Practice Test 2: Multiple Choice

1. The expenditure multiplier equals

   A. 1/(slope of APE curve).
   B. APC-APS where APC is the average propensity to consume and APS is the average propensity to save.
   C. 1/(1 - slope of APE curve).
   D. MPC-MPS where MPC is the marginal propensity to consume and MPS is the marginal propensity to save.

2. At equilibrium expenditure, unplanned changes in inventory

   A. might be either positive or negative.
   B. must be positive.
   C. must be zero.
   D. must be negative.

3. One assumption of the new classical model is that

   A. prices are "sticky" upward.
   B. markets are not purely competitive.
   C. money wage rates are rigid.
   D. people make rational expectations about aggregate demand.

4. Assuming that GDP currently equals potential GDP, a cost push inflation could result from which of the following?

   A. a large crop failure that boosts the prices of raw food materials
   B. an increase in the labor force
   C. an increase in the nation's capital stock
   D. a decrease in tax rates

5. Which of the following is the most liquid asset?

   A. land
   B. a government bond
   C. a share of stock
   D. money

6. The economy is at potential GDP when people correctly anticipate an increase in government expenditure on goods and services. If the money wage rate adjusts immediately, then

   A. real GDP and the price level will increase in the short-run, but the real wage rate will fall.
   B. real GDP remains at potential GDP.
   C. real GDP, the price level, and the real wage rate all increase in the short-run.
   D. real GDP remains at potential GDP, there is no change in the price level, and the real wage rate rises in the short-run.

7. An increase in government expenditure on goods and services

   A. decreases the aggregate quantity demanded.
   B. increases the aggregate quantity demanded.
   C. increases aggregate demand.
   D. decreases aggregate demand.

8. Examples of thrift institutions include

   A. money market mutual funds, commercial banks, and credit unions.
   B. savings deposits and checking deposits.

C. savings and loan associations, savings banks, and credit unions.
D. commercial banks, savings and loan associations, and insurance companies.

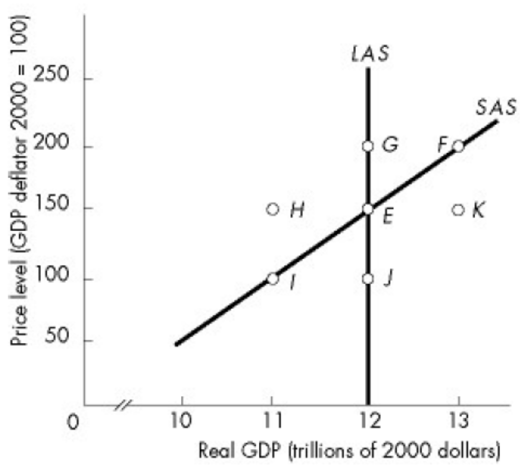
9. The table below gives the aggregate demand and aggregate supply schedules in Lotus Land. With no changes in aggregate demand or long-run aggregate supply, in long-run macroeconomic equilibrium, the price level will be _____ and real GDP will be _____.

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

A. 90; $400
B. 100; $600
C. 120; $400
D. 110; $500

10. In the figure below, which movement illustrates the impact of a constant price level and a rising money wage rate?

A. E to F
B. E to H
C. E to I
D. E to J



11. Demand-pull inflation starts with a shift of the

A. SAS curve rightward.
B. AD curve leftward.
C. AD curve rightward.
D. SAS curve leftward.

12. If an increase in a household's disposable income from $10,000 to $12,000 boosts its consumption expenditure from $8,000 to $9,000, the

A. household is dissaving.
B. slope of the consumption function is 0.2

C. slope of the consumption function is 1000
D. slope of the consumption function is 0.5

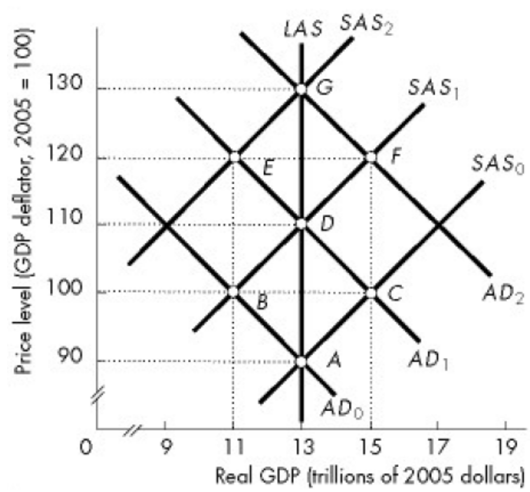
13. Which of the following shifts the aggregate expenditure curve AND shifts the aggregate demand curve?

    I. a decrease in investment
    II. a change in the price level
    III. an increase in exports

    A. II and III
    B. III only
    C. I and II
    D. I and III

14. In the figure, which path represents a cost-push inflation?

    A. point A to C to D to F to G
    B. point A to C to D to E to G
    C. point A to B to D to E to G
    D. point A to B to D to F to G



15. According to the intertemporal substitution effect, a fall in the price level will

    A. decrease the real value of wealth, which causes the quantity of real GDP demanded to increase.
    B. lead to an increase in net exports, which causes the quantity of real GDP demanded to increase.
    C. cause the interest rate to fall. As a result, investment increases and the quantity of real GDP demanded increases.
    D. increase the real value of wealth, which causes interest rates to increase. As a result, the quantity of real GDP demanded decreases.

16. In an economy, the multiplier is 3. If government expenditure increases by \$1 million, then in the short-run, the price level and real _____ GDP _____ \$3 million.

    A. rises; increases by less than
    B. falls; decreases by less than
    C. rises; equals
    D. rises; decreases by less than

17. New Keynesian economists believe that _____ is influenced by _____.

    A. today's money wage rate; yesterday's rational expectations of the price level
    B. yesterday's rational expectations of the price level; today's money wage rate

C. today's money wage rate; today's rational expectations of the price level
D. yesterday's money wage rate; today's rational expectations of the money wage

18. Which of the following is INCORRECT ?

A. The multiplier dampens the increase in income that occurs during expansions and brings the economy to a new equilibrium GDP.
B. Firms experience unplanned decreases in inventories as expansions begin.
C. Firms increase production in response to unplanned decreases in inventories.
D. Expansions usually begin with an increase in autonomous spending.

19. An increase in real GDP leads to

A. an increase in aggregate planned expenditure.
B. a change in aggregate planned expenditure but whether the change is an increase or a decrease depends on whether nominal GDP increases or decreases.
C. no change in aggregate planned expenditure.
D. a decrease aggregate planned expenditure.

20. If the Fed responds to an increase in aggregate demand by increasing the quantity of money

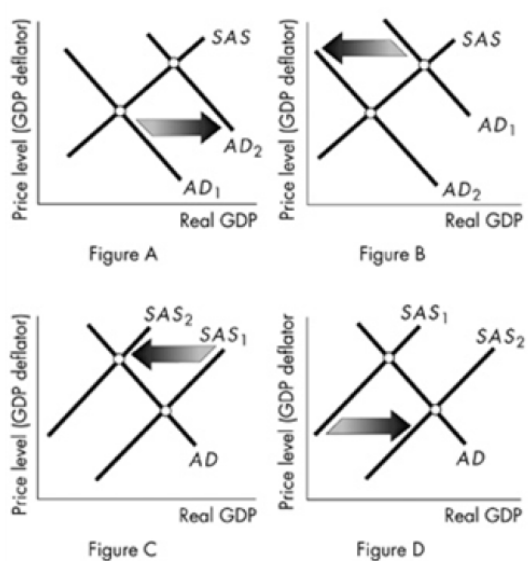
A. nothing happens because aggregate demand had already increased.
B. there will be continued inflation.
C. money wage rates will fall to reduce unemployment.
D. output will begin to decrease more rapidly than in the case in which only the first increase in aggregate demand happened.

21. Inflation occurs over time as a result of

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

22. Which of the figures to the right show how inflation can start in an economy?

A. Figure A and Figure C
B. Figure A and Figure D
C. Figure B and Figure C
D. Figure B and Figure D



23. The multiplier effect exists because a change in autonomous expenditure

A. leaves the economy in the form of imports.
B. prompts further exports.
C. leads to changes in income, which generate further spending.
D. will undergo its complete effect in one round.

24. M2 is

A. smaller than M1.
B. equal to M1, but only when all three functions of money apply.
C. larger than M1.
D. equal to M1, given full employment.

25. An asset category that caries the highest interest rate is

A. savings deposits.
B. checkable deposit accounts.
C. loans.
D. cash in the bank vault.

26. Any expenditure component that depends on the level of real GDP is called

A. induced expenditure.
B. spurious expenditure.
C. equilibrium expenditure.
D. autonomous expenditure.

27. Aside from being a means of payment, the other functions of money are

A. medium of exchange, unit of account, and store of value.
B. medium of exchange, unit of account, and means of lending.
C. pricing, contracts, and store of value.
D. medium of exchange and the ability to buy goods and services.

28. If the money wage and other resource prices do not change when the price level rises by 10 percent, _____.

A. there is movement along the short-run aggregate supply curve
B. the long-run aggregate supply curve shifts leftward
C. the short-un aggregate supply curve shifts leftward
D. massive labor layoffs occur

29. In the table below, there are no taxes and no imports or exports.

Real GDP (dollars)	Consumption expenditure (dollars)	Investment (dollars)	Government expenditure (dollars)
3,000	2,500	500	500
4,000	3,250	500	500
5,000	4,000	500	500
6,000	4,750	500	500
7,000	5,500	500	500
8,000	6,250	500	500

The value of the multiplier for this economy is

A. 0.75.
B. 4.0.
C. 1.33.
D. 0.25.

30. In the short-run with fixed prices, an increase in investment of $100 billion

    A. increases real GDP by $100 billion.
    B. increases real GDP by more than $100 billion.
    C. decreases real GDP by $100 billion because of the decrease in induced expenditures.
    D. increases real GDP by less than $100 billion.