

EC140 PRACTICE QUESTION FOR TERM TEST TWO

(Answers in a separate file in this folder)

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Other things being equal, a fall in the domestic price level leads to a rise in private-sector wealth and thus 1) _____
 A) an increase in desired consumption.
 B) a downward shift in the AE curve.
 C) an increase in saving.
 D) a downward shift in net exports.
 E) domestic goods appearing less attractive to foreigners.
- 2) Consider a simple macro model with demand-determined output. An exogenous increase in the domestic price level will 2) _____
 A) shift the net export function upward and the AE curve downward.
 B) shift the net export function downward and the AE curve upward.
 C) shift both the net export function and the AE curve upward.
 D) pivot the net export function and the AE curve upward.
 E) shift both the net export function and the AE curve downward.
- 3) Suppose there is an exogenous increase in the domestic price level. Which of the individuals listed below would experience an *increase* in wealth? 3) _____
 A) a person with deposits in a bank savings account.
 B) a person with a government bond that promises to pay the holder \$1000, 5 years hence.
 C) a person with cash under the mattress.
 D) a person with a 25-year home mortgage.
 E) a person with a corporate bond that promises to repay the face value of the bond in the future.
- 4) In a macro model with a constant price level, an increase in autonomous desired consumption will cause the *AE* curve to shift 4) _____
 A) upward and the *AD* curve to shift to the right.
 B) downward and the *AD* curve to shift to the left.
 C) upward and a movement to the right along the *AD* curve.
 D) downward and the *AD* curve to shift to the right.
 E) upward and the *AD* curve to shift to the left.
- 5) Which of the following would likely cause an upward parallel shift in the *AE* curve and a rightward shift in the *AD* curve? 5) _____
 A) a reduction in government purchases
 B) an increase in the price level
 C) a decrease in the price level
 D) an increase in the MPC
 E) an increase in the business confidence of firms

- 6) A leftward shift of the aggregate demand (*AD*) curve could result from a fall in _____
- A) induced imports.
 - B) the net tax rate.
 - C) autonomous government purchases.
 - D) autonomous desired saving.
 - E) the price level.
- 7) Consider the basic *AD/AS* macro model. The simple multiplier is reflected by the _____
- A) upward movement along the *AD* curve in response to a change in autonomous expenditure.
 - B) horizontal distance between initial macroeconomic equilibrium and the new intersection of *AD* and *AS* in response to a change in autonomous expenditure.
 - C) downward movement along the *AD* curve in response to a change in autonomous expenditure.
 - D) size of the rightward shift of the *AD* curve in response to a change in autonomous expenditure.
 - E) size of the upward shift of the *AD* curve in response to a change in autonomous expenditure.
- 8) Other things being equal, a _____ marginal propensity to spend will lead to a _____ *AD* curve. _____
- A) lower; parallel leftward shift of the
 - B) higher; flatter
 - C) higher; steeper
 - D) lower; parallel rightward shift of the
 - E) lower; flatter
- 9) The economy's aggregate supply (*AS*) curve shows the relationship between the _____
- A) price level and the total output that firms wish to produce and sell, as technology and input prices vary.
 - B) price level and the marginal propensity to consume (*MPC*).
 - C) price level and the total output that firms wish to produce and sell, with technology and input prices held constant.
 - D) equilibrium real GDP and desired consumption.
 - E) equilibrium real GDP and marginal cost.
- 10) Consider the basic *AD/AS* model. Suppose that a rising percentage of high-school graduates are illiterate, resulting in a decrease in average labour productivity. This change will _____
- A) shift the *AS* curve to the left.
 - B) cause a movement to the right along the *AS* curve.
 - C) shift the *AD* curve to the right.
 - D) shift the *AD* curve to the left.
 - E) shift the *AS* curve to the right.

- 11) Consider the basic AD/AS model. If major labour unions succeed in increasing wages across the economy, the AS curve will shift 11) _____
- A) upward (to the left), increasing the price level.
 - B) downward (to the right), reducing the price level.
 - C) downward (to the right) and then return immediately to its original position.
 - D) upward (to the left) and then return immediately to its original position.
 - E) none of the above -- there will no effect on the AS curve.
- 12) A movement along the economy's AS curve could be caused by a change in 12) _____
- A) labour productivity.
 - B) technology.
 - C) the price level, caused in turn by an AD shock.
 - D) the wage rate.
 - E) the cost of capital.
- 13) Over the horizontal range of the economy's AS curve (if such a range exists), a rightward shift of the AD curve will result in 13) _____
- A) an increase in real GDP and no change in prices.
 - B) an increase in both real GDP and prices.
 - C) a decrease in real GDP but no change in prices.
 - D) a decrease in both real GDP and prices.
 - E) an increase in prices and no change in real GDP.

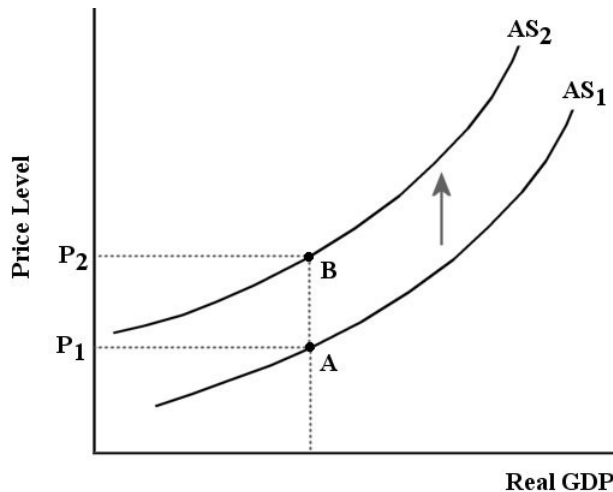


FIGURE 23-1

- 14) Refer to Figure 23-1. Which of the following events could cause the upward (leftward) shift of the AS curve? 14) _____
- A) an increase in the price of raw materials
 - B) a decrease in the world supply of oil as a result of a major hurricane
 - C) rapid technological advances in mass production
 - D) improved quality of the national education system
 - E) both A and B are correct

- 15) Consider the AD/AS model. An increase in government purchases will have **no** impact on equilibrium real GDP if _____
- A) the marginal propensity to spend is very small.
 - B) the AS curve is vertical.
 - C) the AS curve is horizontal.
 - D) the simple multiplier is very small.
 - E) the AS curve slopes upward.
- 16) Consider the AD/AS model. Suppose there is a decrease in aggregate demand and, simultaneously, an increase in aggregate supply. The result will be a _____
- A) rise in real GDP and a rise in the price level.
 - B) an indeterminate change in real GDP and a fall in the price level.
 - C) an indeterminate change in real GDP and a rise in the price level.
 - D) rise in real GDP and a fall in the price level.
 - E) rise in real GDP but price level changes will be indeterminate.
- 17) Consider the basic AD/AS model. A rise in an input price like unit labour costs would be expected to create a new macroeconomic equilibrium which in comparison to the original equilibrium has a price level that is _____
- A) higher and a real GDP that is higher.
 - B) lower and a real GDP that is higher.
 - C) higher and a real GDP that is the same.
 - D) higher and a real GDP that is lower.
 - E) lower and a real GDP that is lower.
- 18) Consider the following news headline: "World commodity prices rise sharply." Choose the statement below that best describes the likely macroeconomic effects in Canada. (Remember that Canada is both a producer and a consumer of commodities.) _____
- A) there is no change in either the AD or the AS curves
 - B) the AD and AS curves both shift to the left; the effect on the price level is indeterminate and real GDP decreases
 - C) the AD curve shifts to the right and the AS curve shifts to the left; the price level rises and the effect on real GDP is indeterminate
 - D) the AD curve shifts to the left and the AS curve shifts to the right; the price level falls and the effect on real GDP is indeterminate
 - E) the AD and AS curves both shift to the right; the effect on the price level is indeterminate and real GDP increases
- 19) Suppose the government embarks on an infrastructure program, spending \$8 billion on the construction of new roads and bridges. What is the size of the multiplier if the AS curve is vertical? _____
- A) infinity
 - B) 0
 - C) greater than 1
 - D) less than 1
 - E) insufficient information to solve

20) Which of the following characteristics define the *short run* in macroeconomics?

- A) Factor prices adjust to output gaps, and technology and factor prices are changing.
- B) Factor prices are exogenous, technology and factor prices are endogenous.
- C) Factor prices adjust to output gaps, and technology and factor supplies are constant.
- D) Factor prices are exogenous, and technology and factor supplies are changing.
- E) Factor prices are exogenous, and technology and factor supplies are constant.

20) _____

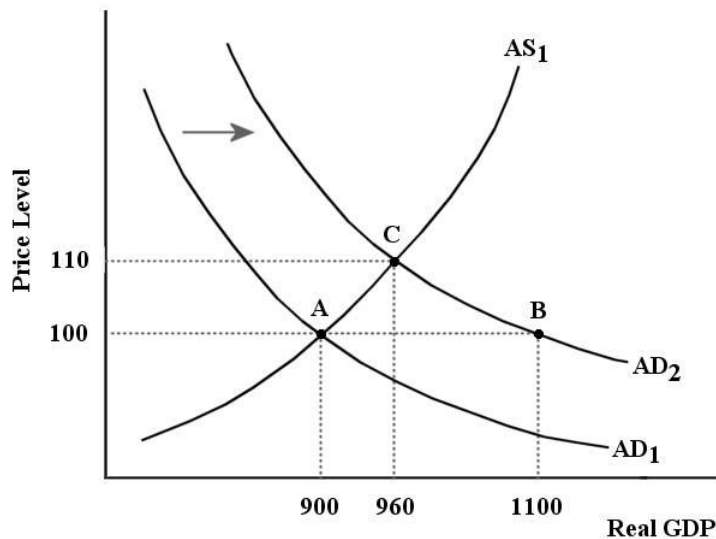


FIGURE 23-2

21) Refer to Figure 23-2. Suppose that an increase in government purchases by 50 causes the AD curve to shift to the right, as shown. The simple multiplier is _____ and the multiplier is _____.

- A) 6; 1.2
- B) 4; 3.2
- C) 4; 2.8
- D) 2.8; 1.2
- E) 4; 1.2

21) _____

22) Refer to Figure 23-2. Suppose that an increase in government purchases caused the AD curve to shift to the right, as shown. If the simple multiplier in this model is 5, then how much was the increase in government purchases?

- A) 40
- B) not enough information to know
- C) 12
- D) 50
- E) 30

22) _____

23) If wages rise faster than increases in labour productivity, then unit labour costs will

- A) fall and the AS curve will shift right.
- B) rise and the AS curve will shift right.
- C) fall and the AS curve will shift left.
- D) not change because only total labour costs change.
- E) rise and the AS curve will shift left.

23) _____

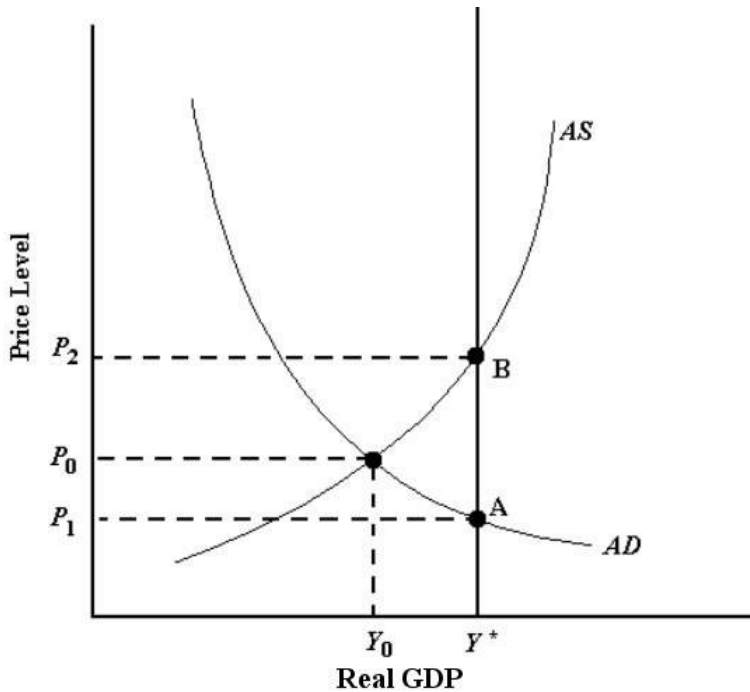


FIGURE 24-1

24) Refer to Figure 24-1. If the economy is currently in a short-run equilibrium at Y_0 , the economy is experiencing

- A) a recessionary output gap.
- B) potential output growth.
- C) a labour shortage.
- D) a long-run equilibrium.
- E) an inflationary output gap.

24) _____

25) Refer to Figure 24-1. If the economy is currently producing output of Y_0 , the economy's automatic adjustment process will have the

- A) vertical line at Y^* shifting to the left until it gets to Y_0 .
- B) AD curve shifting to the right until point B is reached.
- C) economy remaining where it is.
- D) AS curve shifting to the right until point A is reached.
- E) none of the above.

25) _____

- 26) As the macro economy adjusts from the short run to the long run, 26) _____
- A) wages and other factor prices adjust to close output gaps.
 - B) wages and other factor prices remain constant.
 - C) potential output is adjusting to close inflationary or recessionary gaps.
 - D) aggregate demand shocks cause deviations from potential output.
 - E) aggregate supply shocks cause deviations from potential output.
- 27) Suppose that the economy is initially in a long-run macroeconomic equilibrium. A shock then hits the economy and we observe that the **unemployment rate decreases** and the price level increases. We can conclude that there is now 27) _____
- A) an inflationary gap but no change in prices
 - B) an inflationary gap and a permanent increase in prices
 - C) a recessionary gap and a permanent decrease in prices.
 - D) an inflationary gap and a temporary increase in prices.
 - E) a recessionary gap and a temporary decrease in prices.
- 28) Consider an AD/AS model in long-run equilibrium. An output gap, caused by a leftward shift of the *AD* curve, would be eliminated if 28) _____
- A) the *AS* curve shifted upward.
 - B) wages rose quickly.
 - C) wages and other factor prices fell quickly.
 - D) prices rose quickly.
 - E) real national income decreased.
- 29) Consider the basic AD/AS macro model. A negative AS shock will _____ the price level and _____ output in the short run. In the long run, the price level will _____ and output _____. 29) _____
- A) increase; decrease; decrease; will be restored to potential output
 - B) increase; increase; increase further; will be restored to potential output
 - C) decrease; decrease; decrease further; will be restored to potential output
 - D) decrease; decrease; decrease further; will decrease further
 - E) increase; decrease; increase further; will be restored to potential output

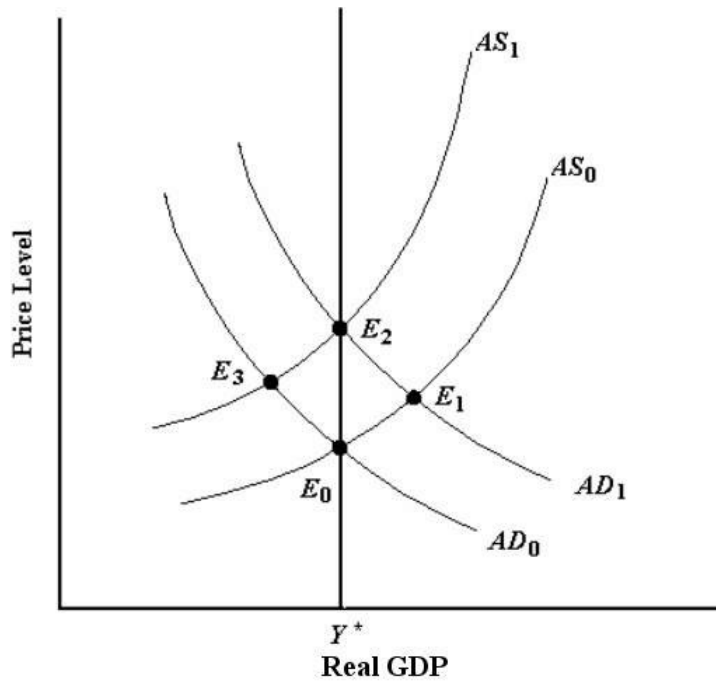


FIGURE 24-3

- 30) Refer to Figure 24-3. The economy cannot be in long-run equilibrium at E_1 because the _____
- Y^* will increase due to an increase in the price level.
 - AS will shift to the right due to a decrease in the price level.
 - AD_1 curve will shift back to AD_0 due to an increase in the price level.
 - AS will shift to the left due to an increase in wages.
 - AD_1 curve will shift back to the left due to a fall in current consumption.
- 31) Refer to Figure 24-3. Following a positive demand shock that takes the economy from E_0 to E_1 , the movement of the economy from E_1 to E_2 indicates that _____
- an increase in the price level causes the AD curve to shift to the left.
 - the economy cannot return to potential output without government intervention.
 - the effect of a demand shock on Y will be reversed in the long run when wages and prices are fully adjusted.
 - an increase in the price level causes the AS curve to shift to the left.
 - a demand shock can keep real GDP above potential output permanently.

- 32) Suppose the economy has a high level of unemployment and a low level of aggregate output. Which of the following policies could the government implement to alleviate these conditions? 32) _____
- A) an expansionary fiscal policy that increases tax rates
 - B) an expansionary fiscal policy that increases government purchases
 - C) a contractionary fiscal policy that increases tax rates
 - D) a contractionary fiscal policy that increases government purchases
 - E) automatic fiscal stabilizers
- 33) An important automatic fiscal stabilizer in Canada is 33) _____
- A) the exchange rate.
 - B) the marginal propensity to consume.
 - C) the income-tax system.
 - D) government purchases of goods and services.
 - E) the marginal propensity to import.
- 34) The "paradox of thrift" refers to the understandable tendency of worried people to _____ their saving, but in aggregate it causes a _____ recession. 34) _____
- A) decrease; less severe
 - B) increase; more severe
 - C) increase; less severe
 - D) increase; shorter
 - E) decrease, more severe
- 35) In the long run, aggregate demand is _____ for determining real GDP, and the paradox of thrift _____. 35) _____
- A) not important; applies
 - B) stable and important; applies
 - C) the most important influence; does not apply
 - D) not important; does not apply
 - E) the only influence; applies
- 36) Other things being equal, a country with a high national saving rate may have a _____ long-run growth rate because more saving increases the _____. 36) _____
- A) low; unemployment and decreases wages in the long run
 - B) high; wealth of people and increases future consumption
 - C) low; consumption in the long run
 - D) high; interest rate and encourages more investment
 - E) high; availability of funds, thus lowering the interest rate
- 37) Consider the basic AD/AS model. In the short run, a shift of the aggregate demand curve would lead to a change in real GDP by mostly changing 37) _____
- A) the productivity of capital.
 - B) the amount of labour employed.
 - C) the amount of land (natural resources) available to the economy.
 - D) the prices of factors of production.
 - E) all of the above

- 38) The level of aggregate output is determined in the short run by _____ 38) _____
but in the long run by the level of _____.
- A) the AS curve; potential output
 - B) the output gap; factor productivity
 - C) the AD and AS curves; factor utilization
 - D) the AD curve; interest rates
 - E) the AD and AS curves; Y^*
- 39) Consider the equation: $GDP = L \times [E/L] \times [GDP/E]$ where L is the supply 39) _____
of labour and E is the level of employment. In this equation, the term
[E/L] represents the
- A) number of people employed.
 - B) productivity of labour.
 - C) capital-utilization rate.
 - D) the ratio of the population unemployed.
 - E) labour employment rate.
- 40) Which of the following policies is most likely to have an effect on GDP 40) _____
in the long run?
- A) increase consumption
 - B) increase labour productivity
 - C) reduce unemployment rates
 - D) increase government purchases
 - E) change factor utilization rates
- 41) The four fundamental determinants of economic growth include all of 41) _____
the following EXCEPT:
- A) growth in human capital
 - B) growth in the labour force
 - C) growth in physical capital
 - D) technological improvement
 - E) growth in financial capital
- 42) If a country transfers resources from the production of consumption 42) _____
goods to the production of capital goods, the result will be to
- A) raise current living standards.
 - B) lower future living standards.
 - C) raise current consumption.
 - D) raise future consumption.
 - E) decrease the long-run growth rate.
- 43) For a given level of national income, an increase in private consumption 43) _____
will cause national saving to
- A) exceed investment.
 - B) remain unchanged from its initial level.
 - C) decrease.
 - D) grow at a constant rate.
 - E) increase.

- 44) Consider the market for loanable funds for a closed economy in the long run. Other things being equal, a country with a high national saving rate will tend to have _____
- an AS curve moving continually to the left.
 - either a high or low growth rate depending on the investment demand schedule.
 - a high growth rate because sustained high investment is possible with high saving.
 - trouble achieving potential real national income in the short run.
 - a high growth rate because aggregate expenditure will be high out of any given income.

The diagram below show the market for loanable funds assuming that national income is constant at Y^* .

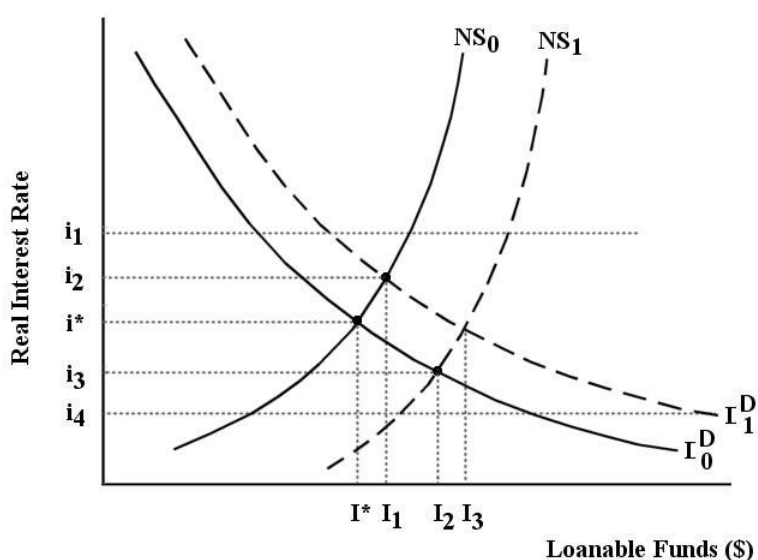


FIGURE 26-2

- 45) Refer to Figure 26-2. Suppose national saving is reflected by NS_0 and investment demand is reflected by I_0^D . If the real interest rate is i_1 , there is _____ which will drive the interest rate down until it reaches i^* .
- an excess demand for loanable funds
 - an excess supply of loanable funds
 - an excess demand for investment
 - an excess demand for financial capital
 - an excess supply of public saving

- 46) Refer to Figure 26-2. Suppose national saving is reflected by NS_0 and investment demand is reflected by I_0^D . Now suppose there is an increase in income taxes. What is the effect on the diagram? 46) _____
- A) investment demand shifts to I_1^D , causing an increase in the quantity of investment demanded from I^* to I_1 .
 - B) investment demand shifts to I_1^D , causing an increase in the quantity of investment demanded from I^* to I_3 .
 - C) national saving shifts to NS_1 , and investment demand shifts to I_1^D , causing an increase in the quantity of investment demanded from I^* to I_3 .
 - D) national saving shifts to NS_1 , causing an increase in the quantity of investment demanded from I^* to I_2 .
 - E) there is no effect on NS or I^D , and the quantity of investment demanded remains at I^* .
- 47) Which of the equations is a correct expression for national saving in the long run when real GDP equals potential output? 47) _____
- A) $NS = T - G - C$
 - B) $NS = Y^* - C - G$
 - C) $NS = Y^* - T - C$
 - D) $NS = T - G$
 - E) $NS = Y^* - C + T - G$
- 48) A person who returns to school to improve her computer skills is an example of an increase in 48) _____
- A) financial capital.
 - B) physical capital.
 - C) the labour force.
 - D) human capital.
 - E) technological capital.
- 49) One important assumption of the Neoclassical growth model is that, with a given state of technology, 49) _____
- A) increases in the use of a single factor result in constant returns.
 - B) increases in the use of a single factor bring increasing returns.
 - C) increases in GDP are possible only if all factors are increased at an equal rate.
 - D) the return from successive units of a single factor increases over time.
 - E) increases in the use of single factor bring diminishing returns.
- 50) In the Neoclassical growth model, decreases in the population, other things being equal, would eventually result in 50) _____
- A) decreasing GDP and falling living standards.
 - B) increasing GDP and falling living standards.
 - C) increasing GDP and increasing living standards.
 - D) decreasing GDP and increasing living standards.
 - E) increasing savings and increasing living standards.