topic: Keynesian Theory**  
**Skill: Recognition**

65) What happens to the price level in the Keynesian version of a recession?
   A) The price level initially falls.
   B) The price level initially rises.
   C) The price level changes very little, if at all.
   D) The price level is unpredictable; it may fall or rise.

**Answer: C**

**Topic: Keynesian Theory**  
**Skill: Conceptual**

66) Based on the Keynesian theory of the business cycle, if the economy is at its full-employment equilibrium and aggregate demand increases then
   A) the price level and real GDP both increase.
   B) the price level rises but real GDP remains unchanged.
   C) the price level and GDP both decrease.
   D) real GDP decreases and the price level remains unchanged.

**Answer: B**

**Topic: Keynesian Theory**  
**Skill: Recognition**

67) According to Keynesian theory, when real GDP is
   A) either above or below potential GDP, prices and wages change rapidly, and return the economy to full employment.
   B) above potential GDP, prices and wages rise very slowly, and return the economy to full employment.
   C) below potential GDP, prices and wages rise very slowly, and return the economy to full employment.
   D) None of the above answers are correct.

**Answer: D**

**Topic: Keynesian Theory**  
**Skill: Conceptual**

68) In the Keynesian theory of the business cycle, a decrease in investment demand leads in the short run to a
   A) leftward shift in the $AD$ curve and a fall in the price level.
   B) rightward shift in the $AD$ curve and an increase in the price level.
   C) leftward shift in the $AD$ curve but no immediate fall in the price level.
   D) rightward shift in the $AD$ curve but no immediate rise in the price level.

**Answer: C**

**Topic: Keynesian Theory**  
**Skill: Conceptual**

69) According to Keynesian theory, the short-run aggregate supply curve is ____, so that a decrease in aggregate demand results in a ____ decrease in real GDP.
   A) horizontal; large
   B) horizontal; small
   C) vertical; large
   D) vertical; small

**Answer: A**
70) In the Keynesian theory of the business cycle, when the economy is in a recession,
A) the short-run aggregate supply curve is positively-sloped.
B) the short-run aggregate supply curve is negatively-sloped.
C) an increase in aggregate demand leads to a change in real GDP but no change occurs in the price level.
D) an increase in aggregate demand changes real GDP and the price level.

Answer: C

71) In the above figure, the economy is initially at point A and investment decreases. In Keynesian business cycle theory, the economy will move to point
A) B.
B) C.
C) D.
D) E.

Answer: A

72) In the above figure, suppose the economy is at point A. According to Keynesian business cycle theory, what could lead the economy to move to point B?
A) expectations that interest rates will fall.
B) expectations that the quantity of money will increase.
C) expectations that profits from investment will fall.
D) expectations that sales will increase.

Answer: C

73) In the above figure, suppose the economy is at point B and policy makers want to end this recession by moving to point A. In Keynesian business theory, this movement could be accomplished by
A) decreasing the quantity of money.
B) increasing the multiplier.
C) decreasing money wages.
D) decreasing taxes so that investment increases.

Answer: D

74) In the above figure, the economy is initially at point B. The government increases its purchases so that the aggregate demand curve becomes AD₂. As a result, the economy moves to point
A) A.
B) C.
C) D.
D) E.

Answer: D

75) In monetarist business cycle theory, the impulse for a business cycle is changes in
A) consumer spending.
B) investment spending.
C) money growth.
D) net exports.

Answer: C
76) In monetarist business cycle theory, decreasing the growth rate of the quantity of money ____ and increasing the growth rate of the quantity of money ____.
   A) increases real GDP; decreases the inflation rate
   B) decreases real GDP; decreases the inflation rate
   C) causes the economy to enter a recession; causes the economy to enter an expansion
   D) causes the economy to enter an expansion; causes the economy to enter a recession

Answer: C

77) In monetarist business cycle theory, increases in money growth temporarily ____ real GDP because interest rates ____.
   A) increase; rise
   B) increase; fall
   C) decrease; rise
   D) decrease; fall

Answer: B

78) In monetarist business cycle theory, decreases in money growth temporarily ____ real GDP because interest rates ____.
   A) increase; rise
   B) increase; fall
   C) decrease; rise
   D) decrease; fall

Answer: C

79) An assumption of the monetarist business cycle theory is that the money wage rate is
   A) temporarily sticky.
   B) fixed under long-term contracts.
   C) rigid downwards.
   D) rigid upwards.

Answer: A

80) In monetarist business cycle theory, the money wage rate
   A) cannot adjust to restore full employment, requiring government intervention to restore full employment.
   B) adjusts over time to restore full employment.
   C) can only restore full employment if the quantity of money increases.
   D) can only restore full employment if the quantity of money decreases.

Answer: B

81) In monetarist business cycle theory, the short-run aggregate supply curve
   A) is horizontal.
   B) has a positive slope.
   C) has a negative slope.
   D) is vertical.

Answer: B

82) Using the monetarist model, place the following events in the order in which they occur in a business cycle.
   I. Money wages fall and the SAS curve shifts rightward.
   II. The Federal Reserve decreases the growth rate of the quantity of money.
   III. The AD curve shifts leftward.

   A) I, III, II.
   B) II, III, I.
   C) I, III, II.
   D) the events are not part of a monetarist model of the business cycle.

Answer: A
Topic: Monetarist Theory
Skill: Analytical
83) In the above figure, suppose the economy starts at point A. The short-run response to a decrease in money growth in monetarist business cycle theory moves the economy to point
A) B.
B) C.
C) D.
D) E.
Answer: C

Topic: Monetarist Theory
Skill: Analytical
84) In the above figure, suppose the economy starts at point A. The short-run response to an increase in money growth in monetarist business cycle theory moves the economy to point
A) B.
B) C.
C) D.
D) E.
Answer: A

Topic: Monetarist Theory
Skill: Analytical
85) In the above figure, suppose the economy is at point A. According to the monetarist business cycle theory, an increase in money growth in the short run moves the economy to point ____ and in the long run moves the economy to point ____.
A) B; A
B) C; E
C) B; C
D) D; E
Answer: C

Topic: Monetarist Theory
Skill: Analytical
86) In the above figure, suppose the economy is at point A. According to the monetarist business cycle theory, a decrease in money growth in the short run moves the economy to point ____ and in the long run moves the economy to point ____.
A) B; A
B) C; E
C) B; C
D) D; E
Answer: D

Topic: Monetarist Theory
Skill: Analytical
87) In the above figure, suppose the economy starts at point A. The short-run response to an increase in the quantity of money in the monetarist business cycle theory is for
A) the price level to fall to 90 and output to remain at $10 trillion.
B) the price level to rise to 120 and output to increase to $12 trillion.
C) the price level to rise to 130 and output to remain at $10 trillion.
D) the price level to remain at 110 and output to remain at $10 trillion.
Answer: B
88) In the above figure, suppose the economy starts at point $A$. The long-run response to an increase in money growth in the monetarist business cycle theory is for
A) the price level to fall to 90 and output to remain at $10$ trillion.
B) the price level to rise to 120 and output to increase to $12$ trillion.
C) the price level to rise to 130 and output to remain at $10$ trillion.
D) the price level to remain at 110 and output to remain at $10$ trillion.
Answer: C

89) The business cycle impulse in the new classical theory of the business cycle is
A) unanticipated changes in aggregate demand.
B) anticipated changes in aggregate demand.
C) fluctuations in money growth with temporarily rigid wages.
D) fluctuations in investment coupled with rigid wages.
Answer: A

90) A key element of the new classical model of the business cycle is
A) sticky prices.
B) a horizontal $SA$ curve.
C) rational expectations.
D) random fluctuations in technology.
Answer: C

92) An assumption of the new classical rational expectations theory of the business cycle is that the money wage rate is
A) rigid for one time period only.
B) rigid for more than one time period.
C) rigidly set at all times.
D) renegotiated when economic conditions change.
Answer: D

93) In the new classical rational expectations theory of the business cycle, an unanticipated decrease in aggregate demand ____ the real wage rate and ____ employment.
A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases
Answer: B

94) In the new classical rational expectations theory of the business cycle, an unanticipated increase in aggregate demand ____ the real wage rate and ____ employment.
A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases
Answer: C

95) In the new Keynesian business cycle theory, ____ can effect real GDP.
A) only anticipated changes in aggregate demand
B) anticipated and unanticipated changes in aggregate demand
C) only unanticipated changes in aggregate demand
D) only unanticipated changes in the money wage rate
Answer: B
**Topic: New Keynesian Theory**

**Skill: Conceptual**

96) In the new Keynesian rational expectations theory of the business cycle, the money wage rate is

A) permanently rigid downward and upward.
B) able to adjust only in an asymmetric way.
C) flexible.
D) fixed for a time under long-term contracts.

**Answer: D**

**Topic: New Keynesian Theory**

**Skill: Conceptual**

97) An assumption of the new Keynesian rational expectations theory of the business cycle is that the money wage rate is

A) rigid upward but not downward.
B) rigid for some period of time.
C) rigid and never changes.
D) completely flexible upward and downward at all times.

**Answer: B**

**Topic: New Classical and New Keynesian Theories**

**Skill: Conceptual**

98) The business cycle impulse in the ____ theory is unexpected fluctuations in aggregate demand while in the ____ theory both unanticipated and anticipated fluctuations in aggregate demand are impulses.

A) new classical; monetarist
B) new classical; new Keynesian
C) new Keynesian; Keynesian
D) monetarist; new Keynesian

**Answer: B**

**Topic: New Classical and New Keynesian Theories**

**Skill: Conceptual**

99) According to the rational expectations theory of the business cycle, an unexpected decrease in the quantity of money shifts the $AD$ curve ____ and ____ the price level.

A) leftward; lowers
B) leftward; leaves unchanged
C) rightward; raises
D) rightward; leaves unchanged

**Answer: A**

**Topic: New Classical Theory**

**Skill: Analytical**

100) In the above figure, suppose the economy is initially at point A. In the new classical model, if there is an unexpected increase in exports, the economy shifts to point

A) B.
B) C.
C) D.
D) E.

**Answer: A**

**Topic: New Classical Theory**

**Skill: Analytical**

101) In the above figure, suppose the economy is initially at point A. In the new classical model, if there is an unexpected decrease in government purchases, the economy shifts to point

A) B.
B) C.
C) D.
D) E.

**Answer: C**
102) In the above figure, suppose that the economy is initially at point A. If the expected level of aggregate demand is given by the $EAD$ curve and if actual aggregate demand is given by the $AD_1$ curve, according to the new Keynesian theory the economy will shift to point

A) $B$
B) $C$
C) $D$
D) $E$
Answer: C

103) In the above figure, suppose the economy is initially at point A. If the expected level of aggregate demand is given by the $EAD$ curve and if actual aggregate demand is given by the $EAD$ curve, according to the new Keynesian theory, the economy will

A) shift to point $B$
B) shift to point $C$
C) remain at point $A$
D) shift to point $E$
Answer: C

■ Real Business Cycle Theory

104) In real business cycle theory, the impulse for a business cycle is

A) changes in investment.
B) changes in the quantity of money.
C) unexpected changes in aggregate demand.
D) technological change.
Answer: D

105) The impulse in the real business cycle theory is changes in the growth rate of

A) the quantity of money.
B) productivity.
C) labor supply.
D) the money wage rate.
Answer: B
110) “Intertemporal substitution” in labor supply describes shifts in labor supply in response to changes in 
A) personal tax rates.  
B) investment spending.  
C) the real interest rate.  
D) consumer demand for goods.  
Answer: C

111) In a real business cycle model, labor supply  
A) increases if the nominal interest rate rises.  
B) is independent of the real interest rate.  
C) decreases if the real interest rate rises.  
D) decreases if the real interest rate falls.  
Answer: D

112) According to real business cycle theory, a fall in the real interest rate ____ current labor supply and ____ current employment.  
A) increases; increases  
B) increases; decreases  
C) decreases; increases  
D) decreases; decreases  
Answer: D

113) If the real interest rate is 4 percent and workers expect real wages to be 2 percent year higher next year, according to real business cycle theory, workers will work  
A) more this year and less next year.  
B) less this year and less next year.  
C) more this year and more next year.  
D) less this year and more next year.  
Answer: A

114) If the real interest rate is 2 percent and workers expect real wages to be 4 percent higher next year, according to real business cycle theory, workers will work  
A) more this year and less next year.  
B) less this year and less next year.  
C) more this year and more next year.  
D) less this year and more next year.  
Answer: D

115) In real business cycle models, a positive technology shock ____ real GDP and ____ the price level.  
A) increases; increases  
B) increases; decreases  
C) decreases; increases  
D) decreases; decreases  
Answer: B

116) In real business cycle models, by itself a change in aggregate demand  
A) has no impact on the price level.  
B) determines how the real interest rate changes.  
C) determines real output.  
D) affects only the price level.  
Answer: D

117) In real business cycle models, the quantity of money  
A) can change real wages.  
B) can increase the real interest rate.  
C) has no effect on real GDP.  
D) can decrease the effect from technology shocks.  
Answer: C
According to which theory of the business cycle do changes in the quantity of money never play a role in helping to explain fluctuations in real variables?

A) Keynesian
B) Monetarist
C) Rational Expectations
D) Real business cycle

Answer: D

In real business cycle models, in order to increase real GDP after a negative technology shock, the government can
I. increase the quantity of money.
II. increase government purchases.

A) Only I.
B) Only II.
C) Both I and II.
D) Neither I nor II.

Answer: D

Critics of the real business cycle model argue that
A) investment spending is strongly related to the real interest rate.
B) labor supply is only weakly related to the real interest rate.
C) investment spending is only weakly related to the real interest rate.
D) labor supply is very strongly related to the real interest rate.

Answer: B

Which of the following is NOT one of the criticisms of real business cycle theory?
A) The money wage rate is sticky in the short run
B) Inter-temporal substitution is too weak
C) Productivity fluctuations are the result of the business cycle, not the cause of business cycles
D) The theory is built on weak microeconomic foundations

Answer: D
Topic: New Classical Theory  
Skill: Analytical  
124) In the above, the initial position of a curve is denoted by the subscript 0. Which part corresponds to a recession according to a new classical model of the economy?  
A) Figure A.  
B) Figure B.  
C) Figure C.  
D) Figure D.  
Answer: C  

Topic: New Keynesian Theory  
Skill: Analytical  
125) In the above, the initial position of a curve is denoted by the subscript 0. Which part corresponds to a recession according to a new Keynesian model of the economy?  
A) Figure A.  
B) Figure B.  
C) Figure C.  
D) Figure D.  
Answer: C  

Topic: Real Business Cycle Theory  
Skill: Analytical  
126) In the above, the initial position of a curve is denoted by the subscript 0. Which part corresponds to a recession according to a real business cycle model of the economy?  
A) Figure A.  
B) Figure B.  
C) Figure C.  
D) Figure D.  
Answer: D  

Expansion and Recession During the 1990s and 2000s  

Topic: U.S. Expansion of the 1990s  
Skill: Recognition  
127) Which of the following are elements of the U.S. expansion in the 1990s?  
I. computer technology.  
II. increased government spending.  
III. unanticipated decreases the growth rate of the quantity of money.  
A) I and III.  
B) I and II.  
C) I only.  
D) III only.  
Answer: C  

Topic: The U.S. Expansion of the 1990s  
Skill: Recognition  
128) In the United States during the 1990s,  
A) fiscal and monetary policy generally were both contractionary.  
B) fiscal and monetary policy generally were both expansionary.  
C) fiscal policy was restrained and monetary policy was expansionary.  
D) fiscal policy was expansionary and monetary policy was restrained.  
Answer: C  

Topic: The U.S. Expansion of the 1990s  
Skill: Recognition  
129) In the United States in the 1990s, technological change  
A) reduced the need for investment but has increased production.  
B) reduced the need for investment and has decreased production.  
C) required additional investment which has increased aggregate demand but not supply.  
D) required additional investment which has increased both aggregate demand and supply.  
Answer: D
The widespread implementation of computers in American workplaces during the 1990s, along with the corresponding gains in labor productivity, are most likely responsible for
A) the decrease in rational expectations.
B) the rise in U.S. inflation.
C) the increase in fiscal policy measures.
D) the high growth in real GDP and potential GDP.
Answer: D

Which of the following is the most accurate characterization of the U.S. economic expansion during the 1990s?
A) Although it lasted a long time, real GDP grew very little during this expansion
B) Expansionary monetary and fiscal policies were the main factors leading to the expansion
C) A high pace of technological progress shifted both the AS and AD curves rightward
D) U.S. exports declined and slowed the pace of the expansion
Answer: C

The economic expansion of the 1990s is most consistent with which theory of the business cycle?
A) Keynesian
B) Monetarist
C) Rational Expectations
D) Real business cycle
Answer: D

The 1920s in the United States were years of
A) economic stagnation.
B) recession.
C) prosperity.
D) stable, slow economic growth.
Answer: C

In the stock market crash of 1929, stock prices
A) were relatively constant.
B) fell by roughly 33 percent in two weeks.
C) fell by roughly 75 percent in two weeks.
D) rose by roughly 25 percent overnight.
Answer: B

During the Great Depression, the unemployment rate
A) remained low as wages fell.
B) climbed to 10 percent.
C) climbed to 25 percent.
D) remained stable but asset prices fell.
Answer: C

During the Great Depression, real GDP ____ and the price level ____.
A) increased; rose
B) increased; fell
C) decreased; rose
D) decreased; fell
Answer: D

A major source of uncertainty during the Great Depression was the
A) real wage rate.
B) real interest rate.
C) international sector.
D) future rate of consumption expenditure.
Answer: C

At the onset of the Great Depression,
A) the Fed contracted the monetary base.
B) investment decreased as a result of uncertainty about the future.
C) government transfer payments rose to 15 percent of GDP.
D) household spending increased to pay off debts.
Answer: B
Topic: Why the Great Depression Happened
Skill: Conceptual
139) Which of the following factors do economists agree played a role in causing the contractionary phase of the Great Depression?
   I. Increased pessimism.
   II. Contraction of the quantity of money.
   III. Increased money wage rate.
A) I.
B) I and II.
C) II and III.
D) I, II, and III.
Answer: B

Study Guide Questions

Topic: Study Guide Question, Business Cycle Patterns
Skill: Recognition
140) An average recession lasts for about ____; an average expansion lasts for about ____.
   A) 1 year; 1 year
   B) 4 years; 1 year
   C) 1 year; 4 years
   D) 4 years; 4 years
Answer: C

Topic: Study Guide Question, Role of Investment and Capital
Skill: Recognition
141) Recessions begin when ____ decreases.
   A) consumption expenditure
   B) investment
   C) government purchases
   D) net exports
Answer: B

Topic: Study Guide Question, Keynesian Theory
Skill: Recognition
142) Which of the following is the impulse in the Keynesian business cycle theory?
   A) An unexpected change in aggregate demand.
   B) A change by the Fed in the growth rate of the quantity of money.
   C) A change in expectations about future sales and profits.
   D) A change in the growth rate of productivity.
Answer: C

Topic: Study Guide Question, Monetarist Theory
Skill: Recognition
143) Which of the following is the impulse in the monetarist business cycle theory?
   A) An unexpected change in aggregate demand.
   B) A change by the Fed in the growth rate of the quantity of money.
   C) A change in expectations about future sales and profits.
   D) A change in the growth rate of productivity.
Answer: B

Topic: Study Guide Question, New Classical Theory
Skill: Recognition
144) Which of the following is the impulse in the new classical business cycle theory?
   A) An unexpected change in aggregate demand.
   B) A change by the Fed in the growth rate of the quantity of money.
   C) A change in expectations about future sales and profits.
   D) A change in the growth rate of productivity.
Answer: A

Topic: Study Guide Question, Real Business Cycle Theory
Skill: Recognition
145) Which of the following is the impulse in the real business cycle theory?
   A) An unexpected change in aggregate demand.
   B) A change by the Fed in the growth rate of the quantity of money.
   C) A change in expectations about future sales and profits.
   D) A change in the growth rate of productivity.
Answer: D

Topic: Study Guide Question, Real Business Cycle Theory
Skill: Conceptual
146) By itself, an increase in aggregate demand increases GDP by the least amount in the ____.
   A) Keynesian theory
   B) monetarist theory
   C) new Keynesian theory
   D) real business cycle theory
Answer: D
**Topic: Study Guide Question, U.S. Expansion in the 1990s**

**Skill: Recognition**

147) The length of the 1991–2001 expansion in the United States was
   A) somewhat shorter than the average expansion.
   B) somewhat longer than the average expansion.
   C) equal to the length of the average expansion.
   D) longer than any other expansion in U.S. economic history.

**Answer: D**

**Topic: Study Guide Question, U.S. Expansion in the 1990s**

**Skill: Recognition**

148) The expansion in the United States during the 1990s most closely resembles the type of expansion predicted by the ____ theory.
   A) Keynesian
   B) monetarist
   C) new Keynesian
   D) real business cycle

**Answer: D**

**Topic: Study Guide Question, Why the Great Depression Happened**

**Skill: Recognition**

149) The Great Depression started as a result of a ____ shift of the aggregate ____ curve.
   A) leftward; supply
   B) rightward; supply
   C) rightward; demand
   D) leftward; demand

**Answer: D**

**Topic: Study Guide Question, Why the Great Depression Happened**

**Skill: Recognition**

150) According to monetarists such as Milton Friedman, the Great Depression was the result of
   A) the stock market crash of 1929.
   B) a massive contraction of the quantity of money, leading to large decreases in aggregate demand.
   C) an expansion of the quantity of money, leading to higher inflation.
   D) loss of business and consumer confidence.

**Answer: D**

**MyEconLab Questions**

**Topic: Business Cycle Patterns**

**Level 1: Definitions and Concepts**

151) The economy functions as if it ____.
   A) swings to and fro like a rocking horse
   B) cycles like a tennis ball that is hit by a tennis racket
   C) is hit by shocks, cycles indefinitely, or cycles in swings until another shock appears
   D) cycles like the earth from day into night

**Answer: C**

**Topic: Keynesian Theory**

**Level 1: Definitions and Concepts**

152) The ____ states that the main source of economic fluctuations is volatile expectations.
   A) real business cycle theory
   B) AS-AD theory of the business cycle
   C) Keynesian theory of the business cycle
   D) monetarist theory of the business cycle

**Answer: C**

**Topic: Keynesian Theory**

**Level 1: Definitions and Concepts**

153) A Keynesian expansion begins when a rise in animal spirits ____.
   A) increases aggregate demand
   B) increases long-run aggregate supply
   C) increases short-run aggregate supply
   D) decreases aggregate demand

**Answer: A**

**Topic: Monetarist Theory**

**Level 1: Definitions and Concepts**

154) The monetarist theory of the business cycle regards the impulse of the business cycle as ____.
   A) the unanticipated increase in aggregate demand
   B) the growth rate of the quantity of money
   C) volatility in the interest rate
   D) volatility in the demand for money

**Answer: B**
**Topic: Rational Expectation**

**Level 1: Definitions and Concepts**

155) Maureen forecasts that the economy will enter a recession in 2003. Her forecast is based on all the relevant information that is available. Maureen’s forecast is called a ____.
A) rational expectation  
B) rational forecast  
C) relevant expectation  
D) correct forecast

**Answer: A**

**Topic: New Classical Theory**

**Level 1: Definitions and Concepts**

156) The ____ theory of the business cycle states that only unanticipated fluctuations in aggregate demand are the main source of economic fluctuations.
A) new Keynesian  
B) new classical  
C) rational expectations  
D) monetarist

**Answer: B**

**Topic: New Keynesian Theory**

**Level 1: Definitions and Concepts**

157) The new Keynesian theory of the business cycle regards ____ as the main source of economic fluctuations.
A) unanticipated fluctuations in aggregate demand  
B) anticipated and unanticipated fluctuations in aggregate demand  
C) anticipated fluctuations in aggregate supply  
D) volatile expectations

**Answer: B**

**Topic: RBC Impulse**

**Level 1: Definitions and Concepts**

158) The theory that regards random fluctuations in productivity as the main source of economic fluctuations is the ____ of the business cycle.
A) real business cycle theory  
B) productivity theory  
C) dynamic general equilibrium theory  
D) Keynesian theory

**Answer: A**

**Topic: U.S. Recession of 2001**

**Level 1: Definitions and Concepts**

159) The 2001 recession resulted from a ____ short-run aggregate supply ____ aggregate demand.
A) decrease in both; and  
B) percentage increase in; that was smaller than the percentage decrease in  
C) percentage decrease in; that was larger than the percentage increase in  
D) percentage decrease in; that was smaller than the percentage increase in

**Answer: A**

**Topic: The Great Depression**

**Level 1: Definitions and Concepts**

160) The Great Depression began with a widespread expectation that the price level would fall that lead to ____ and increased uncertainty that resulted in ____.
A) a decrease in the money supply; an increase in the money wage rate  
B) a lower real wage rate; an increase in investment  
C) a decrease in the money wage rate; a decrease in investment  
D) an increase in the real wage rate; an increase in investment

**Answer: C**

**Topic: Keynesian Theory**

**Level 2: Using Definitions and Concepts**

161) Expected future sales and profits are the main impulse of the ____ of the business cycle.
A) Keynesian theory  
B) new Keynesian theory  
C) rational expectations theories  
D) monetarist theory

**Answer: A**

**Topic: Keynesian Theory**

**Level 2: Using Definitions and Concepts**

162) The Keynesian recession begins when a ____ in animal spirits ____ investment.
A) fall; increases  
B) fall; decreases  
C) rise; decreases  
D) rise; increases

**Answer: B**
**Topic: Monetarist Theory**  
**Level 2: Using Definitions and Concepts**  
163) The monetarist cycle mechanism begins with ____ and then ____ responds to the ____.  
A) a change in aggregate supply; aggregate demand; change in the price level  
B) a change in monetary policy; aggregate supply; change in aggregate demand  
C) a change in the quantity of money; the wage rate; price level  
D) the Fed changing the money growth rate; government; change in aggregate demand  
**Answer: B**

**Topic: New Keynesian Theory**  
**Level 2: Using Definitions and Concepts**  
164) New Keynesian economists believe that ____ is influenced by ____.  
A) yesterday’s money wage rate; today’s rational expectations of the money wage  
B) today’s money wage rate; yesterday’s rational expectations of the price level  
C) yesterday’s rational expectations of the price level; today’s money wage rate  
D) today’s money wage rate; today’s rational expectations of the price level  
**Answer: B**

**Topic: RBC Impulse**  
**Level 2: Using Definitions and Concepts**  
165) In real business cycle theory, all of the following events can be sources of fluctuation in productivity except ____.  
A) the pace of technological change  
B) climate fluctuations  
C) the growth rate of money  
D) natural disasters  
**Answer: C**

**Topic: Real Business Cycle Theory**  
**Level 2: Using Definitions and Concepts**  
166) According to real business proponents, in an expansion an increase in the rate of technological change ____ investment demand, ____ the demand for labor, and ____ the supply of labor. The real interest rate will ____.  
A) increases; increases; there is no change in; fall  
B) increases; increases; there is no change in; rise  
C) decreases; decreases; decreases; fall  
D) increases; increases; increases; rise  
**Answer: D**

**Topic: Can the Great Depression Happen Again?**  
**Level 2: Using Definitions and Concepts**  
170) A severe depression is less likely today than it was 60 years ago for all of the following reasons except ____.  
A) multi-income families  
B) the Fed’s decision to avoid use of monetary policy  
C) bank deposit insurance  
D) the size of the government sector  
**Answer: B**
**Topic: Role of Investment and Capital**

**Level 3: Calculations and Predictions**

171) During a recession, the marginal product of capital ____ because the amount of capital per hour of labor ____.  
A) increases; increases  
B) decreases; decreases  
C) decreases; increases  
D) increases; decreases  
Answer: D

**Topic: Keynesian Theory**

**Level 3: Calculations and Predictions**

172) The ____ theory predicts that a decrease in aggregate demand will lead to a larger decrease in real GDP than that predicted by the alternative theories because the short-run aggregate supply curve is ____.
A) Keynesian; horizontal  
B) Keynesian; vertical  
C) monetarist; horizontal  
D) monetarist; vertical  
Answer: A

**Topic: Monetarist Theory**

**Level 3: Calculations and Predictions**

173) An economy is at full employment and potential GDP is $50 billion. When the central bank in this economy increases the money growth rate, the monetarist theory of the business cycle predicts that in the long run, real GDP will ____.
A) exceed $50 billion and the price level will be higher  
B) exceed $50 billion and the price level will be unchanged  
C) remain at $50 billion and the price level will be unchanged  
D) remain at $50 billion and the price level will be higher  
Answer: D

**Topic: New Classical Theory**

**Level 3: Calculations and Predictions**

174) On the island of Beach, the economy is currently at point A in the figure above. The new classical theory of the business cycle predicts that an anticipated increase in aggregate demand will move the economy to point ____ and an unanticipated increase in aggregate demand will move the economy to point ____.
A) A; C  
B) C; B  
C) B; C  
D) B; D  
Answer: C

**Topic: Rational Expectations Theories**

**Level 3: Calculations and Predictions**

175) The rational expectations theories predict that a ____ than anticipated increase in aggregate ____ brings an expansion and a ____ than anticipated increase in aggregate demand brings a recession.
A) smaller; demand; larger  
B) smaller; supply; smaller  
C) larger; demand; smaller  
D) larger; supply; larger  
Answer: C
Topic: New Keynesian Theory
Level 3: Calculations and Predictions
176) An economy is at potential GDP when the people in the economy expect that the government will cut taxes. The new Keynesian theory of the business cycle predicts that real GDP will \__, employment will \__, and the price level will \__.
A) decrease; decrease; remain constant
B) decrease; increase; fall
C) increase; increase; remain constant
D) increase; increase; rise
Answer: D

Topic: Real Business Cycle Theory
Level 3: Calculations and Predictions
177) Today, the real wage rate is $10 an hour and the real interest rate is 5 percent a year. People expect the real wage rate to be $10.05 an hour in one year. The $10 an hour earned now will be worth \__ a year from now. The intertemporal substitution effect tells us that people will want to work \__.
A) $10.50 an hour; more next year and less now
B) $10.50 an hour; more now and less next year
C) $10.05 an hour; more both now and next year
D) $15.00 an hour; the same amount now and next year
Answer: B

Topic: Real Business Cycle Theory
Level 3: Calculations and Predictions
178) Real business cycle theory predicts that an increase in the growth rate of productivity resulting from technological change will \__ aggregate demand and will \__ potential GDP.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: A

Topic: Real Business Cycle Theory
Level 3: Calculations and Predictions
179) On the island of Beach, the economy is at point A in the figure above. If the economy is hit by a technology shock that decreases investment, real business cycle theory predicts that the economy will \__.
A) move to point D
B) remain at point A
C) move to point C
D) move to point B
Answer: C

Topic: Real Business Cycle Theory
Level 3: Calculations and Predictions
180) In real business cycle theory, the unemployment rate \__ the natural rate in an expansion and \__ the natural rate in a recession.
A) is equal to; rises above
B) falls below; is equal to
C) falls below; rises above
D) is equal to; is equal to
Answer: D
**Topic: Keynesian Theory**
**Level 4: Advanced Calculations and Predictions**

181) The economy is in a recession when businesses begin to expect future sales and profits to increase. The Keynesian theory of the business cycle predicts that aggregate demand will ____, real GDP will ____, and as wages ____, the price level will ____.

A) decrease; decrease; fall; fall
B) decrease; decrease; remain sticky; remain the same
C) increase; increase; remain sticky; rise
D) increase; increase; rise; rise

**Answer: D**

**Topic: Rational Expectations Theories**
**Level 4: Advanced Calculations and Predictions**

182) The rational expectations theories predict that a recession will occur when ____.

A) a larger than anticipated increase in aggregate demand occurs
B) a larger than anticipated increase in short-run aggregate supply occurs
C) a larger than anticipated increase in long-run aggregate supply occurs
D) a smaller than anticipated increase in aggregate demand occurs

**Answer: D**

**Topic: Rational Expectations Theories**
**Level 4: Advanced Calculations and Predictions**

183) In rational expectations theories, a business cycle is generated as real GDP fluctuates ____. But in real business cycle theory, a business cycle is generated as real GDP fluctuates ____.

A) with potential GDP; along the short-run aggregate supply curve
B) with short-run aggregate supply; with short-run aggregate supply
C) along the short-run aggregate supply curve; with potential GDP
D) with short-run aggregate supply; with long-run aggregate supply

**Answer: C**

**Topic: Monetarist Theory**
**Level 4: Advanced Calculations and Predictions**

184) The monetarist business cycle is generated as follows: The Fed changes the growth rate of the quantity of money. Then ____.

A) aggregate demand changes, the price level changes, the money wage rate changes, and the price level changes in the opposite direction
B) investment changes, the real interest rate changes, productivity changes, and employment changes in the opposite direction
C) aggregate demand changes, real GDP changes, the money wage rate changes, and real GDP changes in the opposite direction
D) there are swings of the long-run aggregate supply curve and swings in real GDP

**Answer: D**

**Topic: Real Business Cycle Theory**
**Level 4: Advanced Calculations and Predictions**

185) In real business cycle theory, a decrease in productivity leads to all of the following events except ____.

A) a decrease in the demand for labor
B) a decrease in investment demand
C) a rise in the real wage rate
D) a fall in the interest rate

**Answer: C**

**Topic: Real Business Cycle Theory**
**Level 4: Advanced Calculations and Predictions**

186) Real business cycle theory predicts that a productivity shock that increases investment will ____.

A) decrease employment and increase the real wage rate
B) increase the real interest rate and decrease employment
C) increase employment and increase the real wage rate
D) decrease the real wage rate and increase the real interest rate

**Answer: C**
<table>
<thead>
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<th></th>
<th>1995</th>
<th>1996</th>
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<tbody>
<tr>
<td>Real GDP</td>
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<td>3,800</td>
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<tr>
<td>(billions of 1995 neutrons)</td>
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<tr>
<td>Price level</td>
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<td>90</td>
</tr>
<tr>
<td>(GDP deflator, 1995 = 100)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Topic: Real Business Cycle Theory**
**Level 4: Advanced Calculations and Predictions**

187) The table above gives data regarding the economy of Photon. In 2003, Photon was at full employment. Real business cycle theory explains the data as follows: Between 2003 and 2004, the aggregate demand ____.

A) decreases and long-run aggregate supply increases  
B) increases and long-run aggregate supply decreases  
C) and long-run aggregate supply both decrease  
D) and long-run aggregate supply both increase  

**Answer: C**

**Topic: New Keynesian Theory**
**Level 4: Advanced Calculations and Predictions**

188) The table above gives data regarding the economy of Photon. In 2003, Photon was at full employment. New Keynesian theory of the business cycle explains the data as follows: Between 2003 and 2004, the aggregate demand ____.

A) did not change and the short-run aggregate supply increased  
B) and short-run aggregate supply increased by the same amount  
C) decreased unexpectedly  
D) and the long-run aggregate supply both increased  

**Answer: C**

**Topic: Keynesian Theory**
**Level 4: Advanced Calculations and Predictions**

189) When aggregate demand fluctuates, the ____ theory of the business cycle will predict a business cycle with the biggest swings in real GDP.

A) new classical  
B) Keynesian  
C) real business cycle  
D) monetarist  

**Answer: B**