Questions and Answers

Contd. Chapter 4

Q1: MCQ

GAPS
Aggregate Supply and Aggregate Demand

1) The supply of real GDP is a function of
A) the total expenditures of consumers, investors and government.
B) the sum of wages, salaries, corporate profits, rents and interest.
C) only the state of technology.
D) the quantities of labor, capital and the state of technology.
Answer: D

2) The quantity of real GDP supplied depends on the
A) level of aggregate demand.
B) quantity of capital, bonds, and stocks.
C) quantity of labor, the quantity of capital, and the state of technology.
D) price level, the unemployment rate, and the quantity of government expenditures on goods and services.
Answer: C

3) An aggregate supply curve depicts the relationship between
A) the price level and nominal GDP.
B) household expenditures and household income.
C) the price level and the aggregate quantity supplied.
D) the price level and the aggregate quantity demanded.
Answer: C

4) In the macroeconomic short run,
A) actual real GDP may be less than or more than potential GDP.
B) the unemployment rate is zero.
C) by definition, the economy is always moving away from full employment.
D) actual real GDP always equals potential GDP.
Answer: A

9) In the long run
A) the aggregate supply curve is upward sloping.
B) real GDP is equal to potential GDP.
C) aggregate supply depends on the price level.
D) All of the above answers are correct.
Answer: B

10) The long-run aggregate supply (LAS) curve
A) has a positive slope.
B) has a negative slope.
C) is vertical.
D) is horizontal.
Answer: C

11) When the labor market is in full employment,
A) real GDP equals potential GDP.
B) the price level is stable.
C) the price level equals potential prices.
D) the SAS curve is horizontal.
Answer: A

12) The long-run aggregate supply curve is vertical because
A) at full employment prices are stable.
B) there is no cyclical inflation.
C) potential GDP is independent of the price level.
D) the money wage rate increases faster than the price level.
Answer: C

13) The long-run aggregate supply curve is
A) horizontal at the full employment price level.
B) vertical at the full employment level of real GDP.
C) upward sloping because of the effects of price level changes on real GDP.
D) the same as the short-run aggregate supply curve.
Answer: B

14) Which of the following statements is TRUE?
A) The long-run aggregate supply curve is upward sloping.
B) The long-run aggregate demand curve is upward sloping.
C) The short-run aggregate supply curve is vertical.
D) The long-run aggregate supply curve is vertical.
Answer: D

15) The long-run aggregate supply curve is _______ because along it, as prices rise, the money wage rate _______.
A) vertical; falls
B) vertical; rises
C) upward sloping; falls
D) upward sloping; stays constant
Answer: B

16) The long-run aggregate supply curve illustrates the
A) relationship of the price level and real GDP when the economy is at full employment.
B) relationship of aggregate supply and aggregate demand.
C) amount of products producers offer at various prices when money wages and other resource prices do not change.
D) surpluses, shortages and equilibrium level of GDP.
Answer: A

17) The long-run aggregate supply curve is the relationship between the quantity of real GDP supplied and _______ when _______.
A) the price level; real GDP equals potential GDP
B) real GDP demanded; the wage rate is constant
C) the price level; real GDP equals nominal GDP
D) real GDP demanded; the price level does not change
Answer: A

18) When the price level rises, the long-run aggregate supply curve _______.
A) shifts rightward
B) does not shift
C) slopes upward
D) shifts leftward
Answer: B

19) For movements along the long-run aggregate supply curve,
A) potential GDP is dependent on the price level.
B) the prices of goods and services change while the prices of productive resources hold steady.
C) the price level and the money wage rate change by the same percentage.
D) All of the above are correct.
20) The long-run aggregate supply curve shows the
A) maximum GDP the nation will ever produce.
B) full-employment level of real GDP.
C) level of real GDP associated with a constant price level.
D) level of output at which real GDP equals nominal GDP.
Answer: B

21) Which of the following is true about the long-run aggregate supply curve?
A) It is vertical at the level of potential GDP.
B) It shows the relationship between the price level and real GDP when the economy is at full
employment.
C) It does not shift in response to temporary changes in aggregate demand.
D) All of the above are true.
Answer: D

22) Which of the following events will increase long-run aggregate supply?
A) an increase in the interest rate
B) an increase in resource prices
C) a decrease in expected profit
D) an advance in technology
Answer: D

23) The curve labeled A in the above figure is a
A) short-run aggregate demand curve.
B) short-run aggregate supply curve.
C) long-run aggregate demand curve.
D) long-run aggregate supply curve.
Answer: D

24) The curve labeled A in the above figure will shift rightward when
A) the price level falls.
B) technology increases.
C) population falls.
D) the price level rises.
Answer: B

25) The short-run aggregate supply curve
A) shows what each producer is willing and able to produce at each level of income holding constant
potential GDP and all resource prices.
B) shows the relationship between aggregate production and the price level holding constant potential
GDP and all resource prices.
C) becomes vertical if there is excess production capacity within the economy.
D) shows a negative relationship between the price level and real national income holding constant potential GDP and all resource prices.
Answer: B

26) The short-run aggregate supply curve
A) is vertical.
B) has a negative slope.
C) has a positive slope.
D) is horizontal.
Answer: C

27) The short-run aggregate supply curve is upward sloping because in the short run the
A) money wage rate changes but the price level does not.
B) price level changes but the money wage rate does not.
C) both the money wage rate and the price level change.
D) neither the money wage rate nor the price level can change.
Answer: B

28) The positive relationship between short-run aggregate supply and the price level indicates that, in the short run,
A) firms produce more output as the price level falls.
B) firms produce more output as the price level rises.
C) the money wage rate increases when moving along the short-run aggregate supply curve.
D) lower price levels are more profitable for firms.
Answer: B

29) Moving upward along the SAS results in a ______ in the price level and ______ in real GDP.
A) rise; an increase
B) rise; a decrease
C) fall; an increase
D) fall; a decrease
Answer: A

30) The short-run aggregate supply curve is upward sloping because
A) a lower price level creates a wealth effect.
B) lower taxes motivate people to work more.
C) money wage rates do not immediately change when the price level changes.
D) most business firms operate with long-term contracts for output but not labor.
Answer: C

31) The short-run aggregate supply curve
A) is vertical.
B) shows the impact changes in the price level have on the quantity of real GDP when resource prices are constant.
C) illustrates the level of potential real GDP.
D) shifts whenever the price level changes.
Answer: B

32) In the short-run
A) the aggregate supply curve is upward sloping.
B) real GDP is always equal to potential GDP.
C) the money wage rate can change.
D) the price level does not change.
Answer: A

33) Along a short-run aggregate supply curve, a decrease in the price level means that
A) more output is produced as consumer demand increases.
B) less output is produced as firms decrease production.
C) more output is produced as firms increase production because wages fall more than the price level falls, making it profitable to hire more workers.
D) output does not change because firms do not change the quantity they produce.
34) In the short run, firms expand their production when the price level rises because
A) the money wage rate remains constant so the higher prices for their product makes it profitable for
firms to expand production.
B) each firm must keep its production up to the level of its rivals, and some firms will expand
production as the price level increases.
C) the higher prices allow the firm to hire more workers by offering higher wages, thereby increasing
productivity and profits.
D) firms can increase their profits by increasing their maintenance.
Answer: A

35) Moving along the short-run aggregate supply curve, __________.
A) the real wage rate is constant
B) real GDP equals potential GDP
C) the money wage rate, the prices of other resources, and potential GDP remain constant
D) real GDP equals nominal GDP
Answer: C

36) If the money wage and other resource prices do not change when the price level rises by 10
percent, __________.
A) the long-run aggregate supply curve shifts leftward
B) the short-run aggregate supply curve shifts leftward
C) the long-run aggregate supply curve shifts rightward
D) there is movement along the short-run aggregate supply curve
Answer: D

37) A change in __________ results in a movement along the short-run aggregate supply curve but
does not shift the short-run aggregate supply curve.
A) the money wage rate
B) technology
C) the quantity of capital
D) the price level
Answer: D

38) Which of the following does NOT shift the short-run aggregate supply curve?
A) a change in the money wage rate
B) technological progress
C) a reduction in the price of a raw material
D) a change in the price level
Answer: D

39) Which of the following occurs while moving along a short-run aggregate supply curve?
A) The money wage rate and the price level change by the same percentage.
B) The money wage rate changes and the price level is constant.
C) The price level changes and the money wage rate is constant.
D) Neither the price level nor the money wage rate changes.
Answer: C

40) For movements along the short-run aggregate supply curve,
A) the money wage rate is constant.
B) the real wage rate changes.
C) potential GDP remains constant.
D) All of the above are correct.
Answer: D

41) Moving along a short-run aggregate supply curve, resource prices __________, the money rate wage
__________, and potential GDP __________.
A) do not change; changes; does not change
B) do not change; does not change; changes
C) change; does not change; does not change

D) do not change; does not change; does not change
Answer: D

42) A decrease in the price level accompanied by no change in the money wage rate leads to ______ movement along the ______ aggregate supply curve.
A) a downward; short-run
B) an upward; short-run
C) a downward; long-run
D) an upward; long-run
Answer: A

43) The SAS curve and the LAS curve
A) intersect at potential GDP.
B) are parallel at potential GDP.
C) are perpendicular to one another at potential GDP.
D) None of the above answers is correct.
Answer: A

44) Suppose the price level, the money wage, and the price of all other resources rise by 10 percent. This set of changes leads to
A) an upward movement along the LAS curve.
B) a downward movement along the LAS curve.
C) an upward movement along the SAS curve.
D) a leftward shift of the LAS curve.
Answer: A

45) Suppose the price level rises and the money wage remains constant. This set of changes leads to
A) an upward movement along the LAS curve.
B) an upward movement along the SAS curve.
C) a leftward shift of the SAS curve.
D) a leftward shift of the SAS curve and the LAS curve.
Answer: B

46) Which of the following statements regarding aggregate supply are correct?
A) Moving along the long-run aggregate supply curve, both the price level and the money wage rate change by the same percentage.
B) Moving along the short-run aggregate supply curve, both the price level and the money wage rate change by the same percentage.
C) Moving along the long-run aggregate supply curve, the money wage rate changes but the price level is constant.
D) Moving along the short-run aggregate supply curve, the money wage rate changes but the price level is constant.
Answer: A

47) In the figure above, potential GDP equals
A) $12.5 trillion.
B) $13.0 trillion.
C) $13.5 trillion.
D) None of the above answers is correct.
Answer: B

48) In the figure above, the economy is at point A when the price level rises to 120. Money wage rates and other resource prices remain constant. Firms are willing to supply output equal to
A) $12.5 trillion.
B) $13.0 trillion.
C) $13.5 trillion.
D) None of the above answers is correct.
Answer: C

49) In the figure above, the economy is at point A when the price level falls to 100. Money wage rates and all other resource prices remain constant. Firms are willing to supply output equal to
A) $12.5 trillion.
B) $13.0 trillion.
C) $13.5 trillion.
D) None of the above answers is correct.
Answer: A

50) In the above figure, the economy will be at full employment if the price level
A) is 110.
B) is above 110.
C) is below 100.
D) All of the above are possible because the economy will be at full employment at any price level at, above, or below 110.
Answer: A
51) In the above figure, which movement illustrates the impact of a falling price level and a constant money wage rate?
A) E to I
B) E to F
C) E to J
D) E to H
Answer: A

52) In the above figure, which movement illustrates the impact of a rising price level and a constant money wage rate?
A) E to I
B) E to F
C) E to G
D) E to K
Answer: B

53) In the above figure, which movement illustrates the impact of the price level and money wage rate falling at the same rate?
A) E to H
B) E to K
C) E to J
D) E to G
Answer: C

54) In the above figure, which movement illustrates the impact of a constant price level and a rising money wage rate?
A) E to I
B) E to F
C) E to J
D) E to H
Answer: D

55) Which of the following events will increase short-run aggregate supply?
A) an advance in technology
B) an increase in resource prices
C) an increase in the natural unemployment rate
D) an increase in foreign income
Answer: A

56) The short-run aggregate supply curve shifts when
i. the full-employment quantity of capital changes.
ii. technology advances.
A) i only
B) ii only
C) neither i nor ii
D) i and ii
Answer: D

57) The SAS curve shifts if there is a change in
A) the price level.
B) real GDP.
C) nominal GDP.
D) potential GDP.
Answer: D

58) Which of the following changes does NOT shift the short-run aggregate supply curve?
A) an increase in the price level
B) an increase in technology
C) an increase in the quantity of capital
D) an increase in the money wage rate
Answer: A

59) Which of the following changes does NOT shift the long-run aggregate supply curve?
A) a decrease in the labor force
B) a fall in the price level
C) a rise in number of college graduates in the labor force
D) a tax hike that reduces the capital stock
Answer: B

60) All of the following shift the LAS curve EXCEPT
A) a change in the capital stock.
B) an increase in the money wage rate.
C) an increase in the stock of human capital.
D) technological progress.
Answer: B

61) All of the following shift the short-run aggregate supply curve EXCEPT
A) a change in the price level.
B) a change in the money wage rate.
C) a change in the price of a raw material.
D) technological progress.
Answer: A

62) Which of the following directly shifts the short-run aggregate supply curve?
A) a change in aggregate demand
B) a change in the price level
C) a change in resource prices
D) all of the above
Answer: C

63) Which of the following shifts the short-run aggregate supply curve?
I. changes in the size of the labor force
II. changes in the money wage rate
A) I only
B) II only
C) both I and II
D) neither I nor II
Answer: C

64) The short-run aggregate supply curve shifts leftward when the
A) price level increases.
B) general level of technology advances.
C) money wage rate increases.
D) availability of on-the-job training expands to all workers.
Answer: C

65) Suppose there is a temporary increase in the price of oil. This is represented by
A) a leftward shift of the $SAS$ and the $LAS$ curve.
B) a leftward shift of the $LAS$ curve.
C) a rightward shift of the $SAS$ curve.
D) a leftward shift of the $SAS$ curve.
Answer: D

66) In the above figure, the short-run aggregate supply curve is $SAS_1$. Suppose that the price level in the economy increases. As a result there is
A) an upward movement along $SAS_1$.
B) a downward movement along $SAS_1$.
C) a shift to $SAS_0$.
D) a shift to $SAS_2$.
Answer: A

67) In the above figure, the short-run aggregate supply curve is $SAS_1$. If technology advances, there is
A) an upward movement along $SAS_1$.
B) a downward movement along $SAS_1$.
C) a shift to $SAS_0$.
D) a shift to $SAS_2$.
Answer: D

68) In the above figure, the short-run aggregate supply curve is $SAS_1$. If the money wage rate increases, there is
A) an upward movement along $SAS_1$.
B) a downward movement along $SAS_1$.
C) a shift to $SAS_0$.
D) a shift to $SAS_2$.
Answer: C

69) In the above figure, the short-run aggregate supply curve is $SAS_1$. If the prices of resources fall, there is
A) an upward movement along $SAS_1$.
B) a downward movement along $SAS_1$.
C) a shift to $SAS_0$.
D) a shift to $SAS_2$.
Answer: D

70) A change in the full-employment quantity of labor ______ the short-run aggregate supply curve and ______ the long-run aggregate supply curve.
A) shifts; shifts
B) shifts; does not shift
C) does not shift; shifts
D) does not shift; does not shift
71) If the full-employment quantity of labor increases, then the
A) LAS curve shifts rightward and the SAS curve does not shift.
B) SAS curve shifts rightward and the LAS curve does not shift.
C) SAS curve shifts rightward and the LAS curve shifts rightward.
D) SAS curve shifts rightward and the LAS curve does shifts leftward.
Answer: C

72) When the quantity of capital increases, then the
A) LAS curve shifts rightward and the SAS curve does not shift.
B) SAS curve shifts rightward and the LAS curve does not shift.
C) SAS curve shifts rightward and the LAS curve shifts rightward.
D) SAS curve shifts rightward and the LAS curve does shifts leftward.
Answer: C

73) With an increase in the capital stock, the short-run aggregate supply curve
A) remains as it is.
B) shifts rightward.
C) shifts leftward.
D) becomes steeper.
Answer: B

74) An increase in the amount of human capital ______ the short-run aggregate supply curve and ______ the long-run aggregate supply curve.
A) shifts; shifts
B) shifts; does not shift
C) does not shift; shifts
D) does not shift; does not shift
Answer: A

75) A change in the capital stock ______ the short-run aggregate supply curve and ______ the long-run aggregate supply curve.
A) shifts; shifts
B) shifts; does not shift
C) does not shift; shifts
D) does not shift; does not shift
Answer: A

76) The land of Ur increases its capital stock. As a result, the long-run aggregate supply curve shifts ______ and so does the ______ curve.
A) rightward; aggregate demand
B) leftward; aggregate demand
C) rightward; short-run aggregate supply
D) leftward; short-run aggregate supply
Answer: C

77) Which of the following shifts both the LAS and SAS curves?
A) a change in the price level
B) a change in the money wage rate
C) a simultaneous change in both the price level and the money wage rate
D) an advance in technology
Answer: D

78) A technological advance ______ the long-run aggregate supply curve and ______ the short-run aggregate supply curve.
A) shifts; shifts
B) shifts; does not shift
C) does not shift; shifts
D) does not shift; does not shift
Answer: A
79) Technological progress will
A) shift the \( LAS \) curve rightward but will not shift the \( SAS \) curve.
B) not shift either the \( LAS \) or the \( SAS \) curve.
C) shift both the \( LAS \) and \( SAS \) curves rightward.
D) shift the \( SAS \) curve rightward but will not shift the \( LAS \) curve.
Answer: C

80) The short-run aggregate supply curve shifts because of changes in all of the following EXCEPT
A) the capital stock.
B) technological progress.
C) money wage rates.
D) the price level.
Answer: D

81) If the money prices of resources changes,
A) the \( LAS \) curve shifts.
B) the \( SAS \) curve shifts.
C) the \( AD \) curve shifts.
D) the macroeconomic equilibrium is unaffected.
Answer: B

82) If the money wage rate rises, then the
A) \( SAS \) curve shifts rightward.
B) \( SAS \) curve shifts leftward.
C) \( LAS \) curve shifts rightward.
D) \( LAS \) curve shifts leftward.
Answer: B

83) If the money price of a resource such as oil falls, then the
A) \( LAS \) curve shifts rightward.
B) \( LAS \) curve shifts leftward.
C) \( SAS \) curve shifts leftward.
D) \( SAS \) curve shifts rightward.
Answer: D

84) Suppose that the money wage in the economy increases by 8 percent. As a result the
A) long-run aggregate supply will decrease.
B) long-run and the short-run aggregate supply both decrease.
C) short-run aggregate supply will decrease.
D) long-run aggregate supply will increase and the short-run aggregate supply will decrease.
Answer: C

85) A decrease in the money wage rate
A) increases the long-run aggregate supply.
B) decreases the long-run aggregate supply.
C) increases the short-run aggregate supply.
D) decreases the short-run aggregate supply.
Answer: C

86) An increase in the money wage rate
A) increases the long-run aggregate supply.
B) decreases the long-run aggregate supply.
C) increases the short-run aggregate supply.
D) decreases the short-run aggregate supply.
Answer: D

87) A change in the money wage rate shifts
A) both the \( SAS \) and \( LAS \) curves.
B) the \( LAS \) curve but not the \( SAS \) curve.
C) the \( SAS \) curve but not the \( LAS \) curve.
D) neither the SAS nor the LAS curve.
Answer: C

88) An increase in the money wage rate shifts the short-run aggregate supply curve ________; an increase in technology shifts the long-run aggregate supply curve ________.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: C

89) A decrease in the money wage rate increases ________ and an increase in the full employment quantity of labor increases ________.
A) the SAS and the LAS; only the SAS
B) the SAS and the LAS; only the LAS
C) only the SAS; the SAS and the LAS
D) only the LAS; the SAS and the LAS
Answer: C

90) An increase in the quantity of capital increases ________ and increase in the full employment quantity of labor increases ________.
A) the SAS and the LAS; only the SAS
B) the SAS and the LAS; only the LAS
C) the SAS and the LAS; the SAS and the LAS
D) only the LAS; the SAS and the LAS
Answer: C

91) Suppose there is an increase in short-run aggregate supply with no change in long-run aggregate supply. This situation could be the result of
A) an increase in the price of oil.
B) a decrease in the money wage rate.
C) a technological advancement.
D) an increase in the quantity of capital.
Answer: B

92) In the above figure, the economy is at point A when the money wage rate and the price level both fall by 10 percent. Firms will be willing to supply output equal to
A) less than $13.0 trillion
B) $13.0 trillion
C) more than $13.0 trillion
D) Without more information, it is impossible to determine which of the above answers is correct.
Answer: B

93) In the above figure, the economy is at point A. Then the price level falls to 90 while the money wage rate does not change. Firms will be willing to supply output equal to
A) less than $13.0 trillion
B) $13.0 trillion  
C) more than $13.0 trillion  
D) Without more information, it is impossible to determine which of the above answers is correct.  
Answer: A

94) In the above figure, the economy is at point $A$. Then the price level rises to 110 while the money wage rate remains constant. Firms will be willing to supply output equal to  
A) less than $13.0 trillion  
B) $13.0 trillion  
C) more than $13.0 trillion  
D) Without more information, it is impossible to determine which of the above answers is correct.  
Answer: C

95) In the above figure, the economy is at point $A$ and the money wage rate falls by 10 percent. If the price level is constant, firms will be willing to supply output equal to  
A) less than $13.0 trillion  
B) $13.0 trillion  
C) more than $13.0 trillion  
D) Without more information, it is impossible to determine which of the above answers is correct.  
Answer: C

96) In the above figure, the economy is at point $A$ and the money wage rate rises by 10 percent. If the price level is constant, firms will be willing to supply output equal to  
A) less than $13.0 trillion  
B) $13.0 trillion  
C) more than $13.0 trillion  
D) Without more information, it is impossible to determine which of the above answers is correct.  
Answer: A

97) In the above figure, $B$ is the current long-run aggregate supply curve and $E$ is the current short-run aggregate supply curve. If there is an increase in the full-employment quantity of labor, then the long-run aggregate supply curve and the short-run aggregate supply curve  
A) remain $B$ and $E$.  
B) shift to $A$ and $D$, respectively.  
C) shift to $C$ and $F$, respectively.  
D) shift to $A$ and $E$, respectively.  
Answer: C

98) In the above figure, $B$ is the current long-run aggregate supply curve and $E$ is the current short-run aggregate supply curve. Technological advances mean the long-run aggregate supply curve and short-run aggregate supply curve  
A) remain $B$ and $E$.  
B) shift to $A$ and $D$, respectively.  
C) shift to $C$ and $F$, respectively.  
D) shift to $C$ and remain $E$, respectively.
99) In the above figure, which part corresponds to a destruction of part of the nation’s capital stock?
A) Figure A  
B) Figure B  
C) Figure C  
D) Figure D  
Answer: A

100) In the above figure, which point corresponds to an increase in technology?
A) Figure A  
B) Figure B  
C) Figure C  
D) Figure D  
Answer: C

101) In the above figure, which part corresponds to an increase in the money wage rate?
A) Figure A  
B) Figure B  
C) Figure C  
D) Figure D  
Answer: B

102) In the above figure, which part corresponds to a fall in the money wage rate?
A) Figure A  
B) Figure B  
C) Figure C  
D) Figure D  
Answer: D

103) Moving along which curve does the money wage rate and the price level change in the same proportions?
A) the AD curve  
B) the SAS curve  
C) the LAS curve  
D) None of the above because there is no curve along which both the money wage rate and the price level change in the same proportions.  
Answer: C

104) Long-run aggregate supply will decrease for all of the following reasons EXCEPT
A) reduced money wages.
B) decreased human capital.
C) decrease in the level of full employment.
D) decreased capital.
Answer: A

105) A fall in the money wage rate shifts
A) both the SAS and LAS curves rightward.
B) both the SAS and LAS curves leftward.
C) the SAS curve rightward but leaves the LAS curve unchanged.
D) the LAS curve rightward but leaves the SAS curve unchanged.
Answer: C

106) An increase in the level of technology shifts
A) both the SAS and LAS curves rightward.
B) both the SAS and LAS curves leftward.
C) the SAS curve rightward but leaves the LAS unchanged.
D) the LAS curve rightward but leaves the SAS curve unchanged.
Answer: A

Adjustments

1) In the short run, an increase in government expenditure will
I. shift the aggregate demand curve rightward.
II. increase real GDP.
III. increase the government expenditure multiplier.
IV. increase the tax multiplier.
A) I and II
B) I and III
C) I, II and III
D) III and IV
Answer: A

2) A reason the government expenditure multiplier is larger than 1 is because
A) investment increases when government expenditure increases.
B) government expenditure always increases.
C) government expenditure generates changes in consumption expenditure.
D) taxes are left unchanged.
Answer: C

3) The magnitude of the tax multiplier ________ the magnitude of the government expenditure multiplier.
A) is smaller than
B) is larger than
C) is equal to
D) is not comparable to
Answer: A

4) Suppose the government increases taxes. One effect of this change is that it decreases
A) disposable income, which decreases consumption expenditure and aggregate demand.
B) government expenditure, which decreases aggregate demand.
C) the size of the government expenditure multiplier.
D) disposable income which then decreases aggregate supply.
Answer: A

5) The demand-side effect of a change in taxes is less than the same sized change in government expenditure because
A) only part of the increase in disposable income from the tax cut is spent.
B) the amount by which taxes change is affected by the MPC.
C) changes in government expenditure do not directly affect consumption.
D) tax rates are the same regardless of income levels.
Answer: A

6) The aggregate demand curve is shifted rightward by
A) an increase in tax rates.
B) a decrease in government expenditure.
C) an increase in the federal budget surplus.
D) an increase in government expenditure.
Answer: D

7) An increase in government expenditure shifts the \( AD \) curve ________ and an increase in taxes shifts the \( AD \) curve ________.
A) rightward; rightward
B) rightward; leftward
C) leftward; rightward
D) leftward; leftward
Answer: B

8) Suppose the government of Japan increases its expenditure on goods and services. In the short run, this increase will
A) shift the \( AD \) curve in Japan rightward.
B) shift the \( AD \) curve in Japan leftward.
C) cause the price level in Japan to fall.
D) None of the above answers is correct.
Answer: A

9) If the government wants to engage in fiscal policy to increase real GDP, it could
A) increase government expenditure in order to increase short-run aggregate supply.
B) decrease government expenditure in order to increase short-run aggregate supply.
C) increase government expenditure in order to increase aggregate demand.
D) decrease government expenditure in order to decrease aggregate demand.
Answer: C

10) If real GDP is less than potential GDP, which of the following fiscal policies would increase real GDP?
A) only a decrease government expenditure
B) only an increase taxes
C) increase government expenditure and/or decrease taxes
D) decrease government expenditure and/or increase taxes
Answer: C

11) Using the \( AD-AS \) model, an increase in government expenditure
A) has no impact on real GDP.
B) has no impact on real GDP, but will increase potential GDP.
C) increases both real GDP and the price level.
D) has a full multiplier effect on real GDP, leaving the price level unchanged in the long run.
Answer: C

12) Using fiscal policy, to increase real GDP and employment the government could ________
government expenditure on goods and services or ________ taxes.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: B

13) When real GDP is less than potential GDP, an increase in government expenditures will ________
real GDP and ________ the price level.
A) increase; raise
B) increase; lower
14) Suppose the economy is at a short-run equilibrium with real GDP greater than potential GDP. Which of the following fiscal policies would decrease real GDP and the price level?
A) an increase in government expenditure
B) a decrease in taxes
C) an increase in taxes
D) None of the above answers is correct.
Answer: C

Topic: Equilibrium GDP and the Price Level

15) Suppose real GDP exceeds potential real GDP. If the government decreases its expenditures on goods and services, then real GDP ________ and the price level ________.
A) decreases; rises
B) increases; falls
C) decreases; falls
D) increases; rises
Answer: C

16) Suppose that the government decreases its expenditures on goods and services. Within the AS-AD model, the result will be ________ in real GDP and ________ in the price level.
A) an increase; an increase
B) an increase; a decrease
C) a decrease; an increase
D) a decrease; a decrease
Answer: D

17) In the above figure, if the economy is initially at point $D$ and government expenditure increases, the economy will move to point
A) move to point $C$.
B) move to point $A$.
C) move to point $B$.
D) stay at point $D$.
Answer: A

18) In the above figure, if the economy is initially at point $B$ and government expenditure decreases, the economy will
A) move to point $C$. 

B) move to point A.
C) move to point D.
D) stay at point B.
Answer: B

19) In the above figure, if the economy is initially at point D and taxes are cut, if potential GDP does not change then the economy will move to point
A) move to point C.
B) move to point A.
C) move to point B.
D) stay at point D.
Answer: A

20) In the above figure, if the economy is initially at point B and taxes are raised, if potential GDP does not change then the economy will move to point
A) move to point C.
B) move to point A.
C) move to point D.
D) stay at point B.
Answer: B

21) In the above figure, if the economy initially is at point A and government expenditure increases, in the short run the economy will move to point
A) B.
B) C.
C) A, that is, the equilibrium will NOT change.
D) None of the above answers is correct.
Answer: A
22) The figure above illustrates the aggregate demand, short-run aggregate supply, and long-run aggregate supply in Lotus Land. The economy is currently at point D and the government increases its expenditure on goods and services. The economy will move to ________. The price level will ________, and the change in real GDP will be ________ the increase in aggregate demand.

A) point A; fall; less than
B) point D; rise; less than
C) point C; rise; less than
D) point B; remain constant; the same as

Answer: C

23) The figure above illustrates the aggregate demand, short-run aggregate supply, and long-run aggregate supply in Lotus Land. The economy is currently at point D and the government decreases its taxes. The economy will move to ________. The price level will ________, and the change in real GDP will be ________ the increase in aggregate demand.

A) point A; fall; less than
B) point D; rise; less than
C) point C; rise; less than
D) point B; remain constant; the same as

Answer: C
24) In the above figure, which fiscal policy could help move the economy to potential GDP?
A) decreasing government expenditure
B) decreasing autonomous taxes
C) increasing government expenditure
D) Both answers A and B are correct.
Answer: A

25) In the above figure, which of the following policies could move the economy to potential GDP?
A) decreasing government expenditures and increasing taxes
B) decreasing taxes and not changing government expenditures
C) increasing government expenditures and decreasing taxes
D) None of the above answers is correct.
Answer: A

26) Suppose that real GDP equals potential GDP, but the government believes that the economy is in a below full-employment equilibrium. As a result, the government increases its expenditure on goods and services. In response to the government's fiscal policy,
A) aggregate demand will increase.
B) an equilibrium with real GDP less than potential GDP will occur.
C) potential GDP decreases.
D) None of the above answers is correct.
Answer: A

27) The use of fiscal policy is limited because
A) there is never a long enough time lag.
B) the economy is almost always at full employment.
C) the President may have different goals than Congress.
D) time lags associated with fiscal policy may cause the policy to take effect too late to solve the problem it was supposed to address.
Answer: D

28) The use of discretionary fiscal policy to end a recession is limited because
A) the legislative process is slow.
B) potential GDP changes too rapidly.
C) the real-world multiplier is too small to have an impact on real GDP.
D) in the real world, taxes are not induced.
Answer: A

29) Which of the following are a limitation of fiscal policy?
I. There is a lag between recognizing that fiscal policy might be needed and when it actually takes effect.
II. Economic forecasts might be incorrect.
III. Monetary policy might counter fiscal policy.
A) I only
B) I and II
C) I and III
D) I, II and III
Answer: B

30) Which of the following policies shifts the $AD$ curve the farthest leftward?
A) a rise in taxes of $10$ billion
B) a cut in taxes of $10$ billion
C) a decrease in government expenditure of $10$ billion
D) a decrease in both government expenditure and taxes of $10$ billion
Answer: C
Study the graph below and Answer the following questions:

1) Does the figure above illustrate a recessionary or an inflationary gap? What do potential GDP and real GDP equal? What is an appropriate fiscal policy to restore real GDP to potential real GDP?
Answer: A recessionary gap occurs when real GDP is less than potential GDP, which is precisely what the figure illustrates. In the figure, potential GDP equals $13 trillion but real GDP equals only $12.5 trillion. In order to restore real GDP back to potential GDP using fiscal policy, the government could increase government expenditure on goods and services and/or decrease taxes.

2) A fiscal stimulus can be used to close the gap by increasing production and employment.
Answer: FALSE
It is an inflationary gap closed by a contractionary fiscal policy decreasing production and employment

3) An increase in government expenditure leads to rightward shift of the AD curve.
Answer: TRUE, by increasing autonomous expenditures and shifting the
4) The aggregate demand curve is shifted rightward by an increase in tax rates.
Answer: FALSE

5) The aggregate demand curve is shifted rightward by an increase in government expenditure.
Answer: TRUE

23) Automatic fiscal policy is not subject to all the same time lags to which discretionary fiscal policy is subject.
Answer: TRUE

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**Revision on the Multiplier**

1) The presence of income taxes and imports make the slope of the aggregate expenditure curve
A) the same as it would be without income taxes and exports.
B) steeper than it would be without income taxes and exports.
C) flatter than it would be without income taxes and exports.
D) probably different than it would be without income taxes and exports but income taxes make it steeper while imports make it flatter.
Answer: C

*Show it graphically*

2) What is the relationship between the MPC and the slope of the AE curve?
Answer: If there are no imports or income taxes, then the slope of the AE curve equals the MPC. If there are imports and income taxes, then the slope of the AE curve is less than the MPC.
In either case, an increase in the MPC increases the slope of the AE curve.
*Show it graphically*

3) What is the relationship between the slope of the aggregate expenditure curve and the multiplier?
Answer: The multiplier equals \( 1 / (1 - \text{slope of the AE curve}) \) . This result does not change regardless of the existence or absence of imports or income taxes.
4) How do imports and income taxes affect the multiplier? Why do they have this effect?
Answer: Income taxes and imports shrink the multiplier. They have this effect because they mean that increases in GDP translate into smaller increases of spending on domestic goods and services.
Show it graphically

5) "If the income tax rate is high enough, the multiplier can be negative." Is the previous statement correct or incorrect?
Answer: The statement is incorrect. The higher the income tax rate, the smaller the multiplier, but the multiplier always remains positive.
Show it graphically

6) "When the price level increases, aggregate planned expenditure increases and equilibrium expenditure increases." Is the preceding statement correct or incorrect? Briefly explain your answer.
Answer: The statement is incorrect. An increase in the price level decreases aggregate planned expenditure because the purchasing power of money falls, the real interest rises, and the price of imports becomes less expensive relative to domestically produced goods. Because aggregate planned expenditure decreases, equilibrium expenditure decreases.
Topic: AE Curve, AD Curve, and the Price Level