JOHN MAYNARD KEYNES AND MILTON FRIEDMAN ECO54 UDAYAN ROY

The questions on Keynes are taken from chapter IX of *The Worldly Philosophers* and chapter IX of *New Ideas from Dead Economists*.

1. According to ____, if businesses cut back their plans to invest in new factories or to upgrade existing factories, they would reduce their borrowing from households, making saving less attractive. As a result, households would reduce saving and increase consumption spending. In this way, the fall in business spending would be balanced by an increase in consumption spending. Therefore, a fall in investment spending by businesses would not cause a fall in total production or a rise in unemployment.

   a. John Maynard Keynes
   b. Karl Marx
   c. Classical economists
   d. Thorstein Bunde Veblen

2. John Maynard Keynes's explanation for recessions, which are periods of low production and high unemployment, was as follows:

   a. When businesses become pessimistic (that is, afraid of the future), they cut back their plans to invest in new factories or to upgrade existing factories. As a result, the production of factory equipment falls and unemployment rises. As a result, households reduce their consumption spending and make things worse.
   b. When households reduce their saving, businesses are forced to cut back their plans to invest in new factories or to upgrade existing factories because businesses can do these things only by borrowing the money that households save. As a result, the production of factory equipment falls and unemployment rises.
   c. When businesses become pessimistic (that is, afraid of the future), they cut back their plans to invest in new factories or to upgrade existing factories. As a result, the production of factory equipment falls and unemployment rises. As a result, households become pessimistic too and, as a result, begin to save more and spend less. Lower household spending makes things worse.
   d. None of the above

3. "The long run is a misleading guide to current affairs. In the long run we are all dead. Economists set them too easy a task if in tempestuous seasons they can only tell us when the storm is long past, the ocean will be flat". These are the words of ______.

   a. Karl Marx
   b. Joseph Schumpeter
   c. Thorstein Veblen
   d. John Maynard Keynes

4. According to _____, although increased saving by an individual would be good for that individual, if everybody tried to save more, low consumer demand would cause a "general glut" and make everybody worse off. Adam Smith had earlier argued the opposite: "What is prudence in the conduct of every private family can scarcely be folly in that of a great nation." John Maynard Keynes's views on the consequences of saving were closer to those of _____.

a. David Ricardo; Adam Smith
b. Thomas Malthus; Adam Smith
c. Thomas Malthus; Thomas Malthus
d. Karl Marx; Karl Marx

5. According to John Maynard Keynes,

    a. Although recessions are caused by low investment, investment quickly bounces back because of the way capital markets, in which businesses borrow money from households, work. Therefore, recessions are inevitably brief.
    b. Recessions are caused by low investment. Investment remains low as long as businesses remain pessimistic or afraid of the future. Therefore, investment, once low, could remain low. In other words, there is no reason to believe that a recession would cure itself.
    c. When unemployment rises during a recession, unemployed workers become desperate for a job. As a result, wages fall, businesses increase their hiring, and unemployment falls back to pre-recession levels. Therefore, recessions are inevitably brief.
    d. Recessions are caused by the irrational behavior of firms and households. As people behave irrationally only in exceptional cases, recessions would also be brief in duration.

6. According to John Maynard Keynes,

    a. Recessions are caused by government policies that discourage business investment and/or household consumption. Therefore, recessions would end as soon as the government steps aside.
    b. Recessions are caused by low investment spending by businesses. Therefore, a government can pull an economy out of a recession by (i) increasing its expenditure on the things that governments buy and (ii) cutting taxes to encourage households to spend more.
    c. Recessions are caused by business pessimism. And since governments can't make pessimistic businesses turn optimistic, they would be unable to end a recession.
    d. Recessions happen when total production falls. This happens when people decide to work less. When governments raise taxes, people work harder to make up the money taken by the government. Therefore, the government can end a recession by raising taxes.

7. The Great Depression

    a. Lasted for a brief period, as classical economists would have predicted
    b. Lasted for a brief period, as John Maynard Keynes would have predicted
    c. Lasted ten years. This would have surprised the classical economists
    d. Lasted ten years. This would not have surprised John Maynard Keynes
    e. Both (c) and (d) are correct

8. According to Keynes's view of the way the labor market worked,

    a. When unemployment rises during a recession, unemployed workers become desperate for a job. As a result, wages fall, businesses increase their hiring, and unemployment falls back to pre-recession levels. Therefore, recessions are inevitably brief.

b. Even when unemployment rises during a recession, union contracts prevent wages from falling. As a result, firms have no incentive to hire more workers. Moreover, even when they are desperate, workers resist jobs that pay lower wages.
c. During a recession, unemployment may cause wages to fall. But low demand for goods may cause goods' prices to fall even more. As a result, firms may not hire more workers because even though wages are low, goods' prices are even lower, making production unprofitable.
d. Both (b) and (c) are true

9. According to John Maynard Keynes's view of government policy regarding spending and taxation, during _____ budget surpluses should result (that is, tax revenues should exceed government spending) and during ____ the government should allow budget deficits (that is, tax revenues should be less than government spending). This would keep the government's budget ____ over the entirety of the business cycle (that is, over a period that includes both a recession and a recovery).

   a. Recoveries; recessions; balanced
   b. Recessions; recoveries; balanced
   c. Recoveries; recessions; in surplus
   d. Recessions; recoveries; in surplus

10. On the subject of saving, Adam Smith had written approvingly, "What is prudence in the conduct of every private family can scarce be folly in that of a great nation." With regard to John Maynard Keynes's view, which of the following is true?

   a. Keynes had the same positive view of saving as Adam Smith.
   b. Keynes agreed with Adam Smith that what's good for any individual families had to be good for the nation as a whole. However, he disagreed that saving is good for a family in all situations.
   c. Keynes highlighted the *paradox of thrift*. Your spending is my income, and vice versa. Therefore, if we both cut our spending at the same time, we'll both be poorer. Just because saving is good for any given family does not mean it's good for the whole nation.
   d. Keynes argued that the main cause of the Great Depression was excessive spending by people. He suggested that an immediate increase in saving would help the economy recover.

The following questions are on Chapters X and XII of *New Ideas from Dead Economists* by Todd Buchholz.

11. While __________ maintained that people hold money for daily purchases, ________ additionally introduced the speculative motive.

a. John Maynard Keynes; Milton Friedman.
b. The quantity theorists; John Maynard Keynes.
c. The quantity theorists; Milton Friedman.
d. Robert Lucas; Milton Friedman.

12. According to John Maynard Keynes, the effectiveness of fiscal policy in stabilizing an economy depends heavily on the value of the ____, which in turn depends heavily on the value of the _____.

a. Velocity of money; interest rates.
b. Multiplier; Marginal Propensity to Consume.

c. Multiplier; velocity of money.
d. Marginal propensity to consume; interest rates.

13. According to Milton Friedman, the ____ is in fact very small, which is why ____ is bound to be _____.

a. Marginal propensity to consume; fiscal policy; ineffective.
b. Marginal propensity to consume; monetary policy; ineffective.
c. Marginal propensity to consume; fiscal policy; effective.
d. Velocity of money; monetary policy; ineffective.

14. The debate over the effectiveness of monetary policy can be summarized as follows: monetarists believe that ________ is _______, while Keynesians see it as ________.

a. The velocity of money; stable; unstable.
b. The velocity of money; unstable; stable.
c. The multiplier; small; large.
d. The multiplier; large; small.

15. The U.S. experience of the 1980s suggests that the velocity of money was _____, as the ____ had supposed.

a. Unstable; Keynesians.
b. Stable; monetarists.
c. Stable; Keynesians.
d. Unstable; monetarists.

16. According to monetarists, although monetary policy can, in theory, effectively stabilize an economy, monetary policy should not be used for that purpose because:

    a. Fiscal policy does a better job.
    b. The monetary authorities are motivated by self-interest.
    c. No one can predict how long it would take monetary policy to do the job.
    d. None of the above.

17. _____ would like the Federal Reserve (the U.S.'s central bank) to increase the money supply faster during bad economic times. _____, on the other hand, would like the Fed to expand the money supply at a constant rate at all times.

    a. Monetarists; Keynesians
    b. Keynesians; Monetarists
    c. Keynesians and Monetarists; Institutionalists
    d. Workers; businessmen

18. Although monetarist policies were ____ by central banks in developed countries in the 1970s, they were ____ by the same central banks in the 1980s.

    a. Mostly rejected; mostly accepted

b. Accepted; rejected
c. Rejected; accepted
d. None of the above

19. Although most ____ believe that an increase in the quantity of money would increase output in the short run, ____ believed that the link between the quantity of money and output was not always strong and that, therefore, fiscal policy was more effective. He once wrote, “Some people seem to infer … that output and income can be raised by increasing the quantity of money. But this is like trying to get fat by buying a larger belt.”

    a. Monetarists; Milton Friedman
    b. Keynesians; John Maynard Keynes
    c. Keynesians; Milton Friedman
    d. Monetarists; John Maynard Keynes

20. According to ____, in the short run a rise in the money supply would raise output and reduce unemployment.

    a. Keynesians
    b. Monetarists
    c. Keynesians and Monetarists
    d. Neither Keynesians nor Monetarists