Questions and Answers

Chapter4

Q1: MCQ

Explaining Macroeconomic Trends and Fluctuations

1) The *AS/AD* model studies the relationship between
A) the price level and unemployment.
B) the price level and real GDP.
C) unemployment and real GDP.
D) nominal GDP and inflation.
Answer: B

2) By using only the aggregate demand curve, we can determine
A) only the price level.
B) only the quantity of real GDP.
C) both the price level and quantity of real GDP.
D) neither the price level nor the quantity of real GDP.
Answer: D

3) In short-run macroeconomic equilibrium
A) real GDP equals potential GDP and aggregate demand determines the price level.
B) the price level is fixed and short-run aggregate supply determines real GDP.
C) real GDP and the price level are determined by short-run aggregate supply and aggregate demand.
D) real GDP is less than potential GDP.
Answer: C

4) The economy is in its short run equilibrium at the point where the
A) price level is stable.
B) *SAS* curve intersects the *LAS* curve.
C) *AD* curve intersects the *LAS* curve.
D) *AD* curve intersects the *SAS* curve.
Answer: D

9) In the short run, the equilibrium level of real GDP
A) is necessarily less than potential GDP.
B) is necessarily equal to potential GDP.
C) is necessarily greater than potential GDP.
D) could be less than, equal to, or greater than potential GDP.
Answer: D

10) In the short run, the intersection of the aggregate demand and the short-run aggregate supply curves,
A) determines the equilibrium price level.
B) is a point where there is neither a surplus nor a shortage of goods.
C) determines the equilibrium level of real GDP.
D) All of the above answers are correct.
Answer: D

11) A short-run macroeconomic equilibrium occurs
A) at the intersection of the short-run aggregate supply curve and the long-run aggregate supply curve.

B) at the intersection of the short-run aggregate supply curve and the aggregate demand curve.
C) at the intersection of the short-run aggregate supply curve, the long-run aggregate supply curve, and the aggregate demand curve.
D) when the rate at which prices of goods and services increase equals the rate at which money wage rates increase.
Answer: B

12) Last year in the country of Union, the price level increased and real GDP increased. Such an outcome might have occurred because short-run aggregate supply ________ and aggregate demand ________.
A) decreased; decreased
B) increased; did not change
C) increased; decreased
D) did not change; increased
Answer: D

13) At long-run macroeconomic equilibrium, ________.
A) an inflationary gap exists
B) real GDP equals potential GDP
C) a recessionary gap exists
D) real GDP is less than potential GDP but is as close as it is possible to be
Answer: B

14) If the economy is at long run equilibrium then
A) real GDP equals potential GDP.
B) nominal GDP equals potential GDP.
C) real GDP cannot be equal to potential GDP.
D) real GDP can be greater than, less than, or equal to potential GDP.
Answer: A

15) Full-employment equilibrium occurs when
A) real GDP exceeds potential GDP.
B) real GDP equals potential GDP.
C) potential GDP exceeds real GDP.
D) a result of an increase in long-run aggregate supply.
Answer: B

16) In long-run macroeconomic equilibrium,
A) real GDP equals potential GDP.
B) the price level is fixed and aggregate demand determines real GDP.
C) real GDP and the price level are determined by short-run aggregate supply and aggregate demand and long-run aggregate supply is irrelevant.
D) real GDP is less than potential GDP.
Answer: A

		Real GDP supplied	
Price level	Real GDP demanded (dollars)	Short run (dollars)	Long run (dollars)
90	700	300	600
100	600	400	600
110	500	500	600
120	400	600	600

17) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land.

With no changes in aggregate demand or long-run aggregate supply, in long-run macroeconomic equilibrium, the price level will be ________ and real GDP will be ________.
A) 120; $400
B) 110; $500
C) 90; $400
D) 100; $600
Answer: D

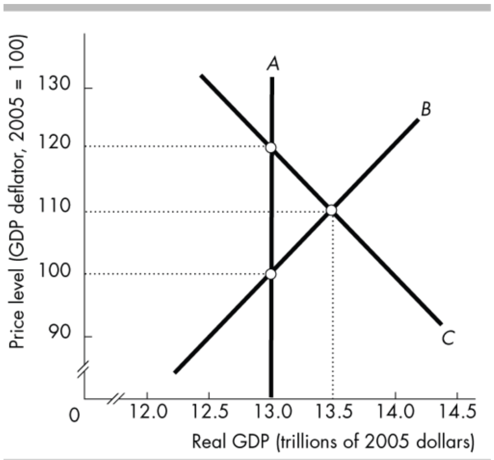
Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
130	8	12	10
120	9	11	10
110	10	10	10
100	11	9	10
90	12	8	10

18) The data in the above table indicate that when the price level is 120,
A) inventories fall and the price level rises.
B) the economy is in a long-run macroeconomic equilibrium.
C) inventories rise and the price level falls.
D) the unemployment rate is at its equilibrium level.
Answer: C

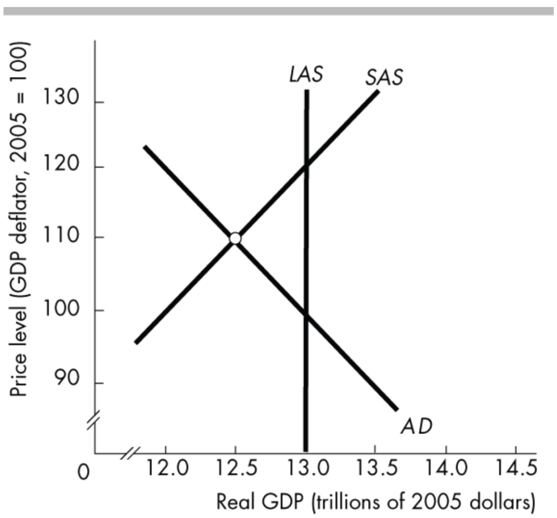
19) The data in the above table indicate that when the price level is 100,
A) inventories fall and the price level rises.
B) the economy is in a long-run macroeconomic equilibrium.
C) inventories rise and the price level falls.
D) the unemployment rate is at its equilibrium level.
Answer: A

20) The data in the above table indicate that when the price level is 100,
A) firms have unexpectedly low inventories, so prices will rise.
B) inventories are at levels planned by firms.
C) firms will plan to decrease the level of output.
D) firms have unexpectedly high inventories, so prices fall.
Answer: A

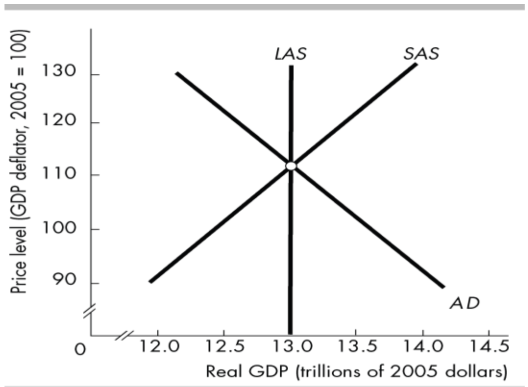
21) The data in the above table indicate that when the price level is 120,
A) firms have unexpectedly low inventories, so prices will rise.
B) inventories are at levels planned by firms.
C) firms will plan to increase the level of output.
D) firms have unexpectedly high inventories, so prices fall.
Answer: D



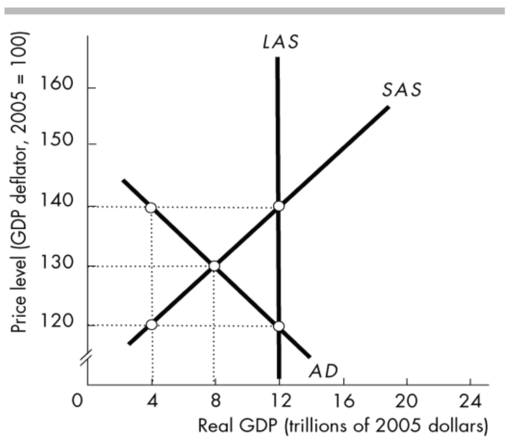
22) In the above figure, curve *A* is the ________ curve, curve *B* is the ________ curve, and curve *C* is the ________ curve.
A) long-run aggregate supply; short-run aggregate supply; aggregate demand
B) aggregate demand; short-run aggregate supply; long-run aggregate supply
C) short-run aggregate supply; long-run aggregate supply; aggregate demand
D) long-run aggregate supply; aggregate demand; short-run aggregate supply
Answer: A



23) In the figure above, in the short-run macroeconomic equilibrium,
A) there is no structural unemployment.
B) real GDP is greater than potential GDP.
C) real GDP equals potential GDP.
D) real GDP is less than potential GDP.
Answer: D



24) The above figure depicts an economy with a short-run equilibrium
A) at full employment.
B) below full employment.
C) at higher than full-employment.
D) None of the above answers are correct.
Answer: A



25) In the above figure, at the price level of 140 and real GDP of
A) $12 trillion, firms will not be able to sell all their output.
B) $4 trillion, firms will not be able to sell all their output.
C) $4 trillion, consumers will not be able to buy all the goods and services they demand.
D) $12 trillion, consumers will not be able to buy all the goods and services they demand.
Answer: A

26) Based on the figure above, short-run equilibrium occurs at the price level of
A) 120 and real GDP of $4 trillion.
B) 130 and real GDP of $8 trillion.
C) 140 and real GDP of $12 trillion.
D) 130 and real GDP of $12 trillion.
Answer: B

27) The data in the above figure indicate that the economy will be in a long-run macroeconomic equilibrium at a price level of
A) 140.
B) 130.
C) 100.
D) 120.
Answer: D

28) Which of the following can be said about economic growth?
I. Economic growth is the result of increases in long-run aggregate supply.
II. Economic growth is the result of increases in aggregate demand.
A) I only
B) II only
C) I and II
D) neither I or II
Answer: A

29) Economic growth is best defined as
A) decreases in potential GDP.
B) increases in potential GDP.
C) rightward shifts of the *AD* curve.
D) rightward shifts of the *SAS* curve.
Answer: B

30) Which of the following helps determine the growth rate of potential GDP?
I. capital accumulation
II. technology advances
III. growth in the quantity of money
A) I
B) I and II
C) I and III
D) I, II and III
Answer: B

31) Economic growth
A) occurs when the long-run aggregate supply curve shifts upward.
B) is an increase in potential GDP as the long-run aggregate supply curve shifts rightward.
C) requires a compensating decrease in aggregate demand to offset the increase in aggregate supply.
D) All of the above answers are correct.
Answer: B

32) Over time in a growing economy, the long-run aggregate supply curve will
A) become horizontal at the long-run potential price level.
B) shift rightward.
C) shift leftward.
D) become increasingly steep.
Answer: B

33) The country of Mu has continuous strong economic growth and a steady price level. This situation is most likely the result of aggregate demand growing ________ aggregate supply.
A) at the same pace as long-run
B) slower than long-run
C) slower than short-run
D) faster than long-run
Answer: A

34) If aggregate demand grows only slightly faster than potential GDP, then the economy will ________.
A) experience economic growth with high inflation
B) experience recession
C) experience economic growth with low inflation
D) be at a business-cycle peak
Answer: C

37) Inflation occurs over time as a result of
A) long-run aggregate supply increasing faster than aggregate demand.

B) long-run aggregate supply increasing faster than short-run aggregate supply.
C) decreases in aggregate demand.
D) aggregate demand increasing faster than long-run aggregate supply.
Answer: D

38) If the aggregate demand curve shifts ________ faster than the long -run aggregate supply curve, then ________ occurs.
A) leftward; economic growth
B) leftward; inflation
C) rightward; economic growth
D) rightward; inflation
Answer: D

39) When an increase in aggregate demand exceeds the increase in aggregate supply,
A) real GDP decreases while nominal GDP increases.
B) the price level falls while real GDP increases.
C) nominal GDP decreases and real GDP decreases.
D) the economy will experience inflation as the price level rises.
Answer: D

40) Business cycles are the result of
A) regular shifts of the *AD* curve only.
B) irregular shifts of the *SAS* curve only.
C) regular shifts of both the *AD* and *SAS* curves.
D) irregular shifts of both the *AD* and *SAS* curves.
Answer: D

41) One result of a decrease in aggregate demand and no change in aggregate supply is
A) a recession.
B) an increase in employment levels.
C) an economic expansion.
D) a rise in the price level.
Answer: A

42) Starting at full employment, a business cycle can be described by the following sequence: ________ equilibrium, ________ equilibrium, ________ equilibrium.
A) full-employment; below full-employment; above full-employment
B) below full-employment; full-employment; above full-employment
C) above full-employment; below full-employment; full-employment
D) below full-employment; full-employment; below full-employment
Answer: B

43) When real GDP exceeds potential GDP, then the economy has
A) an inflationary gap.
B) a below full-employment equilibrium.
C) a recessionary gap.
D) None of the above answers are correct.
Answer: A

44) An inflationary gap is occurs when
A) real GDP is less than potential GDP.
B) real GDP exceeds potential GDP.
C) real GDP equals potential GDP.
D) the economy is at full employment.
Answer: B

45) When the economy is at an above full-employment equilibrium, ________.

A) nominal GDP exceeds real GDP
B) an inflationary gap exists
C) a recessionary gap exists
D) real GDP is less than potential GDP
Answer: B

46) An above full-employment equilibrium is
A) a theoretical possibility but cannot happen in reality.
B) the equilibrium in which the economy is in most of the time.
C) when real GDP exceeds potential GDP.
D) the period of time when prices are falling.
Answer: C

47) A recessionary gap means that short-run macroeconomic equilibrium GDP
A) is less than full-employment GDP.
B) equals full-employment GDP.
C) is more than full-employment GDP.
D) may be less than, more than, or the same as full-employment GDP depending on the level of potential GDP.
Answer: A

48) If real GDP is less than potential GDP, then the economy is ________ equilibrium.
A) at an above full-employment
B) not in short-run macroeconomic
C) at a below full-employment
D) in long-run macroeconomic
Answer: C

49) A recessionary gap occurs when
A) real GDP is less than potential GDP.
B) nominal GDP is less than potential GDP.
C) high rates of inflation occur.
D) nominal GDP is greater than potential GDP.
Answer: A

50) If aggregate demand decreases and neither short-run nor long-run aggregate supply changes, then
A) the price level increases in the short-run and decreases in the long-run.
B) there is an inflationary gap.
C) there is a recessionary gap.
D) in the long run, the long-run aggregate supply will decrease.
Answer: C

51) A below full-employment equilibrium
A) is not possible in the U.S. economy.
B) occurs when real GDP is less than potential GDP.
C) occurs when the price level is rising very quickly.
D) occurs when real GDP exceeds potential GDP.
Answer: B

52) An economy is at full employment. Which of the following events can create a recessionary gap?
A) an increase in foreign income
B) an increase in taxes
C) a decrease in the quantity of capital
D) a decrease in money wages
Answer: B

53) The Great Depression , in which real GDP fell and unemployment rose, can be characterized as a ________.
A) inflationary gap
B) long-run equilibrium
C) recessionary gap
D) full-employment equilibrium
Answer: C

54) Suppose the economy is experiencing a recessionary gap. In the long run, if aggregate demand does not change the money wage rate ________, unemployment ________, and the price level ________.
A) falls; rises; falls
B) falls; falls; falls
C) rises; rises; rises
D) rises; falls; rises
Answer: B

55) An above full-employment equilibrium occurs when
A) aggregate demand decreases while neither the short-run nor long-run aggregate supply changes.
B) short-run aggregate supply decreases while neither aggregate demand nor long –run aggregate supply changes.
C) the equilibrium level of real GDP is greater than potential GDP.
D) the equilibrium level of real GDP is less than potential GDP.
Answer: C

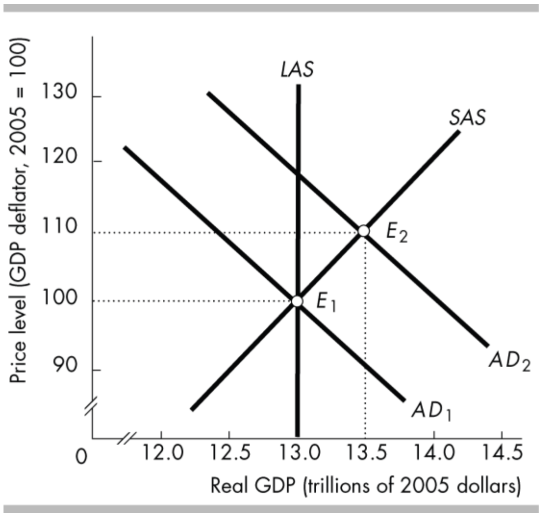
		Real GDP supplied	
Price level	Real GDP demanded (dollars)	Short run (dollars)	Long run (dollars)
90	700	300	600
100	600	400	600
110	500	500	600
120	400	600	600

56) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. The short-run macroeconomic equilibrium is a price level of ________ and a real GDP of ________.
A) 90; $400
B) 100; $400
C) 110; $500
D) 120; $400
Answer: C

57) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. In short-run equilibrium, there is ________.
A) an inflationary gap of $100
B) a recessionary gap of $100
C) a recessionary gap of $200
D) an inflationary gap of $200
Answer: B

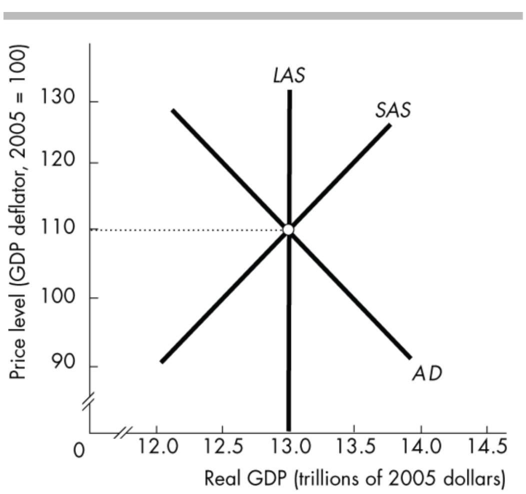
58) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. Lotus Land is in short-run macroeconomic equilibrium. In the long run, if aggregate demand does not change then Lotus Land will return to full-employment as ________.

A) the money wage rate rises
B) the money wage rate falls
C) businesses cut their imports
D) the government cuts taxes
Answer: B



59) In the above figure, the inflationary gap when *AD*2 is the aggregate demand curve equals
A) the difference between 110 and 100.
B) the difference between \$12.5 trillion and \$12.0 trillion.
C) *LAS* minus *SAS* at a price level of 100.
D) *AD*1.
Answer: B

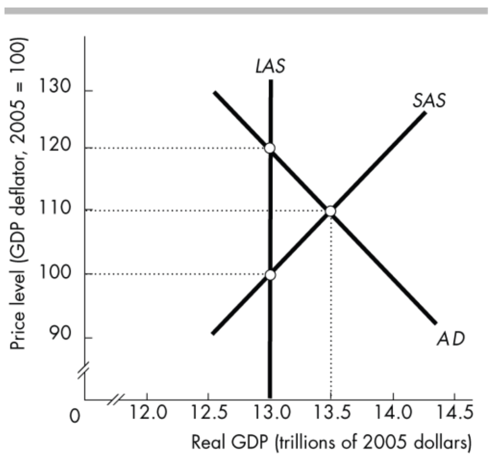
60) The reason that it is possible for the economy in the above figure to be at equilibrium *E*2 rather than at *E*1 is that
A) in the long run there is always less than full employment.
B) in the short run the economy can produce more than it can in a long -run situation.
C) *AD* always shifts rightward and never shifts leftward.
D) the economy must be in a recession.
Answer: B



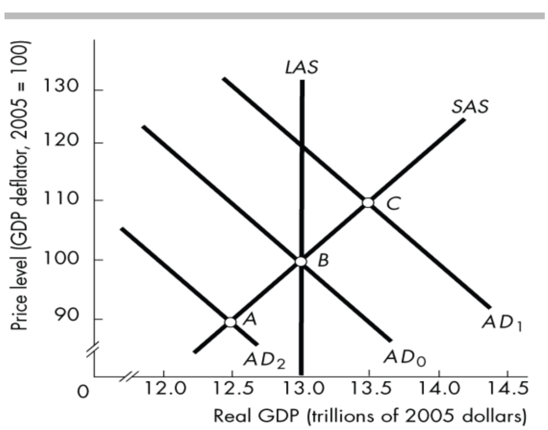
61) The above figure illustrates

A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) an equilibrium at the economy′s physical limits.
Answer: B

62) An inflationary gap means that short-run macroeconomic equilibrium GDP
A) is less than full-employment GDP.
B) equals full-employment GDP.
C) is more than full-employment GDP.
D) may be less than, more than, or the same as full-employment GDP depending on the level of potential GDP.
Answer: C



63) The above figure illustrates
A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) an equilibrium at the economy′s physical limits.
Answer: C

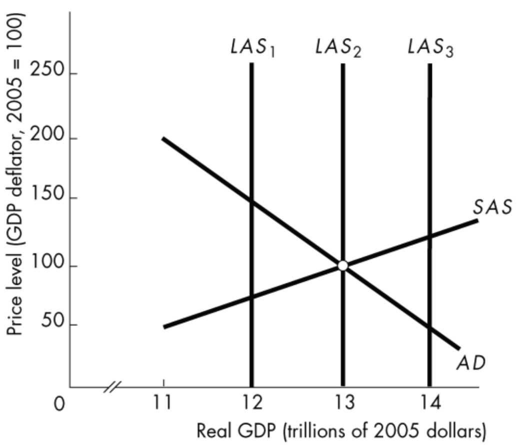


64) In the above figure, point *A* represents
A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) an increase in aggregate demand.

Answer: A

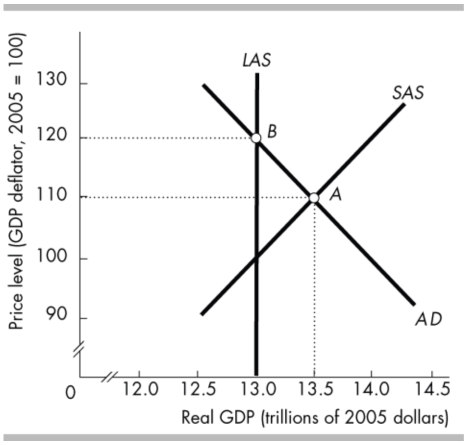
65) In the above figure, point *B* represents
A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) a decrease in aggregate demand.
Answer: B

66) In the above figure, point *C* represents
A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) a decrease in aggregate demand.
Answer: C



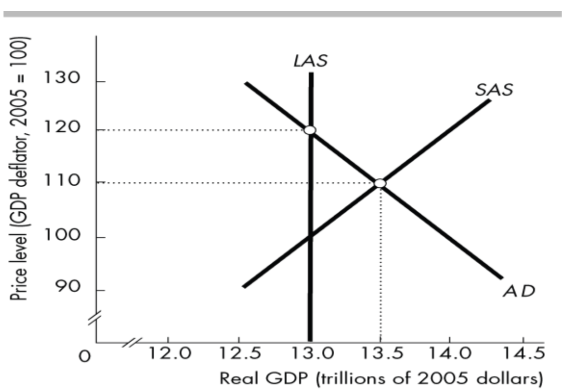
67) In the above figure, the short-run aggregate supply curve is *SAS* and the aggregate demand curve is *AD*. A recessionary gap exists
A) if the long-run aggregate supply curve is *LAS*1.
B) if the long-run aggregate supply curve is *LAS*2.
C) if the long-run aggregate supply curve is *LAS*3.
D) All of the above answers are correct.
Answer: C

68) In the above figure, the short-run aggregate supply curve is *SAS* and the aggregate demand curve is *AD*. An inflationary gap exists
A) if the long-run aggregate supply curve is *LAS*1.
B) if the long-run aggregate supply curve is *LAS*2.
C) if the long-run aggregate supply curve is *LAS*3.
D) All of the above answers are correct.
Answer: A



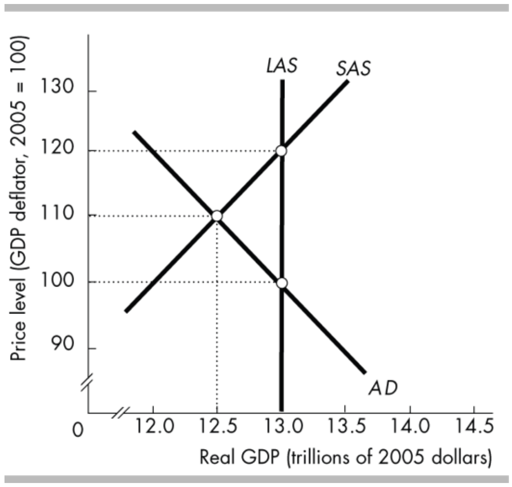
69) In the above figure, if the economy is at point *A*, which of the following is true?
A) Point *A* is the long-run equilibrium point.
B) The economy is in a recession.
C) Money wages can be expected to fall.
D) The economy might be at point *A* as a result of a recent cut in the tax rate.
Answer: D

70) In the above figure, if the economy is at point *A*, which of the following is true?
A) There is a recessionary gap.
B) There is an inflationary gap.
C) Point *A* is the long-run equilibrium point.
D) None of the above answers are correct.
Answer: B



71) The above figure depicts an economy
A) with an inflationary gap.
B) with a recessionary gap.
C) producing at full employment.
D) None of the above answers is correct.
Answer: A

72) In the above figure, the short-run equilibrium will eventually adjust to a long-run equilibrium with a
A) lower price level and smaller real GDP
B) higher price level and larger real GDP.
C) higher price level and smaller real GDP.
D) lower price level and larger real GDP.
Answer: C



73) The above figure illustrates
A) a recessionary gap.
B) a full-employment equilibrium.
C) an inflationary gap.
D) an equilibrium at the economy′s physical limits.
Answer: A

74) In the above figure, if aggregate demand does not change the short -run equilibrium will
A) eventually adjust to a long-run equilibrium with a higher price level.
B) will not adjust on its own.
C) eventually adjust to a long-run equilibrium with a lower price level.
D) None of the above answers are correct.
Answer: C

75) Suppose the economy was initially in a long-run equilibrium. Then the world economy expands so that foreign incomes rise. U.S. aggregate demand ________ and eventually the money wage rate ________.
A) increases; rises
B) increases; falls
C) decreases; rises
D) decreases; falls
Answer: A

76) If the economy is in long run equilibrium and aggregate demand increases, then in the short run
A) nothing happens because the economy is in long run equilibrium.
B) the price level rises and real GDP does not change.
C) real GDP increases and the price level does not change.
D) the price level rises and real GDP increases.
Answer: D

77) The Federal Reserve lowers interest rates. As a result, in the short run, real GDP ________ and the price level ________.
A) increases; rises
B) increases; falls
C) decreases; rises
D) decreases; falls
Answer: A

78) The government increases taxes. As a result, in the short run, real GDP ________ and the price level ________.

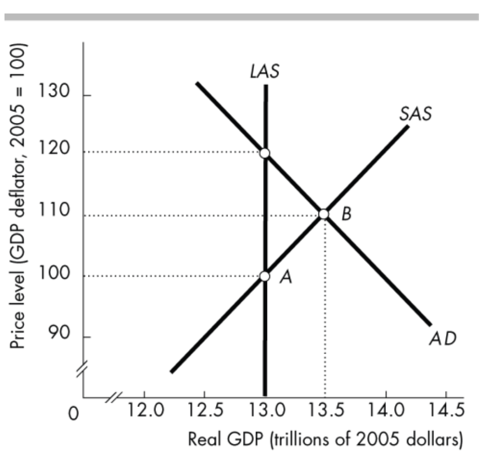
A) increases; rises
B) decreases; falls
C) decreases; rises
D) increases; falls
Answer: B

79) In the short run, an increase in government expenditure on goods and services ________ real GDP and ________ the price level.
A) increases; rises
B) increases; falls
C) decreases; rises
D) decreases; falls
Answer: A

80) In the short-run, a decrease in government expenditure ________ real GDP and ________ the price level.
A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases
Answer: D

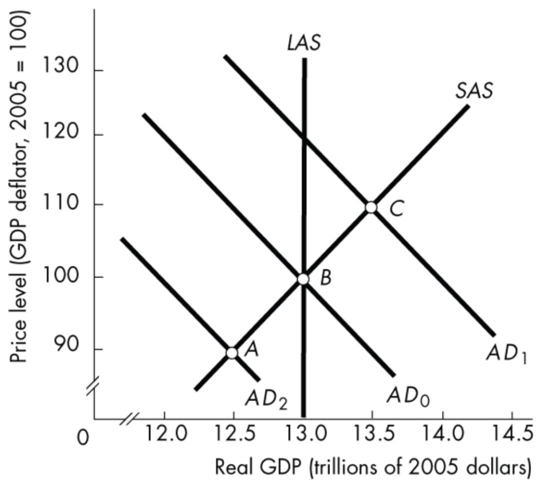
81) In the short run, an increase in aggregate demand
A) lowers the price level and decreases real GDP.
B) lowers the price level and increases real GDP.
C) raises the price level and increases real GDP.
D) raises the price level and decreases real GDP.
Answer: C

82) A lower price level combined with a decrease in real GDP occurs when the
A) short-run aggregate supply curve shifts rightward.
B) short-run aggregate supply curve shifts leftward.
C) aggregate demand curve shifts rightward.
D) aggregate demand curve shifts leftward.
Answer: D



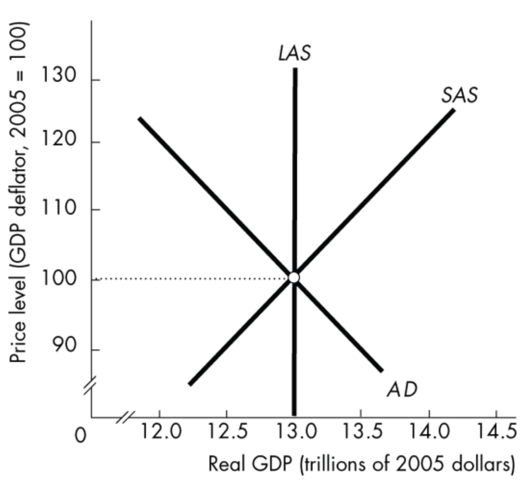
83) In the above figure, suppose the economy had been at point *A* and now is at *B*. What could have lead to the movement to *B*?
A) A tax hike.
B) Government expenditures on goods and services increased.
C) Winter storms cause factories in the north to be shut down for several weeks.

D) Money wage rates rose.
Answer: B



84) Suppose the economy is at point *B*. If firms expect profits will be higher in the future, to what point might the economy′s move in the short run?
A) It stays at point *B*.
B) It shifts to a point such as *A*.
C) It shifts to a point such as *C*.
D) None of the above answers are correct because it is the *SAS* curve that shifts, not the *AD* curve.
Answer: C

85) Suppose the economy is at point *B*. If a recession in another country decreases exports, to what point might economy move in the short run?
A) It stays at point *B*.
B) It shifts to a point such as *A*.
C) It shifts to a point such as *C*.
D) None of the above answers are correct because it is the *SAS* curve that shifts, not the *AD* curve.
Answer: B



86) The figure illustrates aggregate demand and aggregate supply in Sparta. Which of the following events will decrease Sparta's real GDP in the short run?
A) a decrease in taxes

B) a fall in resource prices
C) a decrease in government expenditure
D) an increase in investment
Answer: C

87) The figure above illustrates aggregate demand and aggregate supply in Sparta. Sparta's price level will rise above 100 if ________.
A) government expenditure decreases
B) the quantity of money increases
C) the quantity of capital increases
D) taxes increase
Answer: B

88) In a short-run macroeconomic equilibrium, potential GDP exceeds real GDP. If aggregate demand does not change, then the
A) short-run aggregate supply curve will shift rightward as the money wage rate falls.
B) short-run aggregate supply curve will shift leftward as the money wage rate rises.
C) long-run aggregate supply curve will shift leftward as the money wage rate rises.
D) long-run aggregate supply curve will shift leftward as the money wage rate falls.
Answer: A

89) In a short-run macroeconomic equilibrium, real GDP exceeds potential GDP. If aggregate demand does not change, then the
A) short-run aggregate supply curve will shift rightward as the money wage rate falls.
B) short-run aggregate supply curve will shift leftward as the money wage rate rises.
C) long-run aggregate supply curve will shift leftward as the money wage rate rises.
D) long-run aggregate supply curve will shift leftward as the money wage rate falls.
Answer: B

90) The country of Stanley is at an above-full employment equilibrium. Which of the following events will return Stanley to full-employment?
A) an increase in government expenditures
B) a decrease in the interest rate
C) an increase in the money wage rate
D) an increase in the quantity of money
Answer: C

91) An economy currently has a inflationary gap. An increase in the money wage rate will ________ the inflationary gap and ________ the price level.
A) decrease; decrease
B) increase; increase
C) increase; decrease
D) decrease; increase
Answer: D
Show it graphically

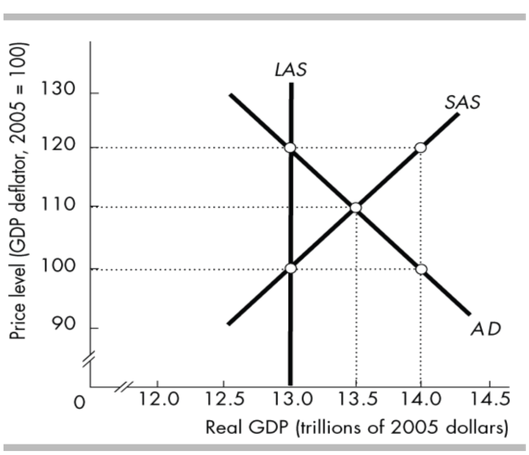
92) Suppose the current situation is such that the price level is 120, real GDP is $13 trillion, and GDP along the long-run aggregate supply curve is $12.6 trillion. What will take place to restore the long-run equilibrium?
A) The price level will fall until long-run aggregate supply increases to $13 trillion.
B) The price level will fall and money wage rates will rise until real GDP along the long-run aggregate supply curve is $13 trillion.
C) Money wage rates will rise until real GDP is $12.6 trillion.
D) Aggregate demand will increase until both short-run and long-run aggregate supply equal $13 trillion.
Answer: C
Show it graphically

93) The long-run aggregate supply curve is vertical at $12 trillion but the short-run aggregate supply curve intersects the aggregate demand curve at $13 trillion. We know that
A) the economy is producing below full employment in the short run, and will adjust by hiring more workers, thus decreasing unemployment.
B) the price level is too high. The long-run equilibrium will occur with a lower price level.
C) adjustments will occur so that the long-run aggregate supply equals $13 trillion.
D) adjustments will occur so that the short-run aggregate supply eventually intersects the aggregate demand curve at $12 trillion.
Answer: D
Show it graphically

94) In long-run macroeconomic equilibrium, the
A) real wage rate has adjusted so that the economy is on the short-run aggregate supply curve but not on the long-run aggregate supply curve.
B) long-run aggregate supply curve has shifted so that potential GDP equals real GDP.
C) aggregate demand curve adjusts to the point where the long-run aggregate supply curve and the short-run aggregate supply curve intersect.
D) None of the above answers is correct.
Answer: D

95) If the economy is in long run equilibrium and then aggregate demand increases, in the long run the increase in aggregate demand means that the
A) price level will be higher but real GDP will be unaffected.
B) real GDP will be larger but the price level will be unaffected.
C) the price level will be higher and real GDP will be larger.
D) neither the price level nor real GDP will be unaffected.
Answer: A

96) In the long-run equilibrium, an increase in the quantity of capital leads to
A) an increase in the equilibrium price level and an increase in equilibrium real GDP.
B) a decrease in the equilibrium price level and an increase in equilibrium real GDP.
C) a decrease in the equilibrium price level, but no change in equilibrium real GDP.
D) no change in the equilibrium price level, but an increase in equilibrium real GDP.
Answer: B



97) In the above figure, at the point where *AD* equals *SAS*,
A) real GDP exceeds potential GDP.
B) potential GDP exceeds real GDP.
C) the economy is in a recession.
D) the unemployment rate is zero.

Answer: A

98) In the above figure, as the economy adjusts toward equilibrium, the
A) *AD* curve will shift rightward.
B) *SAS* curve will shift rightward.
C) *AD* curve will shift leftward.
D) *SAS* curve will shift leftward.
Answer: D

99) In the above figure, when the economy is in a long-run equilibrium, the price level will be
A) 90.
B) 100.
C) 110.
D) 120.
Answer: D

100) In the above figure, when the economy is in a long-run equilibrium, real GDP will be
A) $12.5 trillion.
B) $13.0 trillion.
C) $13.5 trillion.
D) $14.0 trillion.
Answer: B

SHOCKS

Fiscal Policy

1 The Federal Budget

1) Prior to the Great Depression, the purpose of the federal budget was to ________.
A) stabilize the economy
B) finance the activities of the government
C) maintain low interest rates
D) decrease unemployment
Answer: B

2) The use of the U.S. federal budget to help stabilize the economy grew in reaction to the ________ and is known as ________.
A) stagflation of the 1970s; fiscal policy
B) Great Depression of the 1930s; fiscal policy
C) stagflation of the 1970s; government policy
D) Great Depression of the 1930s; monetary policy
Answer: B

3) Fiscal policy includes
A) only decisions related to government expenditure on goods and services.
B) only decisions related to government expenditure on goods and services and the value of transfer payments.
C) only decisions related to the value of transfer payments and tax revenue.
D) decisions related to government expenditure on goods and services, the value of transfer payments, and tax revenue.
Answer: D

4) Fiscal policy involves
A) the use of interest rates to influence the level of GDP.
B) the use of tax and spending policies by the government.
C) decreasing the role of the Federal Reserve in the everyday life of the economy.

D) the use of tax and money policies by government to influence the level of interest rates.
Answer: B

5) Fiscal policy
A) is enacted by the Federal Reserve.
B) involves changing interest rates.
C) involves changing taxes and government spending.
D) involves changing the money supply.
Answer: C

6) Fiscal policy attempts to achieve all of the following objectives EXCEPT ________.
A) a stable money supply
B) price level stability
C) full employment
D) sustained economic growth
Answer: A

7) Changes in which of the following is included as part of fiscal policy?
A) the quantity of money
B) the level of interest rates
C) monetary policy
D) tax rates
Answer: D

8) All of the following are part of fiscal policy EXCEPT
A) setting tax rates.
B) setting government spending.
C) choosing the size of the government deficit.
D) controlling the money supply.
Answer: D

9) The budget process includes the
A) President proposing and Congress passing the budget.
B) President passing the budget as proposed by Congress.
C) House of Representatives proposing and the Senate passing the budget.
D) Senate proposing and the House of Representatives passing the budget.
Answer: A

10) Which branches of the government play a role in the enacting the federal budget?
I. the President.
II. the House of Representatives.
III. the Senate.
A) I and II
B) II and III
C) I, II and III
D) I
Answer: C

11) Which of the following government bodies does NOT participate directly in formulating U.S. fiscal policy?
A) the President and his cabinet
B) the Federal Reserve Board
C) the House of Representatives
D) the Senate
Answer: B

12) The purpose of the Employment Act of 1946 was to

A) establish goals for the federal government that would promote maximum employment, purchasing power, and production.
B) establish an unemployment compensation system.
C) set up the Federal Reserve System.
D) set targets for the unemployment rate to be achieved by the president.
Answer: A

13) Which of the following is NOT a revenue source for the Federal government?
A) personal income taxes
B) indirect taxes
C) interest on corporate bond holdings
D) social security taxes
Answer: C

14) Expenditures such as Social Security benefits, farm subsidies and grants are considered
A) expenditures on goods and services
B) transfer payments
C) debt reduction
D) debt interest
Answer: B

15) Social Security benefits and expenditures on Medicare and Medicaid are classified as
A) debt interest.
B) purchases of goods and services.
C) production of goods and services.
D) transfer payments.
Answer: D

16) Which of the following is NOT a government outlay?
A) transfer payments
B) expenditure on goods and services
C) debt interest on the government′s debt
D) purchases of foreign bonds
Answer: D

17) All of the following are government outlays EXCEPT
A) interest on the government′s debt.
B) transfer payments.
C) purchases of corporate bonds.
D) expenditure on goods and services.
Answer: C

Component	Dollars (billion)
Personal income taxes	500
Social security taxes	400
Corporate income taxes	150
Indirect taxes	75
Transfer payments	1,200
Expenditure on goods and services	225
Debt interest	75

29) The table above has data for a country's government budget. The country has government revenues of ________ billion.
A) $900

B) $1125
C) $725
D) $1700
Answer: B

30) The table above has data for a country′s government budget. Government outlays for the economy equal ________ billion.
A) $1200
B) $1275
C) $1500
D) $1425
Answer: C

31) The table above has data for a country′s government budget. The data show the government is running a ________ billion.
A) budget surplus of $300
B) budget deficit of $375
C) budget deficit of $550
D) budget surplus of $650
Answer: B

32) The largest source of revenue for the federal government is ________ and the largest outlay is for ________.
A) corporate taxes; Social Security
B) personal income taxes; Medicare
C) personal income taxes; interest on national debt
D) personal income taxes; transfer payments
Answer: D

33) The government′s budget deficit or surplus equals the
A) change in outlays divided by change in revenue.
B) average outlay divided by average revenue.
C) change in revenue minus change in outlays.
D) total tax revenue minus total government outlays.
Answer: D

34) A budget surplus occurs when government
A) outlays exceeds tax revenues.
B) tax revenues exceeds outlays.
C) tax revenues equals outlays.
D) tax revenues equal social security expenditures.
Answer: B

35) Whenever the federal government spends more than it receives in tax revenue, then by definition it
A) runs a budget surplus.
B) operates a balanced budget.
C) runs a budget deficit.
D) increases economic growth.
Answer: C

36) The budget deficit
A) is the total outstanding borrowing by the government.
B) is the difference between government outlays and tax revenues.
C) decreased during the Obama Administration.
D) reached its peak in the year 2000.
Answer: B

37) A government incurs a budget deficit when
A) taxes are greater than government outlays.
B) taxes are less than government outlays.
C) exports are greater than imports.
D) exports are less than imports.
Answer: B

38) If taxes exactly equaled government outlays the
A) federal government debt would be zero.
B) federal government debt would decrease.
C) budget deficit would not change.
D) budget deficit would be zero.
Answer: D

39) If the federal government's tax revenues are greater than its outlays, then the federal budget has a
A) deficit.
B) surplus.
C) transfer payment.
D) balanced budget.
Answer: B

40) By definition, a government budget deficit is the situation that occurs when the
A) government outlays exceed what it receives in taxes.
B) government miscalculated how much it will receive in taxes.
C) government spends money on things which do not produce revenue, such as schools.
D) economy goes into a recession.
Answer: A

41) The U.S. government′s budget
A) must be balanced each year.
B) has mostly been in surplus during the past 30 years.
C) has mostly been in deficit during the past 30 years.
D) has always been in deficit during the past 30 years.
Answer: C

42) When tax revenues exceed outlays, the government has a ________, and when outlays exceed tax revenues, the government has a ________.
A) budget surplus; budget debt
B) budget deficit; budget surplus
C) budget debt; budget surplus
D) budget surplus; budget deficit
Answer: D

43) A government that currently has a budget deficit can balance its budget by ________.
A) increasing tax revenues by more than it increases outlays
B) increasing both tax revenues and outlays by the same amount
C) decreasing tax revenues by more than it decreases outlays
D) decreasing tax revenues by more than it increases outlays
Answer: A

44) In 2011, the U.S. government budget had a deficit. By definition, then,
A) tax revenues were less than government outlays.
B) tax revenues were equal to government outlays.
C) tax revenues were greater than government outlays.
D) the government debt became negative.
Answer: A

45) Suppose the only revenue taken in by the government is in the form of income tax, and the tax rate is 10 percent. If aggregate income is $800 billion, and government outlays are $100 billion then the government budget has
A) a deficit of $20 billion.
B) a surplus of $20 billion.
C) neither a surplus nor a deficit.
D) a deficit of $80 billion.
Answer: A

46) In 2011, the federal government of Happy Isle had tax revenues of $1 million, and spent $500,000 on transfer payments, $250,000 on goods and services and $300,000 on debt interest. In 2011, the government of Happy Isle had a ________.
A) balanced budget
B) budget deficit of $50,000
C) budget surplus of $50,000
D) budget deficit of $1,050,000
Answer: B

47) The federal government debt is equal to the
A) obligations of benefits from federal taxes and expenditures.
B) sum of all annual federal government outlays.
C) sum of past budget deficits minus the sum of past budget surpluses.
D) annual difference between federal government tax revenues and outlays.
Answer: C

48) The sum of past budget deficits minus the sum of past budget surpluses refers to
A) the national debt.
B) the cyclically unbalanced budget.
C) the structural national debt.
D) the federal government net worth.
Answer: A

49) If the government has a balanced budget, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: C

50) If the government runs a surplus, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: B

51) If the government runs a deficit, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: A

52) An increase in the government ________ reduces the government's ________.
A) budget deficit; debt
B) budget surplus; debt

C) debt; budget deficit
D) None of the above answers is correct.
Answer: B

53) Suppose a country has been running a persistent government budget deficit. If the deficit is reduced, but remains positive,
A) government debt will increase.
B) government debt will decrease.
C) the country will experience a budget surplus.
D) interest payments on the debt immediately will decrease.
Answer: A

54) If tax revenue equal $1.5 billion and government outlays equal $1.6 billion, then the
A) government budget has a deficit of $0.1 billion.
B) government budget has a surplus of $0.1 billion.
C) government debt is equal to $0.1 billion.
D) government debt declines by $0.1 billion.
Answer: A

55) A country has been in existence for only two years. In the first year, tax revenues were $1.0 million and outlays were $1.5 million. In the second year, tax revenues were $1.5 million and outlays were $2.0 million. At the end of the second year, the total government debt was
________.
A) $0.5 million
B) $1 million
C) $2.5 million
D) $3.5 million
Answer: B

Year	Government tax revenues (billions of dollars)	Government expenditures (billions of dollars)
1	240	240
2	250	245
3	260	255
4	300	320
5	325	340

56) What is the amount of the surplus or deficit incurred in year 1 by the government shown in the above table?
A) $0
B) $25 billion deficit
C) $25 billion surplus
D) $240 billion surplus
Answer: A

57) What is the amount of the surplus or deficit incurred in year 2 by the government shown in the above table?
A) $0
B) $5 billion surplus
C) $5 billion deficit
D) $250 billion surplus
Answer: B

58) What is the amount of the surplus or deficit incurred in year 3 by the government shown in the above table?

A) $0
B) $5 billion surplus
C) $5 billion deficit
D) $260 billion surplus
Answer: B

59) What is the amount of the surplus or deficit incurred in year 4 by the government shown in the above table?
A) $20 billion deficit
B) $35 billion surplus
C) $5 billion surplus
D) $320 billion surplus
Answer: A

60) What is the amount of the surplus or deficit incurred in year 5 by the government shown in the above table?
A) $15 billion deficit
B) $35 billion surplus
C) $5 billion surplus
D) $325 billion surplus
Answer: A

61) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 1?
A) $0
B) $25 billion
C) $240 billion
D) Not enough information is provided to answer the question.
Answer: B

62) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 2?
A) $245 billion
B) $5 billion
C) $250 billion
D) $20 billion
Answer: D

63) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 3?
A) $15 billion
B) $5 billion
C) $20 billion
D) $260 billion
Answer: A

64) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 4?
A) -$20 billion (The government has net saving rather than debt.)
B) $35 billion
C) $5 billion
D) $320 billion
Answer: B

65) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 5?
A) -$20 billion (The government has net saving rather than debt.)

B) $35 billion
C) $50 billion
D) $325 billion
Answer: C

Short Run and Long Run Equilibrium

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
140	9.0	11.5	10.0
130	9.5	11.0	10.0
120	10.0	10.5	10.0
110	10.5	10.0	10.0
100	11.0	9.5	10.0

1) The data in the above table indicate that the economy will be in a short-run macroeconomic equilibrium at a price level
A) between 130 and 121.
B) between 119 and 111.
C) of 120.
D) of 110.
Answer: B

2) From the data in the above table, when the economy is at its short -run equilibrium, if aggregate demand does not change, then as time passes the
A) short-run aggregate supply curve shifts rightward.
B) short-run aggregate supply curve shifts leftward.
C) long-run aggregate supply curve shifts rightward.
D) long-run aggregate supply curve shifts leftward.
Answer: B
Show it graphically

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
140	4	8	7
130	5	7	7
120	6	6	7
110	7	5	7
100	8	4	7

3) The data in the above table show that the economy will be in a short -run macroeconomic equilibrium at a price level of
A) 90.
B) 110.
C) 100.
D) 120.
Answer: D

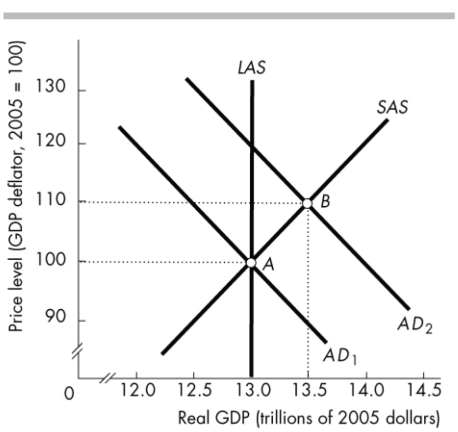
4) The data in the above table show that when the price level is 120,
A) the unemployment rate is below its natural rate.
B) the unemployment rate is above its natural rate.
C) money wages rates will rise in the future.
D) the long-run aggregate supply curve will shift leftward in the future.
Answer: B

5) The data in the above table show that when the price level is 120, the economy
A) is in a long-run macroeconomic equilibrium.
B) has an inflationary gap.
C) has a recessionary gap.
D) will have falling money wage rates sometime in the future.
Answer: C

6) The data in the above table show that when the price level is 120, if aggregate demand does not change then the
A) money wage rate will rise in the future.
B) money wage rate will fall in the future.
C) short-run aggregate supply curve will shift leftward.
D) long-run aggregate supply curve will shift leftward.
Answer: B

7) The data in the above table show that when the price level is 120, if aggregate demand does not change then the
A) short-run aggregate supply curve will shift rightward.
B) short-run aggregate supply curve will shift leftward.
C) long-run aggregate supply curve will shift rightward.
D) long-run aggregate supply curve will shift leftward.
Answer: A

Show it graphically



8) In the above figure, point *B* depicts
A) an inflationary gap with real GDP in excess of potential GDP.
B) an inflationary gap with real GDP less than potential GDP.
C) a recessionary gap with real GDP in excess of potential GDP.
D) a recessionary gap with real GDP less than potential GDP.
Answer: A

9) In the above figure, real GDP at full employment is
A) $13 trillion.

B) $13.5 trillion.
C) more than $13 and less than $13.5 trillion.
D) None of the above answers is correct.
Answer: A

10) In the above figure, the aggregate demand curve is *AD*2, so the short-run equilibrium level of real GDP is
A) $13 trillion.
B) $13.5 trillion.
C) more than $13 and less than $13.5 trillion.
D) None of the above answers is correct.
Answer: B

11) In the above figure, the aggregate demand curve is *AD*2, so the long-run equilibrium level of real GDP is
A) $13 trillion.
B) $13.5 trillion.
C) more than $13 and less than $13.5 trillion.
D) None of the above answers is correct.
Answer: A

12) In the above figure, the shift from *AD*1 to *AD*2 might have been the result of
A) an increase in government expenditure.
B) a decrease in taxes.
C) an increase in the quantity of money.
D) All of the above answers are correct.
Answer: D

13) Higher resource prices shift the
A) long-run aggregate supply curve leftward, decreasing real GDP and increasing potential GDP.
B) short-run aggregate supply curve leftward, raising the price level and decreasing potential GDP.
C) short-run aggregate supply curve leftward, raising the price level and decreasing real GDP so it is less than potential GDP.
D) short-run aggregate supply curve rightward, raising the price level and decreasing real GDP so it is less than potential GDP.
Answer: C

14) Suppose that the economy begins at a long-run equilibrium. Which of the following raises the price level and decrease real GDP in the short run?
A) a decrease in the quantity of money
B) an increase in the price of oil that decreases aggregate supply
C) an increase in the stock of capital that increases aggregate supply
D) an increase in government expenditures
Answer: B

15) A decrease in short-run aggregate supply ________ the equilibrium price level and ________ the equilibrium quantity of real GDP.
A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases
Answer: B

16) In the short run, a rightward shift of the short-run aggregate supply curve ________ real GDP and ________ the price level.
A) decreases; lowers

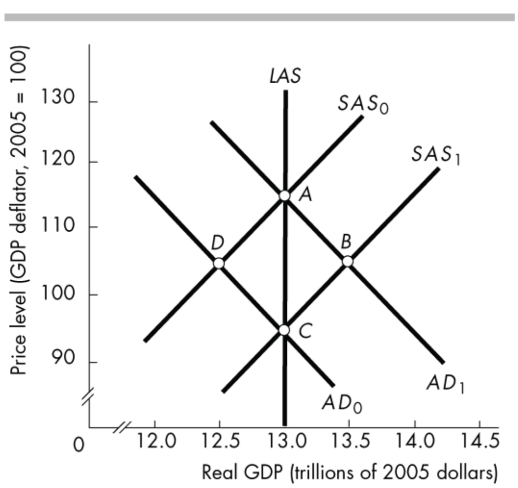
B) increases; raises
C) decreases; raises
D) increases; lowers
Answer: D

17) In the short run, a supply shock that shifts the short-run aggregate supply curve leftward ________ real GDP and ________ the price level.
A) increases; raises
B) decreases; raises
C) increases; lowers
D) decreases; lowers
Answer: B

18) Assume the economy is at long run equilibrium and oil prices rise. As a result, the ________ shifts ________.
A) *AD*; rightward
B) *AD*; leftward
C) *SAS*; rightward
D) *SAS*; leftward
Answer: D

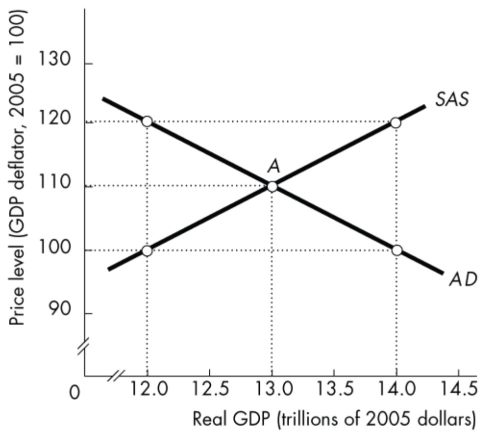
19) In the short-run, a rise in the money wage rate leads to
A) an increase in the price level and an increase in real GDP.
B) an increase in the price level and a decrease in real GDP.
C) an increase in the price level, but no change in real GDP.
D) no change in the price level, but an increase in real GDP.
Answer: B

20) Stagflation is the combination of
A) inflation and increasing real GDP.
B) deflation and recession.
C) inflation and recession.
D) deflation with increasing real GDP.
Answer: C



21) The economy is initially at point *A* in the figure. An increase in ________ will move the economy to point ________ and then an increase in ________ will move the economy to point ________.
A) taxes; *D*; government expenditure; *B*
B) the money wage rate; *B*; government expenditure; *C*

C) the money wage rate; *C*; taxes; *D*
D) government expenditure; *D*; the money wage rate; *B*
Answer: A



22) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 120 and real GDP of $12.0 trillion, then it must be the case that
A) aggregate demand has increased.
B) aggregate demand has decreased.
C) aggregate supply has decreased.
D) aggregate supply has increased.
Answer: C

23) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 100 and real GDP of $14.0 trillion, then it must be the case that
A) aggregate demand has decreased.
B) aggregate supply has decreased.
C) aggregate demand has increased.
D) aggregate supply has increased.
Answer: D

24) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 100 and real GDP of $12.0 trillion, then it must be the case that
A) aggregate demand has increased.
B) aggregate demand has decreased.
C) aggregate supply has decreased.
D) aggregate supply has increased.
Answer: B

25) If the actual real GDP is less than potential real GDP, the economy is
A) not in macroeconomic equilibrium.
B) at full employment.
C) in an above full-employment equilibrium.
D) in a below full-employment equilibrium.
Answer: D

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
100	13	9	10

105	12	10	10
110	11	11	10
115	10	13	10

26) Using the data in the above table, in the short-run macroeconomic equilibrium, the price level is ________ and the level of real GDP is ________.
A) 105; $10 trillion
B) 110; $10 trillion
C) 110; $11 trillion
D) 115; $10 trillion
Answer: C

26) Using the data in the above table, in the short-run macroeconomic equilibrium, there is
A) an inflationary gap of $1 trillion.
B) an inflationary gap of $2 trillion.
C) a recessionary gap of $1 trillion.
D) a recessionary gap of $2 trillion.
Answer: A

27) Using the data in the above table, in the long-run macroeconomic equilibrium, the price level is ________ and the level of real GDP is ________.
A) 115; $10 trillion
B) 110; $10 trillion
C) 105; $11 trillion
D) 115; $11 trillion
Answer: A