

## Sample Multiple-Choice Questions

Circle the letter of each correct answer.

- Which of the following best describes aggregate supply?
  - The amount buyers plan to spend on output
  - A schedule showing the relationship between inputs and outputs
  - A schedule showing the trade-off between inflation and unemployment
  - A schedule indicating the level of real output that will be purchased at each possible price level
  - A schedule indicating the level of real output that will be produced at each possible price level
- A change in which of the following will cause the aggregate demand curve to shift?
  - Energy prices
  - Productivity rates
  - Consumer wealth
  - Prices of inputs
  - Prices of consumer goods
- The short-run aggregate supply curve will shift to the right when
  - energy prices increase.
  - government regulation increases.
  - prices of inputs decrease.
  - investment spending decreases.
  - productivity rates decrease.
- A rightward shift in the aggregate demand curve with a horizontal aggregate supply curve will cause employment and the price level to change in which of the following ways?
 

	Employment	Price Level
(A)	Increase	Increase
(B)	Increase	Decrease
(C)	Increase	No change
(D)	Decrease	No change
(E)	No change	No change
- An increase in the capital stock will cause the
  - aggregate demand curve to shift leftward.
  - production possibilities curve to shift in.
  - Phillips curve to shift out.
  - long-run aggregate supply curve to shift rightward.
  - consumption function to shift down.
- Which of the following is a fiscal policy that would increase aggregate demand in the Keynesian model?
  - A decrease in personal income taxes
  - A decrease in government spending
  - An increase in corporate income taxes
  - A purchase of government bonds by the Federal Reserve
  - A sale of government bonds by the Federal Reserve

7. An increase in labor productivity would most likely cause real gross domestic product and the price level to change in which of the following ways?
- | Real GDP     | Price Level |
|--------------|-------------|
| (A) Increase | Increase    |
| (B) Increase | Decrease    |
| (C) Increase | No change   |
| (D) Decrease | Increase    |
| (E) Decrease | No change   |
8. If Maria Escalera's disposable income increases from \$600 to \$650 and her level of personal-consumption expenditures increase from \$480 to \$520, you may conclude that her marginal propensity to
- (A) consume is 0.8.  
(B) consume is 0.4.  
(C) consume is 0.25.  
(D) save is 0.8.  
(E) save is 0.25.
9. In the Keynesian aggregate-expenditure model, if the MPC is 0.75 and gross investment increases by \$6 billion, equilibrium GDP will increase by
- (A) \$6 billion.  
(B) \$8 billion.  
(C) \$12 billion.  
(D) \$24 billion.  
(E) \$42 billion.
10. In the Keynesian aggregate-expenditure model, the simple spending multiplier can be calculated by dividing
- (A) the initial change in spending by the change in real gross domestic product (GDP).  
(B) the change in real gross domestic product by the initial change in spending.  
(C) one by one minus the marginal propensity to save.  
(D) one by one plus the marginal propensity to consume.  
(E) the propensity to save by the propensity to consume.
11. Which of the following will cause the consumption schedule to shift upward?
- (A) An increase in the amount of consumer indebtedness  
(B) A reduction in the wealth or assets held by consumers  
(C) An expectation of future declines in the consumer price index  
(D) An expectation of future shortages of essential consumer goods  
(E) A growing belief that personal income will decline in the future
12. The investment demand curve will shift to the right as the result of
- (A) excess productive capacity.  
(B) an increase in corporate business taxes.  
(C) businesses becoming more optimistic with respect to future business conditions.  
(D) recessions in foreign nations that trade with the United States, causing a lower demand for U.S. products.  
(E) a decrease in the real interest rate.

13. Automatic stabilizers in the economy include which of the following?

- I. A progressive personal income tax
- II. Unemployment compensation
- III. Congressional action that increases tax rates

- (A) I only
- (B) II only
- (C) III only
- (D) I and II only
- (E) I and III only

14. In order to be called an automatic, or built-in, stabilizer, which of the following must taxes automatically do in a recessionary period and in an inflationary period?

Recessionary Period	Inflationary Period
(A) Decrease	Decrease
(B) Decrease	Increase
(C) Increase	Decrease
(D) Increase	Increase
(E) No change	No change

15. The balanced-budget multiplier indicates that

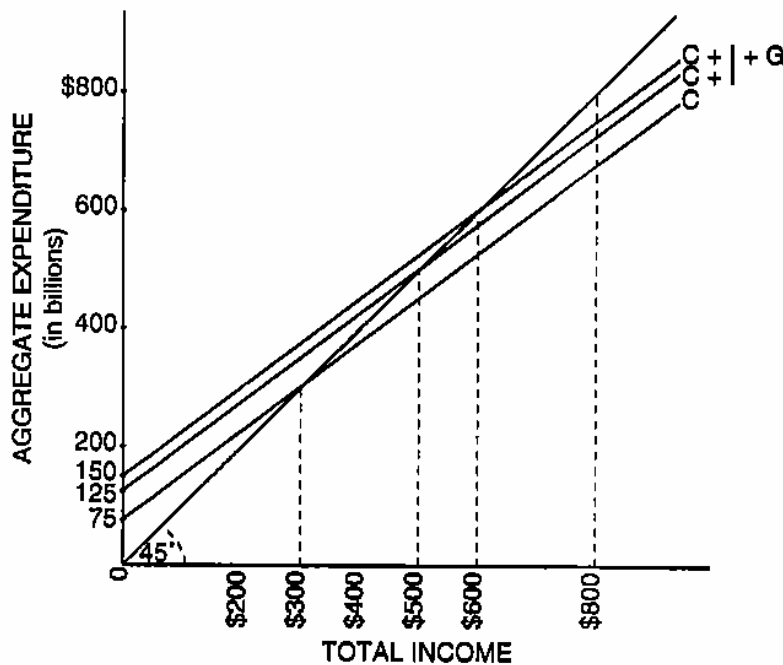
- (A) equal increases in government spending and taxation will make a recession worse.
- (B) equal increases in government spending and taxation will increase total spending.
- (C) government deficits might have a contractionary impact on the economy.
- (D) supply will necessarily create its own demand.
- (E) the level of gross domestic product is never less than the level of disposable income.

16. In which of the following ways will increases in short-run aggregate supply change the price level and unemployment?

	Price Level	Unemployment
(A)	Increase	No change
(B)	Decrease	Decrease
(C)	Decrease	Increase
(D)	Decrease	No change
(E)	No change	Increase

17. Assume the aggregate supply curve is upward sloping and the economy is in a recession. If the government increases both taxes and government spending by \$25 billion, the price level and real GDP will most likely change in which of the following ways?

	Price Level	Real GDP
(A)	Increase	Increase
(B)	Increase	Decrease
(C)	Increase	No Change
(D)	Decrease	Decrease
(E)	Decrease	No Change



Use the information in the graph above to answer questions 18, 19 and 20. Assume a closed economy with no tax function.

18. Which of the following are true statements about total income?
- I. Equilibrium total income is \$800 billion.
  - II. Planned investment is \$50 billion.
  - III. Equilibrium aggregate expenditure is \$600 billion.
- (A) I only  
 (B) II only  
 (C) III only  
 (D) I and III only  
 (E) II and III only

19. In the graph, if full-employment GDP is \$800 billion, the minimum increase in autonomous expenditures that would be required to move total income to full employment income is
- (A) \$200 billion.  
 (B) \$100 billion.  
 (C) \$50 billion.  
 (D) \$25 billion.  
 (E) zero because total income is already at full employment.

20. In the graph, the values of the MPC, MPS and simple-expenditure multiplier are

	MPC	MPS	Multiplier
(A)	0.5	0.5	2.0
(B)	0.6	0.4	2.5
(C)	0.75	0.25	4.0
(D)	0.8	0.2	5.0
(E)	0.9	0.1	10.0

21. Which of the following fiscal policy actions would be most effective in combating a recession?

Taxes	Government Spending
(A) \$25 billion decrease	\$25 billion decrease
(B) \$25 billion decrease	\$25 billion increase
(C) \$25 billion decrease	No change
(D) \$25 billion increase	\$25 billion decrease
(E) \$25 billion increase	\$25 billion increase

22. If the primary goal is to reduce inflation, which of the following fiscal policy actions would be appropriate during a period of a rapidly increasing consumer price index?

- I. Reduce government expenditures for defense and space research.
- II. Increase transfer payments to those most severely affected by the rising price index.
- III. Increase personal income tax rates.

- (A) I only
- (B) II only
- (C) III only
- (D) I and III only
- (E) II and III only

23. As the average price level decreases, the purchasing power of people's cash balances increases. This results in an increase in spending. This effect is called

- (A) the Laffer effect.
- (B) the Keynesian effect.
- (C) the money illusion effect.
- (D) the real-balance effect.
- (E) the neutrality of money.

24. A severe, sustained increase in oil prices would most likely cause short-run and long-run aggregate supply curves and the production possibilities curve to change in which of the following ways?

Short-Run Aggregate Supply Curve	Long-Run Aggregate Supply Curve	Production Possibilities Curve
(A) Decrease	No change	Shift outward
(B) Decrease	Decrease	Shift outward
(C) Decrease	Decrease	Shift inward
(D) Increase	No change	No change
(E) Increase	Increase	Shift inward

25. A decrease in lump-sum personal income taxes will most likely result in an increase in real GDP because which of the following occurs?

- I. Government spending decreases to maintain a balanced budget.
- II. Consumption spending increases because disposable personal income increases.
- III. Investment spending decreases because disposable personal income increases.

- (A) I only
- (B) II only
- (C) III only
- (D) I and III only
- (E) I, II and III

26. A rapid increase in successful research and development projects for the nation will most likely result in which of the following changes in the short-run and the long-run aggregate supply curves and the production possibilities curve?

Short-Run Aggregate Supply Curve	Long-Run Aggregate Supply Curve	Production Possibilities Curve
--	---------------------------------------	--------------------------------------

- |              |           |               |
|--------------|-----------|---------------|
| (A) Decrease | No change | No change     |
| (B) Decrease | Decrease  | Shift inward  |
| (C) Increase | No change | Shift inward  |
| (D) Increase | Increase  | No change     |
| (E) Increase | Increase  | Shift outward |

27. If the marginal propensity to consume is two-thirds, then an increase in personal income taxes of \$100 will most likely result in

- (A) a decrease in consumption of \$100.
- (B) a decrease in autonomous investment of \$100.
- (C) a decrease in consumption of \$67 and an increase in savings of \$33.
- (D) a decrease in consumption of \$67 and a decrease in savings of \$33.
- (E) an increase in government spending of more than \$100.

28. An increase in personal income taxes will most likely result in which of the following changes in real GDP and the price level in the short-run?

Real GDP	Price Level
(A) Decrease	Decrease
(B) Decrease	Increase
(C) Increase	No change
(D) Increase	Increase
(E) Increase	No change

29. One of the reasons the aggregate demand curve is downward sloping is that as the value of cash balances decreases, aggregate spending decreases. This is called

- (A) a positive externality.
- (B) a negative spillover.
- (C) the Pareto effect.
- (D) the substitution effect.
- (E) the real-balance effect.

30. If there is a decrease in the short-run aggregate supply curve and no changes in monetary and fiscal policies are implemented, the economy over time will

- (A) remain at the new price and output level.
- (B) continue to have rising prices and decreasing real GDP.
- (C) experience increasing nominal wages.
- (D) return to the original output and price level.
- (E) experience a leftward shift in the aggregate demand curve.

## *Sample Short Free-Response Questions*

1. In the 1960s many newspaper reporters were accustomed to reporting a decrease in the unemployment rate when the overall price level increased. However, in the 1970s, when increases in the overall price level were accompanied by increases, not decreases, in the unemployment rate, some reporters went so far as to declare macroeconomics “bankrupt” and unable to explain this “mystery.”

Using short-run aggregate demand and aggregate supply analysis, explain the “mystery” of why the increases in the overall price level during the 1960s might have been accompanied by decreases in the unemployment rate and the increases in the overall price level during the 1970s might have been accompanied by increases in the unemployment rate.



5. Recently, an economist was asked if the Great Depression could occur again. The reply was, "It is possible, but we have many more automatic stabilizers today than we had in 1929." Describe three automatic stabilizers and explain how they might prevent a depression.
6. A town's largest industry invests \$50 million to expand its plant capacity. Without using a formula, explain how this expenditure will affect the town's economy through the multiplier effect.
7. Throughout most of the decade of the 1990s, gains were made in productivity. What effect do these yearly gains have on the short-run aggregate supply curve? Is there any change in long-run aggregate supply?



## Sample Long Free-Response Questions

1. Assume you are a member of Congress. A member of your staff has just given you the following economic statistics:

	Year Ago Quarter	Last Quarter	Estimate for Quarter Now Ending
Real gross domestic product (in billions of 1997 dollars)	\$2,789	\$2,689	\$2,598
Consumer price index	197	201	204
Unemployment rate	5%	8%	10.2%
Gross private investment (in billions of 1997 dollars)	\$312	\$300	\$287

- (A) What economic problem is this nation facing?
- (B) Identify the fiscal policy actions you would recommend.
- (C) What are the goals of your fiscal policy actions?
- (D) Explain how each policy action you identified in Question 1(B) will fit the goals you stated in Question 1(C).

- (E) Use a correctly labeled aggregate demand and aggregate supply graph to show the effects of your fiscal policy on the economy. Show the changes that will occur in the price level and the level of real GDP.

2. Assume you are a member of Congress. A staff member has just given you the following economic statistics:

	Year Ago Quarter	Last Quarter	Estimate for Quarter Now Ending
Real gross domestic product (in billions of 1997 dollars)	\$2,356	\$2,589	\$2,752
Consumer price index	210	240	250
Unemployment rate	10%	6.5%	5.1%
Gross private investment (in billions of 1997 dollars)	\$312	\$340	\$352

- (A) What economic problem is this nation facing?
- (B) Identify the fiscal policy actions you would recommend.
- (C) What are the goals of your fiscal policy actions?

(D) Explain how each policy action you identified in Question 2(B) will fit the goals you stated in Question 2(C).

(E) Use a correctly labeled aggregate demand and aggregate supply graph to show the effects of your fiscal policy on the economy. Show the changes that will occur in the price level and the level of real GDP.

3. Assume that the economy has been operating at the full-employment levels of output and employment but has recently experienced a decrease in consumption spending because of a sharp decline in stock market indexes that has reduced the wealth of the nation by about 18 percent. Consumption expenditures have decreased at all levels of income.

(A) Use correctly labeled aggregate demand and aggregate supply graphs to illustrate the short-run effect of the decrease in consumption expenditures on each of the following:

- (i) Output
- (ii) Employment
- (iii) The price level

- (B) Identify two fiscal policy actions that could be used to counter the effects of the initial decrease in consumption spending. Explain, using correctly labeled aggregate demand and aggregate supply graphs, the short-run effects of each of your policies on each of the following:
- (i) Output
  - (ii) Employment
  - (iii) The price level

4. Assume that political problems restrict the supply of oil in international markets. Consequently, increased production costs result in the following economic conditions in the United States:
- The unemployment rate is 8 percent and rising.
  - The CPI is rising 9 percent annually and accelerating.
  - The annual rate of growth of real GDP is  $-1.5$  percent.
- (A) Identify and describe the major macroeconomic problems in the economy. Using correctly labeled aggregate demand and aggregate supply graphs, show the condition of the economy.

- (B) With a federal budget deficit of nearly \$350 billion, fiscal authorities are considering the following policy actions to address the existing economic problems:

Policy 1: Increase government expenditures.

Policy 2: Increase personal income taxes.

Policy 3: Decrease business taxes and regulations.

Describe the effect of each of the policies on the economy, and demonstrate each on an individual aggregate demand and aggregate supply graph. Be sure to include each of the following in your description:

- (i) Output
- (ii) Employment
- (iii) The price level

Policy 1:

Policy 2:

Policy 3: