AP Econ Practice Test Unit 5

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

1. The marginal propensity to consume is equal to:
   A. the proportion of consumer spending as a function of aggregate disposable income.
   B. the change in saving divided by the change in aggregate disposable income.
   C. one.
   D. the change in saving divided by the change in consumer spending.
   E. the change in consumer spending divided by the change in aggregate disposable income.

2. Suppose the marginal propensity to consume is equal to 0.90 and investment spending increases by $50 billion. Assuming no taxes and no trade, by how much will real GDP change?
   A. $450 billion increase.
   B. $90 billion increase.
   C. $500 billion increase.
   D. $500 billion decrease.
   E. $900 billion increase.

3. Suppose investment spending increases by $50 billion, and as a result the equilibrium income increases by $200 billion. The value of the \( MPC \) is:
   A. 0.8.
   B. 0.4.
   C. 0.75.
   D. 4.
   E. 0.5.

4. David receives a tax refund of $800. He spends $600 and saves $200. David’s marginal propensity to consume is:
   A. 0.6.
   B. 0.33.
   C. 0.25.
   D. 0.20.
   E. 0.75.

5. Planned investment spending is _______ to the interest rate because _______.
   A. positively related; a fall in the market interest rate decreases the supply of loanable funds
   B. negatively related; a rise in the market interest rate makes any given investment project less profitable
   C. positively related; a fall in the market interest rate decreases the opportunity cost of investing
   D. negatively related; a rise in the market interest rate causes consumption to “crowd out” investment
   E. negatively related; a rise in the market interest rate causes a lower opportunity cost of using retained earnings to fund the investment project.
6. If households _____ savings in their bank accounts, ______ and the interest rate ______, therefore increasing investment spending.
   A. increase; the supply of loanable funds shifts right; rises
   B. increase; the demand of loanable funds shifts right; rises
   C. increase; the supply of loanable funds shifts right; falls
   D. decrease; the demand of loanable funds shifts left; falls
   E. increase; the demand for loanable funds shifts right; falls

7. Planned investment spending will decrease if:
   A. the interest rate rises.
   B. firms expect the growth of real GDP to increase.
   C. firms are currently producing near full capacity.
   D. consumer expectations about future wealth grow more optimistic.
   E. firms have more optimistic expectations about future profits.

8. The slope of the consumption function equals:
   A. 1 – \( MPS \)
   B. \( 1/(1 - MPS) \)
   C. 1 – \( MPC \)
   D. \( MPC/MPS \)
   E. \( MPS \)

9. If the \( MPC \) equals 0.75, then based on the simple model presented in this chapter, one would expect a $100 decrease in government spending to lead to:
   A. an increase in spending which will total $100 by the end of all the rounds.
   B. an increase in spending which will total $400 by the end of all the rounds.
   C. a decrease in spending which will total $100 by the end of all the rounds.
   D. a decrease in spending which will total $400 by the end of all the rounds.
   E. a decrease in spending which will total $500 by the end of all the rounds.

10. A graphical representation of the relationship between the total quantity of goods and services demanded and the price level is the:
    A. aggregate demand curve.
    B. average price level.
    C. circular flow model.
    D. GDP curve.
    E. aggregate supply curve.

11. The wealth effect suggests:
    A. a positive relationship between the price level and consumption spending.
    B. that price level changes do not affect real wealth.
    C. a negative relationship between the price level and consumption spending.
    D. that when the price level increases, the real value of money increases also.
    E. that when the price level rises, the real value of wealth also rises.

12. If prices are constant, but there is an increase in the value of financial assets:
    A. aggregate supply shifts to the left.
    B. aggregate supply shifts to the right.
    C. aggregate demand shifts to the left
    D. aggregate demand shifts to the right.
    E. there is a movement down the aggregate demand curve.
Figure 18-1: Aggregate Supply Movements

13. Use the “Aggregate Supply Movements” Figure 18-1. Using the accompanying figure we can safely conclude that:
   A. an increase in the price level is responsible for pushing the \( SRAS \) curve to the right.
   B. a decrease in the price level is responsible for pushing the \( SRAS \) curve to the right.
   C. there has been an increase in the \( SRAS \) supply curve.
   D. there has been a decrease in the \( SRAS \) supply curve.
   E. an increase in the price level has caused an upward movement along the \( SRAS \) curve.

14. A general decrease in wages will result in the:
   A. aggregate demand shifting to the right.
   B. aggregate demand shifting to the left.
   C. short-run aggregate supply shifting to the right.
   D. short-run aggregate supply shifting to the left.
   E. long-run aggregate supply shifting to the right.

15. According to the long-run aggregate supply curve, when ________, the quantity of aggregate output supplied ________.
   A. nominal wages rise; falls
   B. the aggregate price level rises; does not change
   C. the aggregate price level rises; falls
   D. the price of commodities falls; rises
   E. the unemployment rate rises; does not change

16. The level of output in the long run is known as:
   A. recognized output.
   B. structural output.
   C. potential output.
   D. balanced budget output.
   E. inflationary output.
17. A negative demand shock can cause:
A. a liquidity trap.
B. crowding out.
C. a recessionary gap.
D. an inflationary gap.
E. an economic expansion.

18. When an economy experiences stagflation, it is usually caused by a:
A. negative demand shock.
B. positive supply shock.
C. negative supply shock.
D. positive demand shock.
E. negative supply shock and a positive demand shock.

19. Suppose the equilibrium aggregate price level is rising and the equilibrium level of real GDP is falling. Which of the following most likely caused these changes?
A. An increase in short-run aggregate supply.
B. An increase in aggregate demand.
C. A decrease in short-run aggregate supply.
D. A decrease in aggregate demand.
E. An increase in short-run aggregate supply and an increase in aggregate demand.

20. The intersection of the economy's aggregate demand and long-run aggregate supply curves:
A. determines its equilibrium real GDP in both the long run and the short run.
B. determines its equilibrium price level in both the long run and the short run.
C. occurs at the economy's potential output.
D. occurs at high levels of cyclical unemployment.
E. occurs at the level of output that corresponds to an unemployment rate of 0%.
Figure 19-3: Inflationary and Recessionary Gaps

____ 21. Use the “Inflationary and Recessionary Gaps” Figure 19-3. In Panel (a), the intersection of $SRAS$ with $AD$ indicates:
   A. an economy experiencing a recessionary gap.
   B. an economy experiencing an inflationary gap.
   C. that the economy is in long-run equilibrium.
   D. that the economy has an unusually low unemployment rate.
   E. that the economy is operating at potential output.

____ 22. A recessionary gap will be eliminated because there is ______ pressure on wages, causing the _______.
   A. downward; short-run aggregate supply curve to shift rightward.
   B. downward; short-run aggregate supply curve to shift leftward.
   C. downward; aggregate demand curve to shift rightward.
   D. upward; aggregate demand curve to shift to leftward.
   E. upward; short-run aggregate supply curve to shift rightward.
23. Use the “AD–AS Model I” Figure 19-6. If the economy is at point X, there is:
   A. an inflationary gap with low unemployment.
   B. an inflationary gap with high unemployment.
   C. a recessionary gap with low unemployment.
   D. a recessionary gap with high unemployment.
   E. long-run equilibrium with full employment.
24. Use the “AD–AS Model II” Figure 19-7. If productivity increases, which of the following will take place?
   A. SRAS curve will shift to the left.
   B. SRAS curve will shift to the right.
   C. AD curve will shift to the left.
   D. AD curve will shift to the right.
   E. LRAS curve will shift to the left.

25. If there is an inflationary gap, which of the following accurately describes the adjustment to long-run equilibrium?
   A. Nominal wages decrease, and the aggregate demand curve shifts left until the economy reaches long-run equilibrium.
   B. Nominal wages increase, and the aggregate demand curve shifts right until the economy reaches long-run equilibrium.
   C. Nominal wages decrease, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
   D. Nominal wages increase, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
   E. Nominal wages increase, and the short-run aggregate supply curve shifts left until the economy reaches long-run equilibrium.

26. If actual GDP is less than potential output, then the economy is
   A. in an inflationary gap.
   B. in a recessionary gap.
   C. in a long-run equilibrium.
   D. at full employment.
   E. experiencing zero cyclical unemployment.
27. Use the “AD–AS” Figure 19-8. Assume that the economy is in long-run equilibrium. Suppose that the Federal Reserve lowers key interest rates, as a result of this action:
   A. there will be an upward movement along the aggregate demand curve $AD_1$.
   B. the aggregate demand curve will stay unchanged at $AD_1$.
   C. there will be a downward movement along the aggregate demand curve $AD_1$.
   D. the aggregate demand curve will shift to $AD_3$.
   E. the aggregate demand curve will shift to $AD_2$.

28. If an economy is in short-run equilibrium such that the level of output is greater than the potential output, then this means that:
   A. in the long run, nominal wages will rise.
   B. the economy is in long-run equilibrium.
   C. in the long run, the short run AS curve will shift to the right.
   D. unemployment in the economy is much higher than the natural rate of unemployment.
   E. in the long run, the unemployment rate will decrease as the short run AS curve shifts to the right.

29. In the short run, when the $AD$ curve increases:
   A. the aggregate price level will rise and the aggregate output level will fall.
   B. the aggregate price level will rise and the aggregate output level will increase.
   C. the aggregate price level will fall and the aggregate output level will increase.
   D. the aggregate price level will fall and the aggregate output level will decrease.
   E. the aggregate price level will remain constant and the aggregate output level will increase.

30. The short-run aggregate supply curve is ______, and the long-run aggregate supply curve is ______.
   A. vertical; upward sloping
   B. upward sloping; vertical
   C. downward sloping; vertical
   D. vertical; horizontal
   E. Upward sloping; downward sloping
31. Economic theory in 1936 changed dramatically with the publication of:
   B. *The Wealth of Nations* by Adam Smith.
   C. *The Road to Serfdom* by F.A. Hayek.
   D. *Principles of Economics* by Paul Samuelson.
   E. *A Theory of the Consumption Function* by Milton Friedman.

32. The economic policy that uses changes in government spending and taxes to affect the overall spending in the economy, is known as the:
   A. tax and spend policy.
   B. monetary policy.
   C. fiscal policy.
   D. free trade policy.
   E. free market policy.

33. A government might want to increase aggregate demand to:
   A. close an inflationary gap.
   B. close a recessionary gap.
   C. lower prices in the economy.
   D. lower employment in the economy.
   E. decrease nominal interest rates.

34. Expansionary fiscal policy includes:
   A. increasing taxes.
   B. increasing the money supply.
   C. decreasing government expenditures.
   D. increasing government expenditures.
   E. decreasing the federal funds rate.

**Scenario 20-1: Fiscal Policy**
Consider the economy of Arcadia. The households of Arcadia spend 75% of their income. There are no taxes and no foreign trade. The currency of Arcadia is called “Arcs”. The level of potential output in Arcadia is 600 billion arcs.

35. Use **Scenario 20-1**. Refer to the information provided. Suppose the actual real GDP in Arcadia is 500 billion arcs. Then, the economy has:
   A. a recessionary gap.
   B. production at the full-employment level.
   C. an inflationary gap.
   D. a liquidity trap.
   E. an unemployment rate that is higher than the natural rate of unemployment.

36. Other things being equal, investment spending ______ as long as ______.
   A. decreases; technological innovation develops faster than technological obsolescence
   B. increases; sales exceed the existing production capacity
   C. increases; the rate of growth of real GDP is lower than the marginal propensity to save
   D. decreases; the rate of growth of physical capital is positive
   E. increases; market interest rates continue to rise
Scenario 16-2: Income-Expenditure Equilibrium
Suppose GDP is $8,000, autonomous consumption is $500, and planned investment spending is $200. The marginal propensity to consume is 0.8.

37. Use Scenario 16-2. If GDP is $3,000, how much is unplanned inventory investment?
   A. 0
   B. $600
   C. $100
   D. –$100
   E. $200

38. When the aggregate price level increases, the purchasing power of many assets falls, causing a decrease in consumer spending. This is known as the _____ effect and is a reason why the _____ curve slopes _____.
   A. interest rate; aggregate demand; downward
   B. wealth; aggregate demand; downward
   C. interest rate; investment demand; downward
   D. wealth; short-run aggregate supply; upward
   E. substitution; aggregate demand; downward

39. The wealth effect explains why:
   A. the aggregate demand curve slopes downward since changes in aggregate price levels change the purchasing power of peoples' assets.
   B. the short-run aggregate supply curve slopes upward since an increase in wealth leads to more consumption.
   C. the short-run aggregate supply curve shifts since changes in wealth affect production.
   D. the aggregate demand curve slopes upward since wealth allows consumers to purchase more regardless of the price level.
   E. the long-run aggregate supply curve is vertical as there is no relationship between aggregate price level and aggregate output in the long run.

40. The short-run aggregate supply curve shows:
   A. the price level at which real output will be consumed.
   B. the price level at which real output will be in equilibrium.
   C. the positive relationship between the aggregate price level and aggregate output supplied.
   D. the negative relationship between the aggregate price level and aggregate output supplied.
   E. the inverse relationship between real GDP and the unemployment rate.

41. A natural disaster that destroys part of a country's infrastructure is a type of _______ and therefore shifts the _______ to the _______.
   A. negative demand shock; aggregate demand curve; right
   B. negative supply shock; aggregate demand curve; left
   C. negative supply shock; short-run aggregate supply curve; left
   D. negative demand shock; long-run aggregate supply curve; left
   E. negative supply shock; short-run aggregate supply curve; right

42. A recessionary gap can be closed by _______ wages that shift the _______.
   A. lower; SRAS curve rightward
   B. lower; LRAS curve rightward
   C. lower; SRAS curve leftward
   D. higher; SRAS curve rightward
   E. higher; SRAS curve leftward
43. Use the “Fiscal Policy I” Figure 20-5. Suppose that this economy is in equilibrium at $E_1$. If there is an increase in government purchases, then:

A. $AD_2$ will shift to the left, causing an increase in the price level and a decrease in real GDP.

B. $AD_2$ will shift to the left, causing a decrease in the price level and a decrease in the real GDP.

C. $AD_1$ will shift to the right, causing an increase in the price level and an increase in real GDP.

D. $AD_1$ will shift to the right, causing a decrease in the price level and an increase in real GDP.

E. $AD_1$ will shift to the right, causing an increase in the price level and a decrease in real GDP.
44. Use the "Short-Run Equilibrium" Figure 21-1. The accompanying graph shows the economy in short-run equilibrium. To move the economy to potential GDP, the government needs to reduce government spending by an amount equal to:
A. \((Y_1 - Y_p)\)
B. \((Y_1 - Y_p)/(1 - MPC)\)
C. \((Y_1 - Y_p)MPC\)
D. \((Y_1 - Y_p)(1 - MPC)\)
E. \((1 - MPC)/(Y_1 - Y_p)\)
AP Econ Practice Test Unit 5
Answer Section

MULTIPLE CHOICE

1. ANS: E  PTS: 1  SKL: Definitional
2. ANS: C  PTS: 1  SKL: Critical Thinking
3. ANS: C  PTS: 1  SKL: Analytical Thinking
4. ANS: E  PTS: 1  SKL: Critical Thinking
5. ANS: B  PTS: 1  SKL: Concept-Based
6. ANS: C  PTS: 1  SKL: Critical Thinking
7. ANS: A  PTS: 1  SKL: Concept-Based
8. ANS: A  PTS: 1  SKL: Critical Thinking
9. ANS: D  PTS: 1  SKL: Critical Thinking
10. ANS: A  PTS: 1  SKL: Definitional
11. ANS: C  PTS: 1  SKL: Concept-Based
12. ANS: D  PTS: 1  SKL: Concept-Based
13. ANS: C  PTS: 1  SKL: Concept-Based
14. ANS: C  PTS: 1  SKL: Concept-Based
15. ANS: B  PTS: 1  SKL: Concept-Based
16. ANS: C  PTS: 1  SKL: Definitional
17. ANS: C  PTS: 1  SKL: Concept-Based
18. ANS: C  PTS: 1  SKL: Concept-Based
19. ANS: C  PTS: 1  SKL: Critical Thinking
20. ANS: C  PTS: 1  SKL: Concept-Based
21. ANS: A  PTS: 1  SKL: Critical Thinking
22. ANS: A  PTS: 1  SKL: Concept-Based
23. ANS: D  PTS: 1  SKL: Critical Thinking
24. ANS: B  PTS: 1  SKL: Critical Thinking
25. ANS: E  PTS: 1  SKL: Analytical Thinking
26. ANS: B  PTS: 1  SKL: Definitional
27. ANS: E  PTS: 1  SKL: Analytical Thinking
28. ANS: A  PTS: 1  SKL: Critical Thinking
29. ANS: B  PTS: 1  SKL: Critical Thinking
30. ANS: B  PTS: 1  SKL: Fact-Based
31. ANS: A  PTS: 1  SKL: Fact-Based
32. ANS: C  PTS: 1  SKL: Definitional
33. ANS: B  PTS: 1  SKL: Critical Thinking
34. ANS: D  PTS: 1  SKL: Fact-Based
35. ANS: A  PTS: 1  SKL: Concept-Based
36. ANS: B  PTS: 1  SKL: Critical Thinking
37. ANS: D  PTS: 1  SKL: Analytical Thinking
38. ANS: B  PTS: 1  SKL: Concept-Based
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