

## AP Econ Practice Test Unit 10

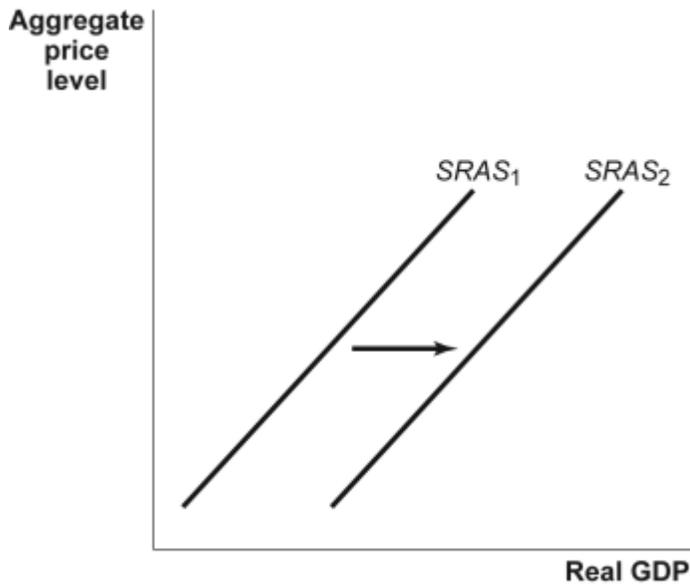
### Multiple Choice

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

- \_\_\_\_\_ 1. The marginal propensity to consume is equal to:
- the proportion of consumer spending as a function of aggregate disposable income.
  - the change in saving divided by the change in aggregate disposable income.
  - one.
  - the change in saving divided by the change in consumer spending.
  - 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?
- \$450 billion increase.
  - \$90 billion increase.
  - \$500 billion increase.
  - \$500 billion decrease.
  - \$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:
- 0.8.
  - 0.4.
  - 0.75.
  - 4.
  - 0.5.
- \_\_\_\_\_ 4. David receives a tax refund of \$800. He spends \$600 and saves \$200. David's marginal propensity to consume is:
- 0.6.
  - 0.33.
  - 0.25.
  - 0.20.
  - 0.75.
- \_\_\_\_\_ 5. Planned investment spending is \_\_\_\_\_ to the interest rate because \_\_\_\_\_.
- positively related; a fall in the market interest rate decreases the supply of loanable funds
  - negatively related; a rise in the market interest rate makes any given investment project less profitable
  - positively related; a fall in the market interest rate decreases the opportunity cost of investing
  - negatively related; a rise in the market interest rate causes consumption to “crowd out” investment
  - 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.
- increase; the supply of loanable funds shifts right; rises
  - increase; the demand of loanable funds shifts right; rises
  - increase; the supply of loanable funds shifts right; falls
  - decrease; the demand of loanable funds shifts left; falls
  - 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.

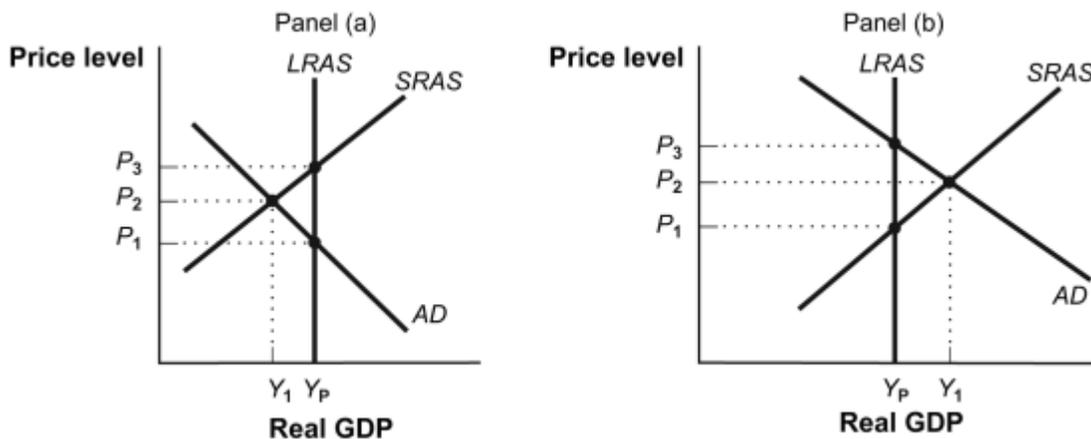
**Figure 18-1: Aggregate Supply Movements**



- \_\_\_ 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 liquidity trap.
  - crowding out.
  - a recessionary gap.
  - an inflationary gap.
  - an economic expansion.

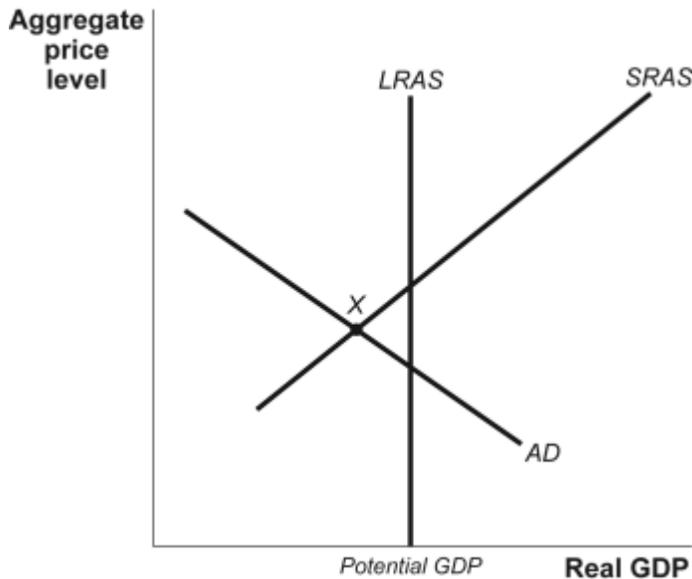
- \_\_\_\_\_ 18. When an economy experiences stagflation, it is usually caused by a:
- negative demand shock.
  - positive supply shock.
  - negative supply shock.
  - positive demand shock.
  - negative supply shock and a positive demand shock.
- \_\_\_\_\_ 19. Suppose the equilibrium aggregate price level is rising and the equilibrium level of real GDP is falling. Which of the following most likely caused these changes?
- An increase in short-run aggregate supply.
  - An increase in aggregate demand.
  - A decrease in short-run aggregate supply.
  - A decrease in aggregate demand.
  - 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:
- determines its equilibrium real GDP in both the long run and the short run.
  - determines its equilibrium price level in both the long run and the short run.
  - occurs at the economy's potential output.
  - occurs at high levels of cyclical unemployment.
  - occurs at the level of output that corresponds to an unemployment rate of 0%.

**Figure 19-3: Inflationary and Recessionary Gaps**



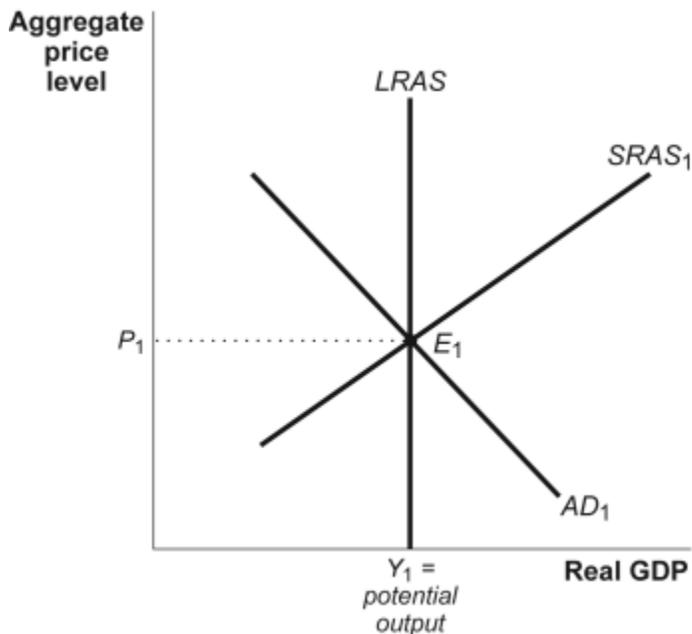
- \_\_\_\_\_ 21. Use the “**Inflationary and Recessionary Gaps**” Figure 19-3. In Panel (a), the intersection of *SRAS* with *AD* indicates:
- an economy experiencing a recessionary gap.
  - an economy experiencing an inflationary gap.
  - that the economy is in long-run equilibrium.
  - that the economy 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.

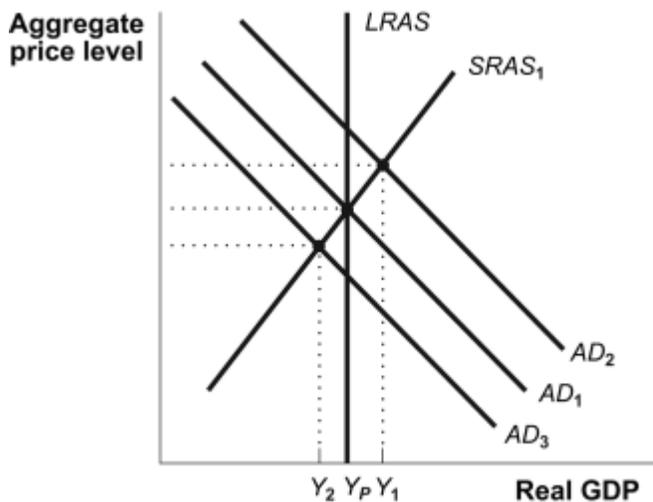
**Figure 19-7: AD–AS Model II**



- \_\_\_ 24. Use the “AD–AS Model II” Figure 19-7. If productivity increases, which of the following will take place?
- 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.

**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:
- 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:
- 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 recessionary gap.
  - production at the full-employment level.
  - an inflationary gap.
  - a liquidity trap.
  - an unemployment rate that is higher than the natural rate of unemployment.
- \_\_\_ 36. Other things being equal, investment spending \_\_\_\_\_ as long as \_\_\_\_\_.
- decreases; technological innovation develops faster than technological obsolescence
  - increases; sales exceed the existing production capacity
  - increases; the rate of growth of real GDP is lower than the marginal propensity to save
  - decreases; the rate of growth of physical capital is positive
  - increases; market interest rates continue to rise

**Scenario 16-2: Income-Expenditure Equilibrium**

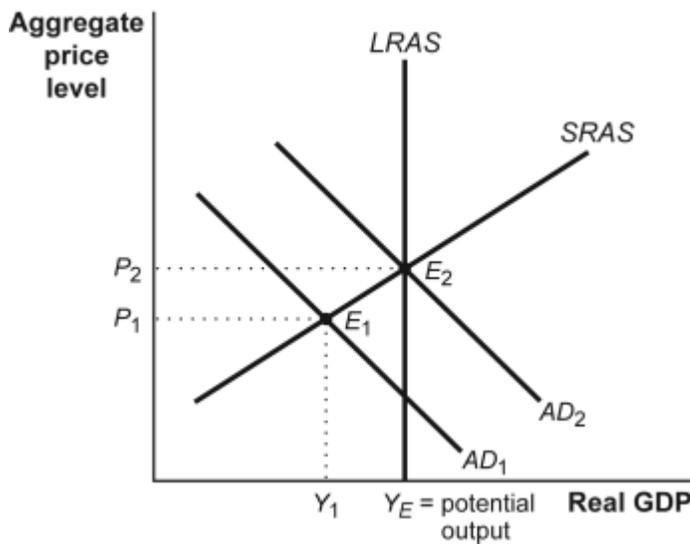
Suppose GDP is \$8,000, autonomous consumption is \$500, and planned investment spending is \$200. The marginal propensity to consume is 0.8.

- \_\_\_ 37. Use **Scenario 16-2**. If GDP is \$3,000, how much is unplanned inventory investment?
- 0
  - \$600
  - \$100
  - \$100
  - \$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 \_\_\_\_\_.
- interest rate; aggregate demand; downward
  - wealth; aggregate demand; downward
  - interest rate; investment demand; downward
  - wealth; short-run aggregate supply; upward
  - substitution; aggregate demand; downward
- \_\_\_ 39. The wealth effect explains why:
- the aggregate demand curve slopes downward since changes in aggregate price levels change the purchasing power of peoples' assets.
  - the short-run aggregate supply curve slopes upward since an increase in wealth leads to more consumption.
  - the short-run aggregate supply curve shifts since changes in wealth affect production.
  - the aggregate demand curve slopes upward since wealth allows consumers to purchase more regardless of the price level.
  - 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:
- the price level at which real output will be consumed.
  - the price level at which real output will be in equilibrium.
  - the positive relationship between the aggregate price level and aggregate output supplied.
  - the negative relationship between the aggregate price level and aggregate output supplied.
  - 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

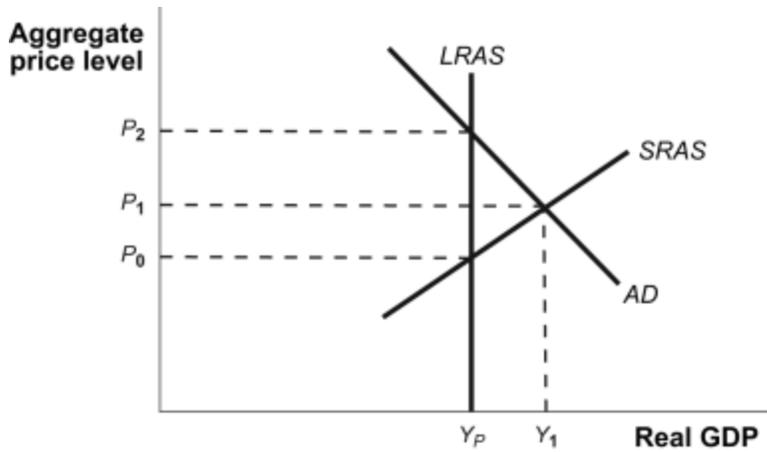
- \_\_\_\_\_ 42. A recessionary gap can be closed by \_\_\_\_\_ wages that shift the \_\_\_\_\_ .
- A. lower; *SRAS* curve rightward
  - B. lower; *LRAS* curve rightward
  - C. lower; *SRAS* curve leftward
  - D. higher; *SRAS* curve rightward
  - E. higher; *SRAS* curve leftward

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