Questions and Answers

Chapter 1

Q1: MCQ

Aggregate demand

1. The aggregate demand curve:
   A) is up-sloping because a higher price level is necessary to make production profitable as production costs rise.
   B) is down sloping because production costs decline as real output increases.
   C) shows the amount of expenditures required to induce the production of each possible level of real output.
   D) shows the amount of real output that will be purchased at each possible price level.
   Answer: D

2. The aggregate demand curve is:
   A) vertical if full employment exists.
   B) horizontal when there is considerable unemployment in the economy.
   C) down sloping because of the interest-rate, real-balances, and foreign purchases effects.
   D) down sloping because production costs decrease as real output rises.
   Answer: C

3. The interest-rate effect suggests that:
   A) a decrease in the supply of money will increase interest rates and reduce interest-sensitive consumption and investment spending.
   B) an increase in the price level will increase the demand for money, reduce interest rates, and decrease consumption and investment spending.
   C) an increase in the price level will increase the demand for money, increase interest rates, and decrease consumption and investment spending.
   D) an increase in the price level will decrease the demand for money, reduce interest rates, and increase consumption and investment spending.
   Answer: C

4. The real-balances effect indicates that:
A) an increase in the price level will increase the demand for money, increase interest rates, and reduce consumption and investment spending.
B) a lower price level will decrease the real value of many financial assets and therefore reduce spending.
C) a higher price level will increase the real value of many financial assets and therefore increase spending.
D) a higher price level will decrease the real value of many financial assets and therefore reduce spending.
Answer: D

5. The interest-rate and real-balances effects are important because they help explain:
A) rightward and leftward shifts of the aggregate demand curve.
B) why fiscal policy cannot be used effectively to curb inflation.
C) the shape of the aggregate demand curve.
D) the shape of the aggregate supply curve.
Answer: C

6. The foreign purchases effect suggests that an increase in the U.S. price level relative to other countries will:
A) increase the amount of U.S. real output purchased.
B) increase U.S. imports and decrease U.S. exports.
C) increase both U.S. imports and U.S. exports.
D) decrease both U.S. imports and U.S. exports.
Answer: B

7. The foreign purchases effect suggests that a decrease in the U.S. price level relative to other countries will:
A) shift the aggregate demand curve leftward.
B) shift the aggregate supply curve leftward.
C) decrease U.S. exports and increase U.S. imports.
D) increase U.S. exports and decrease U.S. imports.
Answer: D

8. The foreign purchases effect:
A) shifts the aggregate demand curve rightward.
B) shifts the aggregate demand curve leftward.
C) shifts the aggregate supply curve rightward.
D) moves the economy along a fixed aggregate demand curve.
Answer: D
9. If the price level increases in the United States relative to foreign countries, then American consumers will purchase more foreign goods and fewer U.S. goods. This statement describes:

A) the output effect.  
B) the foreign purchases effect.  
C) the real-balances effect.  
D) the shift-of-spending effect.  
Answer: B

10. The real-balances, interest-rate, and foreign purchases effects all help explain:

A) why the aggregate demand curve is down sloping.  
B) why the aggregate supply curve is up sloping.  
C) shifts in the aggregate demand curve.  
D) shifts in the aggregate supply curve.  
Answer: A

11. Which of the following explains why the aggregate demand schedule is downward sloping:

A) the real-balances effect  
B) the interest-rate effect  
C) the foreign purchases effect  
D) all of the above  
Answer: D

12. Which of the following is incorrect?

A) As the U.S. price level rises, U.S. goods become relatively more expensive so that U.S. exports fall and U.S. imports rise.  
B) As the price level falls, the demand for money declines, the interest rate declines, and interest-rate sensitive spending increases.  
C) When the price level increases, real balances increase, businesses and households find themselves wealthier and therefore increase their spending.  
D) Given aggregate demand, an increase in aggregate supply increases real output and, assuming downward flexible prices, reduces the price level.  
Answer: C

13. The factors that affect the amounts that consumers, businesses, government, and foreigners wish to purchase at each price level are the:

A) real-balances, interest-rate, and foreign purchases effects.  
B) determinants of aggregate supply.  
C) determinants of aggregate demand.  
D) sole determinants of the equilibrium price level and the equilibrium real output.  
Answer: C
14. The determinants of aggregate demand:
A) explain why the aggregate demand curve is down sloping.
B) explain shifts in the aggregate demand curve.
C) demonstrate why real output and the price level are inversely related.
D) include input prices and resource productivity.
Answer: B

15. Other things equal, if the national incomes of the major trading partners of the United States were to rise, the U.S.:
A) aggregate demand curve would shift to the right.
B) aggregate supply curve would shift to the left.
C) aggregate supply curve would shift to the right.
D) aggregate demand curve would shift to the left.
Answer: A

16. Which one of the following would not shift the aggregate demand curve?
A) a change in the price level
B) depreciation of the international value of the dollar
C) a decline in the interest rate at each possible price level
D) an increase in personal income tax rates
Answer: A

17. Other things equal, a decrease in the real interest rate will:
A) expand investment and shift the AD curve to the left.
B) expand investment and shift the AD curve to the right.
C) reduce investment and shift the AD curve to the left.
D) reduce investment and shift the AD curve to the right.
Answer: B

18. A decline in investment will shift the AD curve to the:
A) left by a multiple of the change in investment.
B) left by the same amount as the change in investment.
C) right by the same amount as the change in investment.
D) right by a multiple of the change in investment.
Answer: A

19. An increase in net exports will shift the AD curve to the:
A) left by a multiple of the change in investment.
B) left by the same amount as the change in investment.
C) right by the same amount as the change in investment.
D) right by a multiple of the change in investment.
Answer: D

20. If investment increases by $10 billion and the economy's MPC is .8, the aggregate demand curve will shift:

A) leftward by $40 billion at each price level. C) rightward by $50 billion at each price level.
B) rightward by $10 billion at each price level. D) leftward by $20 billion at each price level.
Answer: C

21. If investment decreases by $20 billion and the economy's MPC is .5, the aggregate demand curve will shift:

A) leftward by $40 billion at each price level.
B) rightward by $20 billion at each price level.
C) rightward by $40 billion at each price level.
D) leftward by $20 billion at each price level.
Answer: A

22. An economy's aggregate demand curve shifts leftward or rightward by more than changes in initial spending because of the:

A) net export effect. B) wealth effect. C) real-balances effect. D) multiplier effect.
Answer: D

23. The aggregate supply curve:

A) is explained by the interest rate, real-balances, and foreign purchases effects.
B) gets steeper as the economy moves from the top of the curve to the bottom of the curve.
C) shows the various amounts of real output that businesses will produce at each price level.
D) is down sloping because real purchasing power increases as the price level falls.
Answer: C

24. The graphical relationship between the price level and the amount of real GDP that businesses will offer for sale is known as the:

A) aggregate demand curve. C) investment demand curve.
B) investment supply curve. D) aggregate supply curve.
Answer: D
25. The aggregate supply curve (short-run):
A) slopes downward and to the right. C) slopes upward and to the right.
B) graphs as a vertical line. D) graphs as a horizontal line.
Answer: C

26. The aggregate supply curve (short-run):
A) graphs as a horizontal line.
B) is steeper above the full-employment output than below it.
C) slopes downward and to the right.
D) presumes that changes in wages and other resource prices match changes in the price level.
Answer: B

27. The aggregate supply curve (short-run) slopes upward and to the right because:
A) changes in wages and other resource prices completely offset changes in the price level.
B) the price level is flexible upward but inflexible downward.
C) supply creates its own demand.
D) wages and other resource prices adjust only slowly to changes in the price level.
Answer: D

28. The aggregate supply curve (short-run) is up-sloping because:
A) wages and other resource prices match changes in the price level.
B) the price level is flexible upward but inflexible downward.
C) per-unit production costs rise as the economy moves toward and beyond its full-employment real output.
D) wages and other resource prices are flexible upward but inflexible downward.
Answer: C

Use the following diagrams for the U.S. economy to answer the following questions
29. Which of the above diagrams best portrays the effects of an increase in resource productivity?

A) A B) B C) C D) D
Answer: A

30. Which of the above diagrams best portrays the effects of a decrease in the availability of key natural resources?

A) A B) B C) C D) D
Answer: B

31. Which of the above diagrams best portrays the effects of an increase in foreign spending on U.S. products?

A) A B) B C) C D) D
Answer: C

32. Which of the above diagrams best portrays the effects of an increase in consumer spending?

A) A B) B C) C D) D
Answer: C
33. Which of the above diagrams best portrays an improvement in expected rates of return on investment?
   A) A  B) B  C) C  D) D
   Answer: C

34. Which of the above diagrams best portrays the effects of declines in the incomes of U.S. trading partners?
   A) A  B) B  C) C  D) D
   Answer: D

35. Which of the above diagrams best portrays the effects of declines in the prices of imported resources?
   A) A  B) B  C) C  D) D
   Answer: A

36. Which of the above diagrams best portrays the effects of a substantial reduction in government spending?
   A) A  B) B  C) C  D) D
   Answer: D

37. Which of the above diagrams best portrays the effects of a dramatic increase in energy prices?
   A) A  B) B  C) C  D) D
   Answer: B

Use the following to answer questions 38-124:

![Graph showing shifts in the AS curve]
38. In the above diagram, a shift from AS1 to AS3 might be caused by a(n):

A) increase in productivity.
B) increase in the prices of imported resources.
C) decrease in the prices of domestic resources.
D) decrease in business taxes.
Answer: B

39. In the above diagram, a shift from AS1 to AS2 might be caused by a(n):

A) increase in market power of resource sellers.
B) increase in the prices of imported resources.
C) decrease in the prices of domestic resources.
D) increase in business taxes.
Answer: C

40. In the above diagram, a shift from AS3 to AS2 might be caused by an increase in:

A) business taxes and government regulation.
B) the prices of imported resources.
C) the prices of domestic resources.
D) productivity.
Answer: D

41. In the above diagram, a shift from AS2 to AS3 might be caused by a(n):

A) decrease in interest rates.
B) increase in business taxes and costly government regulation.
C) decrease in the prices of domestic resources.
D) decrease in the price level.
Answer: B

42. In the above diagram, the most favorable shift of the aggregate supply curve for the economy would be from:

A) AS1 to AS2.    B) AS1 to AS3.    C) AS2 to AS3.    D) AS3 to AS2.
Answer: D

43. In the above diagram, a substantial appreciation of the U.S. dollar with no immediate change in the U.S. price level would result in a:

A) movement upward along an existing aggregate supply curve such as AS1.
B) movement downward along an existing aggregate supply curve such as AS1.
C) rightward shift of the aggregate supply curve, such as from AS1 to AS2.
D) leftward shift of the aggregate supply curve, such as from AS1 to AS3.
Answer: C

44. Other things equal, an improvement in productivity will:
A) shift the aggregate demand curve to the left.
B) shift the aggregate supply curve to the left.
C) shift the aggregate supply curve to the right.
D) increase the price level.
Answer: C

45. A rightward shift in the aggregate supply curve is best explained by an increase in:
A) business taxes. B) productivity. C) nominal wages. D) the price of imported resources.
Answer: B

Use the following to answer questions 46-49:

Suppose that real domestic output in an economy is 20 units, the quantity of inputs is 10, and the price of each input is $4. Answer the following question(s) on the basis of this information.

46. Refer to the above information. The level of productivity is:
Answer: D

47. The per unit cost of production in the economy described above is:
A) $.50. B) $1. C) $2. D) $5.
Answer: C

48. Refer to the above information. All else being equal, if the price of each input increased from $4 to $6, productivity would:
A) fall from 2 to 3. B) fall from .50 to .33. C) rise from 1 to 2. D) remain unchanged.
Answer: D

49. Refer to the above information. Given an increase in input price from $4 to $6, we would expect the aggregate:
A) supply curve to shift to the left.  C) demand curve to shift to the left.
B) supply curve to shift to the right.  D) demand curve to shift to the right.
Answer: A

50. Other things equal, if the U.S. dollar were to depreciate, the:

A) aggregate demand curve would remain fixed in place.
B) aggregate supply curve would shift to the left.
C) aggregate supply curve would shift to the right.
D) aggregate demand curve would shift to the left.
Answer: B

51. Which one of the following would increase per unit production cost and therefore shift the aggregate supply curve to the left?

A) a reduction in business taxes
B) production bottlenecks occurring when producers near full plant capacity
C) an increase in the price of imported resources
D) deregulation of industry
Answer: C

52. Shifts in the aggregate supply curve are caused by changes in:

A) consumption spending.
B) the quantity of real output demanded.
C) the quantity of real output supplied.
D) one or more of the determinants of aggregate supply.
Answer: D

Use the following to answer questions 53-57:

![Graph showing aggregate demand (AD) and aggregate supply (AS) curves.]

- Real domestic output
- Price level
- Point $P_1$ on AD curve
- Point $P_2$ on AS curve
- Quantity $Q_1$, $Q_2$, $Q_3$
53. Refer to the above diagram. If equilibrium real output is Q2, then:
A) aggregate demand is AD1.  C) producers will supply output level Q1.
B) the equilibrium price level is P1. D) the equilibrium price level is P2.
Answer: D

54. Refer to the above diagram. If the equilibrium price level is P1, then:
A) aggregate demand is AD2.
B) the equilibrium output level is Q3.
C) the equilibrium output level is Q2.
D) producers will supply output level Q1.
Answer: D

55. Refer to the above diagram. At the equilibrium price and quantity:
A) aggregate demand exceeds aggregate supply.
B) the amount of real output demanded and supplied are equal.
C) aggregate demand equals aggregate supply.
D) aggregate supply exceeds aggregate demand.
Answer: B

56. Refer to the above diagram. Which of the following would shift the aggregate demand curve from AD2 to AD1?
A) a decline in personal income tax rates
B) an increase in the international value of the dollar
C) an increase in government spending
D) an upward revision of expected rates of return on investment projects
Answer: B

57. Refer to the above diagram. Suppose that aggregate demand increased from AD1 to AD2. For the price level to stay constant:
A) the aggregate supply curve would have to shift rightward.
B) the aggregate supply curve would have to shift leftward.
C) real domestic output would have to remain constant.
D) the aggregate supply curve would have to be vertical.
Answer: A

58. The size of the multiplier associated with an initial increase in spending will be:
A) the same whether or not inflation occurs.
B) diminished if inflation occurs.
C) zero if any increase in the price level occurs.
D) enhanced if inflation occurs.
Answer: B

59. Which of the following is a true statement?

A) firms and resource suppliers generally find it easier to reduce prices than to raise them.
B) as the price level increases, interest rates will rise and therefore consumption and investment spending will also rise.
C) an initial increase in aggregate demand may cause a further increase in aggregate demand because higher prices mean higher incomes.
D) a decline in aggregate demand will primarily affect real output and employment if prices are inflexible downward.
Answer: D

60. Prices and wages tend to be:

A) flexible both upward and downward.
B) inflexible both upward and downward.
C) flexible downward, but inflexible upward.
D) flexible upward, but inflexible downward.
Answer: D

61. Efficiency wages are:

A) above-market-wages that bring forth so much added work effort that per-unit production costs are lower than at market wages.
B) wage payments necessary to compensate workers for unpleasant or risky work conditions.
C) usually less than market wages.
D) relevant to macro economics because they explain rightward shifts in aggregate demand.
Answer: A

62. When aggregate demand declines, wage rates may be inflexible downward, at least for a time, because of:

A) the foreign purchases effect. B) inflexible product prices.
C) wage contracts. D) the wealth effect.
Answer: C

63. When aggregate demand declines, many firms may reduce employment rather than wages because wage reductions may:

A) reduce per unit production costs.
B) reduce worker morale and work effort, and thus lower productivity.
C) increase the firms' cost of raising financial capital.
D) reduce the demands for their products.
Answer: B

64. When aggregate demand declines, some firms may reduce employment rather than wages because wage reductions may:

A) not be possible due to the minimum wage law.
B) increase the cost of raising money capital.
C) reduce the demands for their products.
D) may set off a price war.
Answer: A

65. When aggregate demand declines, the price level may remain constant, at least for a time, because:

A) firms individually fear that their price cut may set off a price war.
B) menu costs rise.
C) price cuts tend to increase efficiency wages.
D) product markets are highly competitive.
Answer: A

66. Menu costs:

A) increase during recession.
B) decrease during recession.
C) are the costs to firms of changing prices and communicating them to customers.
D) are sunk costs and therefore should be disregarded.
Answer: C

67. The fear of unwanted price wars may explain why many firms are reluctant to:

A) reduce wages when a decline in aggregate demand occurs.
B) reduce prices when a decline in aggregate demand occurs.
C) expand production capacity when an increase in aggregate demand occurs.
D) provide wage increases when labor productivity rises.
Answer: B

AD in relation to the AE model

68. The aggregate expenditures model and the aggregate demand curve can be reconciled because, other things equal, in the aggregate expenditures model:
A) changes in the price level have no effect on the equilibrium level of GDP.  
B) an increase in the price level increases the real value of wealth.  
C) the level of aggregate expenditures and therefore the level of real GDP vary inversely with the price level.  
D) the level of aggregate expenditures and therefore the level of real GDP vary directly with the price level.  
Answer: C  

69. In deriving the aggregate demand curve from the aggregate expenditures model we note that:  
A) the real-balances effect is irrelevant to both models.  
B) a change in the price level will have no impact on the aggregate expenditures schedule.  
C) an increase (decrease) in the price levels shifts the aggregate expenditures schedule upward (downward).  
D) an increase (decrease) in the price level shifts the aggregate expenditures schedule downward (upward).  
Answer: D  

70. An increase in aggregate expenditures resulting from a decrease in the price level is equivalent to a:  
A) rightward shift of the aggregate demand curve.  
B) leftward shift of the aggregate demand curve.  
C) movement downward along a fixed aggregate demand curve.  
D) decrease in aggregate supply.  
Answer: C
71. Refer to the above diagrams. A decline in aggregate expenditures from AE2 to AE1 resulting from the real balances, interest-rate effect, and foreign purchases effects would be depicted as:

A) a movement from A to C along aggregate demand curve AD1.
B) a movement from C to A along aggregate demand curve AD1.
C) a shift of aggregate demand from AD1 to AD2.
D) a shift of aggregate demand from AD2 to AD1.
Answer: B

72. Refer to the above diagrams. Assuming a constant price level, an increase in aggregate expenditures from AE1 to AE2 would:

A) move the economy from A to C along AD1.
B) move the economy from C to A along AD1.
C) increase aggregate demand from AD1 to AD2.
D) decrease aggregate demand from AD2 to AD1.
Answer: C

73. An increase in net exports will shift the:

A) aggregate expenditures curve upward and the aggregate demand curve rightward.
B) aggregate expenditures curve upward and the aggregate demand curve leftward.
C) aggregate expenditures curve downward and the aggregate demand curve rightward.
D) aggregate expenditures curve downward and the aggregate demand curve leftward.
Answer: A

74. An increase in investment spending caused by higher expected rates of return will:

A) shift the aggregate supply curve to the left.
B) move the economy up along an existing aggregate demand curve.
C) shift the aggregate expenditures curve downward and the aggregate demand curve to the left.
D) shift the aggregate expenditures curve upward and the aggregate demand curve to the right.
Answer: D

75. An increase in aggregate expenditures resulting from some factor other than a change in the price level is equivalent to:

A) a rightward shift of the aggregate demand curve in the AD-AS model.
B) a leftward shift of the aggregate demand curve in the AD-AS model.
C) a movement downward along a fixed aggregate demand curve in the AD-AS model.
D) a decrease in aggregate supply in the AD-AS model.
Answer: A

76. When deriving the aggregate demand (AD) curve from the aggregate expenditure model, an increase in U.S. product prices would cause an increase in:

A) the value of household wealth and lower consumption expenditures.
B) interest rates and lower investment expenditures.
C) exports and imports.
D) U.S. resource prices and an increase in aggregate supply.
Answer: B

77. Assume that the MPS is .33 in an economy that has an aggregate supply curve with a slope of 1. An increase in investment spending of $10 billion will shift the aggregate demand curve rightward by:

A) $30 billion and increase real GDP by $15 billion.
B) $30 billion and increase real GDP by $30 billion.
C) $10 billion and increase real GDP by $30 billion.
D) $10 billion and increase real GDP by $10 billion.
Answer: A

Q2. True/False Questions

1. The interest-rate effect is one of the determinants of aggregate demand. Answer: False

2. Other things equal, an increase in productivity will shift the aggregate supply curve rightward. Answer: True

3. An increase in wealth from a substantial increase in stock prices will move the economy along a fixed aggregate demand curve. Answer: False

4. In order to study the macroeconomy we must combine the prices and quantities generated in single-product markets into broad aggregates. Answer: True

5. An increase in imports (independently of a change in the U.S. price level) will increase both U.S. aggregate supply and U.S. aggregate demand. Answer: False
6. An increase in business excise taxes will shift the aggregate supply curve leftward.
Answer: True

7. A decrease in per unit production costs will shift the aggregate supply curve leftward.
Answer: False

8. Unemployment and inflation can coexist.
Answer: True

9. The shape of the aggregate supply curve is determined by what happens to aggregate demand as real output expands.
Answer: False

10. The real-balances effect indicates that inflation makes the public feel wealthier and they therefore spend more out of their current incomes.
Answer: False

11. In locating a particular aggregate demand curve it is assumed that the money supply is fixed.
Answer: True

12. The aggregate supply curve (short-run) becomes steeper as the economy moves rightward and upward along it.
Answer: True

13. The equilibrium price level and equilibrium level of real GDP occur at the intersection of the aggregate demand curve and the aggregate supply curve.
Answer: True

14. The greater the upward slope of the AS curve, the larger is the realized multiplier effect of a change in investment spending.
Answer: False

15. The price level in the United States is more flexible downward than upward.
Answer: False