

DO NOT WRITE ON THIS TEST!

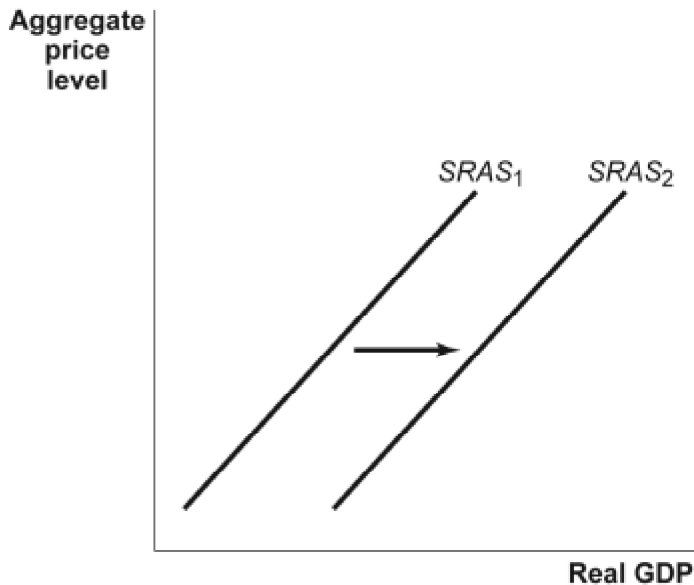
AP Econ Practice Test Unit 5

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.

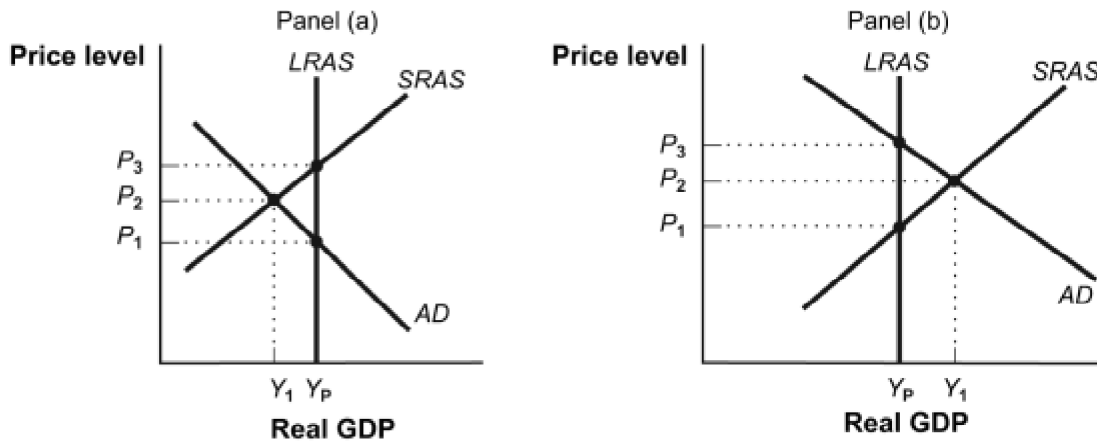
- _____ 6. If households _____ savings in their bank accounts, _____ and the interest rate _____, therefore increasing investment spending.
- A. increase; the supply of loanable funds shifts right; rises
 - B. increase; the demand of loanable funds shifts right; rises
 - C. increase; the supply of loanable 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

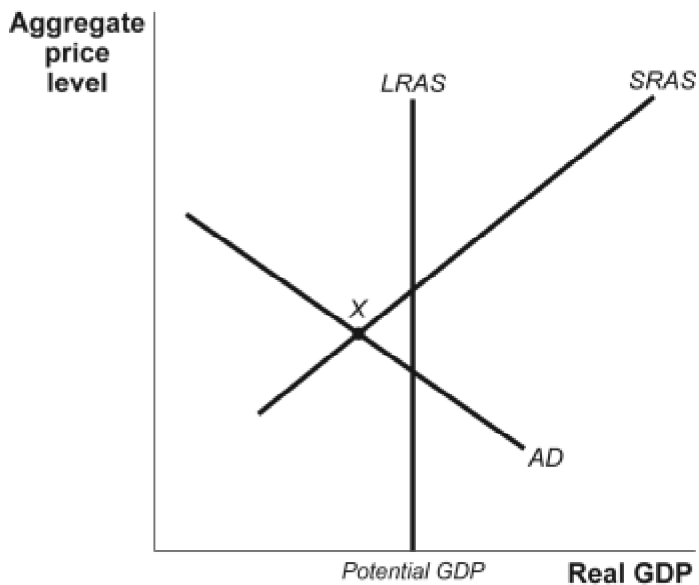
- _____ 13. Use the “**Aggregate Supply Movements**” **Figure 18-1**. Using the accompanying figure we can safely conclude that:
- an increase in the price level is responsible for pushing the *SRAS* curve to the right.
 - a decrease in the price level is responsible for pushing the *SRAS* curve to the right.
 - there has been an increase in the *SRAS* supply curve.
 - there has been a decrease in the *SRAS* supply curve.
 - 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:
- aggregate demand shifting to the right.
 - aggregate demand shifting to the left.
 - short-run aggregate supply shifting to the right.
 - short-run aggregate supply shifting to the left.
 - long-run aggregate supply shifting to the right.
- _____ 15. According to the long-run aggregate supply curve, when _____, the quantity of aggregate output supplied _____.
- nominal wages rise; falls
 - the aggregate price level rises; does not change
 - the aggregate price level rises; falls
 - the price of commodities falls; rises
 - the unemployment rate rises; does not change
- _____ 16. The level of output in the long run is known as:
- recognized output.
 - structural output.
 - potential output.
 - balanced budget output.
 - 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%.

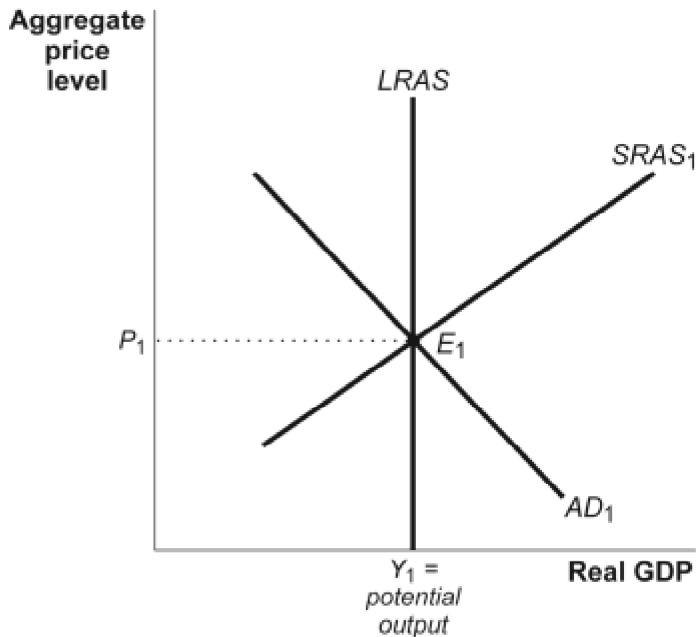
Figure 19-3: Inflationary and Recessionary Gaps



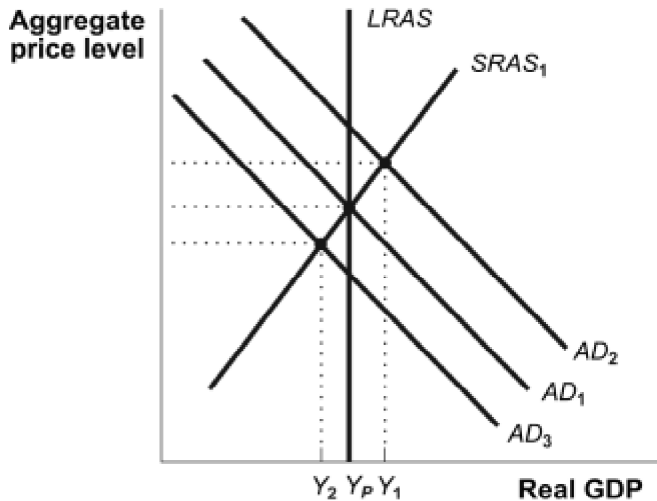
- _____ 21. Use the “**Inflationary and Recessionary Gaps**” Figure 19-3. In Panel (a), the intersection of *SRAS* with *AD* indicates:
- an economy experiencing a recessionary gap.
 - an economy experiencing an inflationary gap.
 - that the economy is in long-run equilibrium.
 - that the economy has an unusually low unemployment rate.
 - that the economy is operating at potential output.
- _____ 22. A recessionary gap will be eliminated because there is _____ pressure on wages, causing the _____ .
- downward; short-run aggregate supply curve to shift rightward.
 - downward; short-run aggregate supply curve to shift leftward.
 - downward; aggregate demand curve to shift rightward.
 - upward; aggregate demand curve to shift to leftward.
 - upward; short-run aggregate supply curve to shift rightward.

Figure 19-6: *AD-AS Model I*

- _____ 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.

Figure 19-7: *AD-AS Model II*

- _____ 24. Use the “*AD-AS Model II*” **Figure 19-7**. If productivity increases, which of the following will take place?
- SRAS* curve will shift to the left.
 - SRAS* curve will shift to the right.
 - AD* curve will shift to the left.
 - AD* curve will shift to the right.
 - 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?
- Nominal wages decrease, and the aggregate demand curve shifts left until the economy reaches long-run equilibrium.
 - Nominal wages increase, and the aggregate demand curve shifts right until the economy reaches long-run equilibrium.
 - Nominal wages decrease, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
 - Nominal wages increase, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
 - 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
- in an inflationary gap.
 - in a recessionary gap.
 - in a long-run equilibrium.
 - at full employment.
 - experiencing zero cyclical unemployment.

Figure 19-8: *AD-AS*

- _____ 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:
- there will be an upward movement along the aggregate demand curve AD_1 .
 - the aggregate demand curve will stay unchanged at AD_1 .
 - there will be a downward movement along the aggregate demand curve AD_1 .
 - the aggregate demand curve will shift to AD_3 .
 - 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:
- in the long run, nominal wages will rise.
 - the economy is in long-run equilibrium.
 - in the long run, the short run *AS* curve will shift to the right.
 - unemployment in the economy is much higher than the natural rate of unemployment.
 - 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:
- the aggregate price level will rise and the aggregate output level will fall.
 - the aggregate price level will rise and the aggregate output level will increase.
 - the aggregate price level will fall and the aggregate output level will increase.
 - the aggregate price level will fall and the aggregate output level will decrease.
 - 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 _____.
- vertical; upward sloping
 - upward sloping; vertical
 - downward sloping; vertical
 - vertical; horizontal
 - Upward sloping; downward sloping

- _____ 31. Economic theory in 1936 changed dramatically with the publication of:
- A. *The General Theory of Employment, Interest and Money* by John Maynard Keynes.
 - 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.

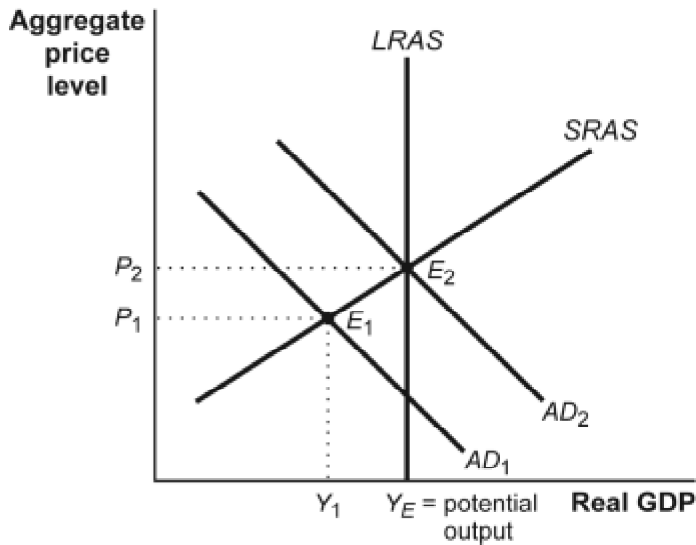
- _____ 35. Use **Scenario 20-1**. Refer to the information provided. Suppose the actual real GDP in Arcadia is 500 billion arcs. Then, the economy has:
- A. a recessionary gap.
 - B. production at the full-employment level.
 - C. an inflationary gap.
 - D. a liquidity trap.
 - E. an unemployment rate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

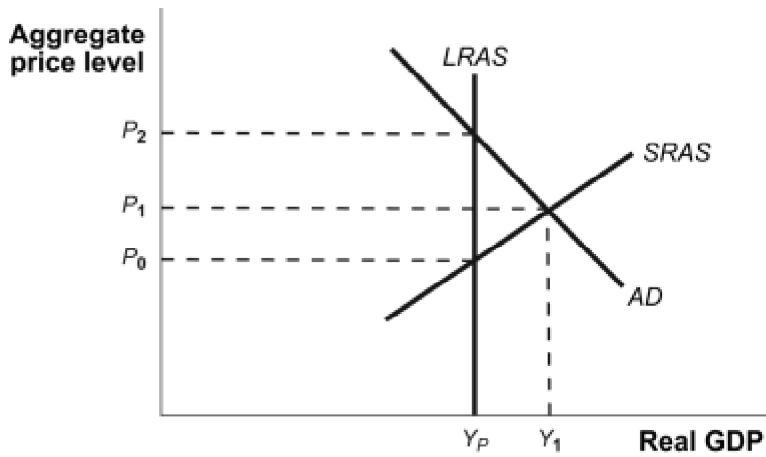
- _____ 37. Use **Scenario 16-2**. If GDP is \$3,000, how much is unplanned inventory investment?
- A. 0
 - B. \$600
 - C. \$100
 - D. -\$100
 - E. \$200
- _____ 38. When the aggregate price level increases, the purchasing power of many assets falls, causing a decrease in consumer spending. This is known 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

Figure 20-5: Fiscal Policy I



- _____ 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:
- AD_2 will shift to the left, causing an increase in the price level and a decrease in real GDP.
 - AD_2 will shift to the left, causing a decrease in the price level and a decrease in the real GDP.
 - AD_1 will shift to the right, causing an increase in the price level and an increase in real GDP.
 - AD_1 will shift to the right, causing a decrease in the price level and an increase in real GDP.
 - AD_1 will shift to the right, causing a increase in the price level and a decrease in real GDP.

Figure 21-1: Short-Run Equilibrium



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:
- $(Y_1 - Y_P)$
 - $(Y_1 - Y_P)/(1 - MPC)$
 - $(Y_1 - Y_P)MPC$
 - $(Y_1 - Y_P)(1 - MPC)$
 - $(1 - MPC)/(Y_1 - Y_P)$

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
39. ANS: A	PTS: 1	SKL: Concept-Based

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|------------|--------|--------------------------|
| 40. ANS: C | PTS: 1 | SKL: Concept-Based |
| 41. ANS: C | PTS: 1 | SKL: Critical Thinking |
| 42. ANS: A | PTS: 1 | SKL: Concept-Based |
| 43. ANS: C | PTS: 1 | SKL: Critical Thinking |
| 44. ANS: D | PTS: 1 | SKL: Analytical Thinking |