Macroeconomic Principles
Third Exam —Fall 2005
Schellberg

PART I (75 points)

Multiple Choice
Identify the letter of the choice that best completes the statement or answers the question.

________ 1. Which of the following is not a component of aggregate demand?
a. Investment expenditures
b. Government expenditures
c. Net exports
d. Consumption
e. All of the above are components of aggregate demand.

_____ 2. Aggregate demand can be defined as:
a. the total spending by all consumers, business firms, government agencies, and foreigners in the United States.
b. the total amounts that all consumers, business firms, government agencies, and foreigners wish to spend on all final American goods and services at various price levels.
c. the total spending by consumers, business firms, and government agencies in one year.
d. the total spending by consumers, business firms, and government agencies on final goods and services.

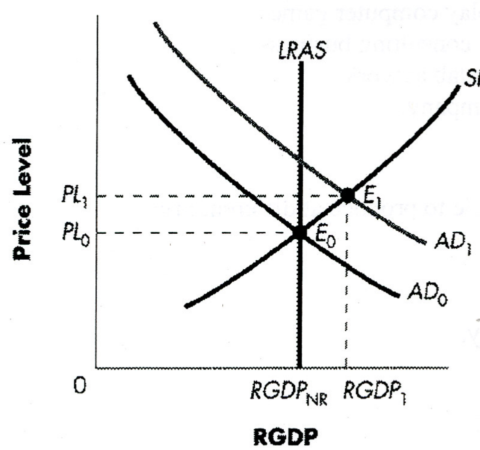
_____ 3. Vannah earned $250,000 in 1999 as a celebrity endorser and spokesperson. She spent 85 percent of her earnings. In 2000, with a new contract she earned $750,000 per year. Her consumption increased by $250,000. Which of the following statements is *not* true?
a. Her 1999 average propensity to consume is 0.85.
b. Her average propensity to consume falls between 1999 and 2000.
c. Her marginal propensity to consume equals 0.85.
d. Her marginal propensity to consume equals 0.50.
e. Her average propensity to consume in 2000 is 0.67.

_____ 4. Which of the following expenditures would be counted as consumption in GDP accounts?
a. Mary buys a new computer to check her e-mail and play computer games.
b. Mark buys a new computer for his medical economic consulting business.
c. Leslie, an EPA scientist, buys a new computer for her lab at work.
d. Juan leases a new computer for his graphic design company.

_____ 5. Short-run aggregate supply:
a. is a fixed volume of output.
b. reflects how much RGDP suppliers are willing and able to produce at different price levels.
c. shifts only when the *LRAS* shifts.
d. is not affected at all by the price level.
e. Both a) and d) characterize short-run aggregate supply.

6. If the price level rises, what will happen to the quantity of RGDP produced along the long-run aggregate supply curve?
   a. It will increase.
   b. It will usually increase, but not always.
   c. Nothing.
   d. It will decrease.
   e. It will usually decrease, but not always.
7. The short-run aggregate supply curve will shift to the left, other things being equal, if:
   a. energy prices fall.
   b. technology and productivity increase in the nation.
   c. there is a short-term increase in input prices.
   d. the capital stock of the nation increases.
8. If money wages increase, the most likely impact is to:
   a. increase short-run aggregate supply.
   b. decrease short-run aggregate supply.
   c. increase output in the long run.
   d. decrease output in the long run.
9. Which of the following would increase *SPAS?*
   a. Firms adopt more powerful computers and more advanced machine tools for their workers.
   b. Investments in education and vocational programs make workers better prepared.
   c. On-the-job training causes worker productivity to rise.
   d. All of the above will increase *SRAS.*
   e. None of the above will increase *SRAS.*
10. Higher production costs will:
   a. increase short-run aggregate supply, illustrated by an upward shift in the *SRAS* curve.
   b. increase short-run aggregate supply, illustrated by a rightward shift in the *SRAS* curve.
   c. decrease short-run aggregate supply, illustrated by a downward shift in the *SPAS* curve.
   d. decrease short-run aggregate 'supply, illustrated by a leftward shift in the *SEAS* curve.

Diagram 21-2
Use the following graph to answer the Fallowing questions.



11 Refer to Diagram 21-2. A shift from *AD_o* to *AD,* would indicate:

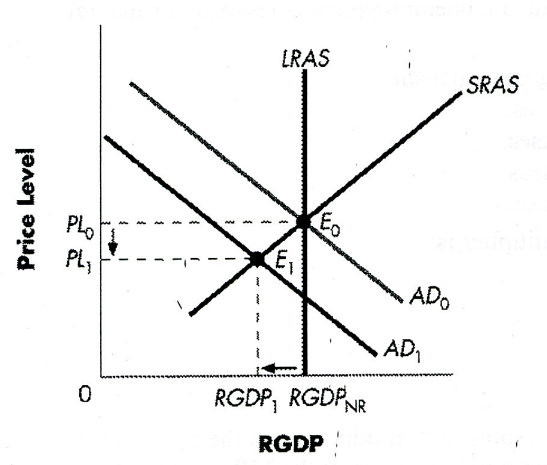
a. increasing aggregate demand.
b. increasing *SRAS.*
c. decreasing real GDP.
d. cost-push inflation.

12. Refer to Diagram 21-2. If the economy is operating at $GRDR_{(1)}$ you would conclude that:

a. this point is impossible to achieve.
b. this point is possible and is permanent.
c. this point is possible, but only temporarily.
d. none of the above are true.

Diagram 21-3

Use the following graph to answer the following questions.



13. Refer to Diagram 21-3. What might one of the reasons that aggregate demand has shifted from $AD_{(0)}$ to *AD(1)?*

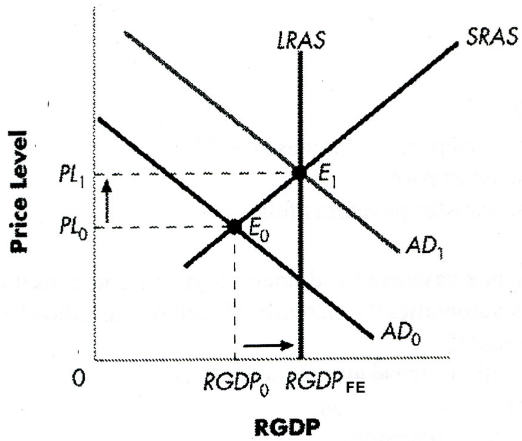
a. Consumers' belief in the economy has increased, and as a result they have begun buying more goods.
b. Consumers have lost faith in the economy and as a result have begun buying fewer goods.
c. Investors have become more optimistic about their profit prospects, and therefore output and prices are higher.
d. None of the above.

14. Refer to Diagram 21-3. Where *SRAS* and AD currently intersect at a real output level less than the natural level of real output,

a. it is a short-run equilibrium and real output will tend to fall from its current level as it adjusts to long-run equilibrium.
b. it is a short-run equilibrium and real output will tend to rise from its current level as it adjusts to long-run equilibrium.
c. it is a short-run disequilibrium and real output will tend to fall from its current level as it adjusts to long-run equilibrium.
d. it is a short-run disequilibrium and real output will tend to rise from its current level as it adjusts to long-run equilibrium.

15. Starting from long-run equilibrium, a decrease in aggregate demand will cause:
    a. an expansionary (inflationary) gap in the short run and the long run.
    b. a contractionary (recessionary) gap in the short run and the long run.
    c. an expansionary (inflationary) gap in the short run.
    d. a contractionary (recessionary) gap in the short run.
    e. neither an expansionary (inflationary) nor a contractionary (recessionary) gap in the short run or the long run.
16. When there is an expansionary (inflationary)gap,
    a. real output exceeds the natural level of output and unemployment exceeds its natural rate.
    b. real output exceeds the natural level of output and unemployment is less than its natural rate.
    c. real output is less than the natural level of output and unemployment exceeds its natural rate.
    d. real output is less than the natural level of output and unemployment is less than its natural rate.
17. During the self-correction process after a fall in aggregate demand,
    a. unemployment increases and real output increases.
    b. unemployment increases and real output decreases.
    c. unemployment decreases and real output increases.
    d. unemployment decreases and real output decreases.
18. If the marginal propensity to consume is 4/5, the multiplier is:
    a. 20.
    b. 5.
    c. 1.
    d. 1/5.
    e. 5/4.
19. The federal government buys $15 million worth of surplus farm products from the nation's farmers in order to provide food supplements for the subsidized milk and lunch program. If the MPC is .90 what will be the impact on aggregate demand, what will be the impact on aggregate demand and GDP? (use the multiplier)
    a. Aggregate demand will increase $150 million.
    b. Aggregate demand will increase $80 million.
    c. Aggregate demand will increase $30 million.
    d. Aggregate demand will increase $16.7 million.
    e. Aggregate demand will increase $13.5 million.
20. When taxes are decreased, disposable income ________ , and hence consumption ________
    a. increases; increases
    b. increases; decreases
    c. decreases; increases
    d. decreases; decreases
    a stays the same
21. A $100 billion decrease in government purchases would: (use the multiplier)
    a. increase AD by $500 billion if MPC = 0.8.
    b. decrease AD by $300 billion if MPC = 2/3.
    c. increase AD by $200 billion if MPC = 0.5.
    d. decrease AD by $40 billion if MPC = 0.4.

Diagram 22-2



Using the graph above, answer the following question.

22. Refer to Diagram 22-2. In order for the economy pictured above to get back to *RGDP* $_{F,}$, this economy could use:
    a. decreased taxes and increased government purchases.
    b. increased taxes and increased government purchases.
    c. decreased taxes and decreased government purchases.
    d. increased taxes and decreased government purchases.
23. In the short run, expansionary fiscal policy can cause a rise in real GDP:
    a. in combination with a rise in the price level.
    b. in combination with no rise in the price level.
    c. in combination with a reduction in the price level.
    d. in combination with a rise or a reduction in the price level, depending on the economy.
24. Assume that the government is considering plans to increase aggregate demand in order to reduce unemployment. Which of the following would be effective?
    a. Increase government purchases of goods and services.
    b. Decrease taxes.
    c. Increase transfer payments.
    d. Any of the above.
25. Starting from long-run equilibrium and a balanced budget, contractionary fiscal policy will tend to:
    a. move the federal budget toward surplus and increase net exports.
    b. move the federal budget toward surplus and decrease net exports.
    c. move the federal budget toward deficit and increase net exports.
    d. move the federal budget toward deficit and decrease net exports.
26. M increase in transfer payments combined with a decrease in government purchases would:
    a. increase AD.
    b. decrease AD.
    c. leave AD unchanged.
    d. have an indeterminate effect on AD.

27. An increase in taxes combined with a decrease in government purchases would:
    a. increase AD.
    b. decrease AD.
    c. leave AD unchanged.
    d. have an indeterminate effect on AD.
28. AD will shift to the left, other things being equal,. when:
    a. the government budget surplus increases because government purchases fell.
    b. the government budget surplus increases because taxes rose.
    c. the government budget surplus increases because transfer payments fell.
    d. under any of the above circumstances.
29. During a boom expansionary economy, public assistance payments and unemployment compensation payments automatically decrease while income taxes automatically increase. Which of the following best describes the effect of these changes on aggregate demand?
    a. Aggregate demand will be less than it would be without these automatic stabilizers.
    b. Aggregate demand will be the same as it was before the expansion.
    c. Aggregate demand will be less than it was before the expansion.
    d. Aggregate demand will be greater than it was before the expansion.
    e. Both a) and d) accurately describe their effect.
30. When the economy goes into a ______ the amount of taxes collected by the government ______ automatically.
    a. recession; falls
    b. recession; rises
    c. boom; falls
    d. None of the above.

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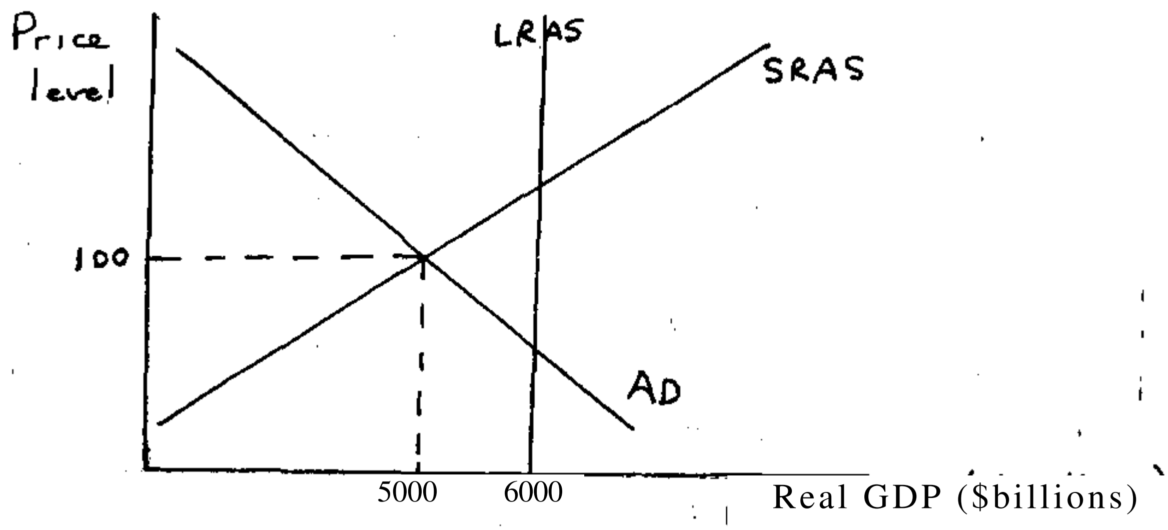
PART II (25 points) 1.

(12 points)

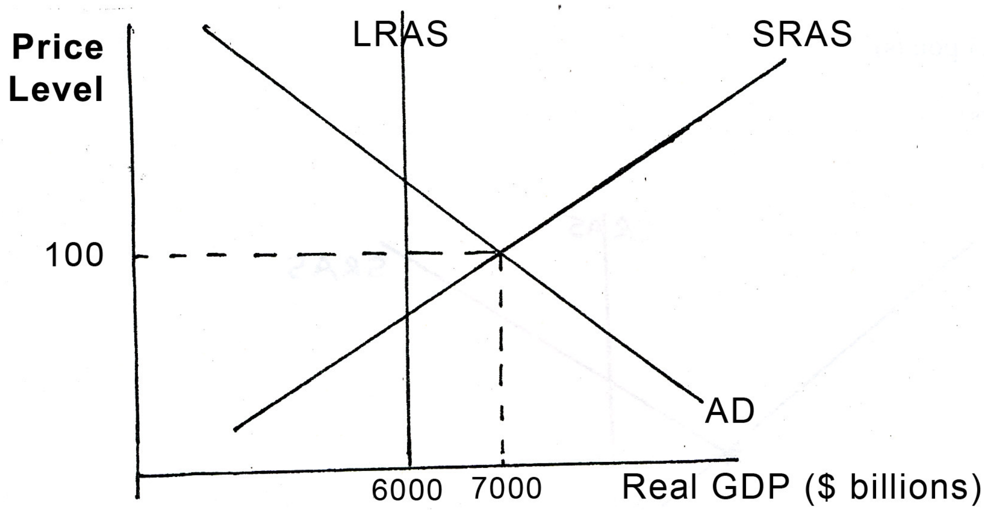


a. Suppose the marginal propensity to consume is .75. The government expenditures multiplier is _________(fill in the value of the multiplier). If the government wishes to use expansionary fiscal policy to return the economy to full employment, it should (pick one: increase, decrease) government purchases by (fill in an amount) ________billion.

b. Show this expansionary fiscal policy on the graph above. Label the new equilibrium price level and real GDP.

_________ ________ ______________________ ______________

2. (13 points) Suppose the economy is experiencing an inflationary gap.



a . Show the economy's self correcting mechanism on the graph above. Label the new equilibrium price level and real GDP.

b. Complete the following;

With an inflationary gap, there is a (pick one: surplus, shortage) of labor and other inputs. As the economy self-corrects from the inflationary gap, wages and prices (pick one: rise, fall), and spending on goods and services (pick one: increases, decreases). As a result of these changes, the unemployment rate (pick one: increases, decreases), so as to return to its long-run natural rate.