

VERSION B ECONOMICS 212  
 27/4/2004, EXAM 2, 50 QUESTIONS  
 TIME DURATION: 60 MINUTES

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Suppose a Mexican citizen takes a Greyhound bus trip from Mexico City to a U.S. City. While on her trip, she gets sick and receives treatment at a hospital. Which of the following represents the trade that took place?

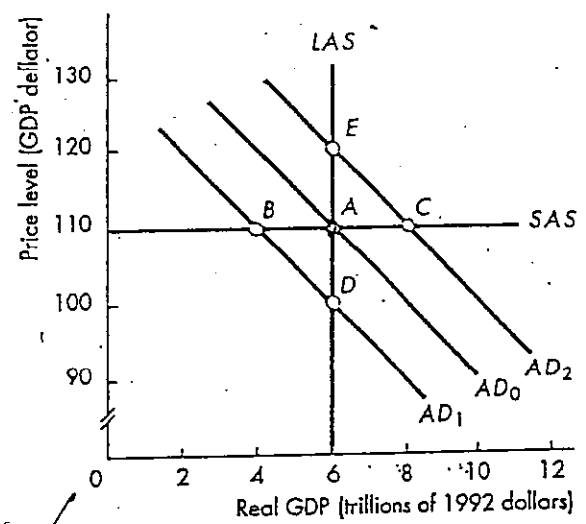
- A) The bus trip and the medical care are counted as a Mexican imported service.
- B) The trip is a U.S. export and the medical service is not counted.
- C) The trip is not counted in the balance of trade and the medical service is a U.S. export.
- D) Neither the trip nor medical service appears in the balance of trade accounts.

Suppose you buy a plane ticket on Swiss Air, travel to Zurich, buy chocolate, and bring it back to the U.S. The plane ticket is an \_\_\_\_\_ for the U.S. and the chocolate is an \_\_\_\_\_ for the U.S.

- A) export of a service; export of a good
- B) import of a service; import of a good
- C) import of a good; import of a service
- D) export of a good; export of a service

Suppose that a shock causes the aggregate demand curve to shift rightward.

- A) the economy will experience a temporary reduction in employment but will eventually return to full employment.
- B) output initially will exceed potential GDP, but the economy will return to potential GDP with a higher price level.
- C) the short-run aggregate supply curve will not shift leftward and there will be continued inflation.
- D) eventually the short-run aggregate supply curve will shift leftward and there will be continued inflation.



In the above figure, suppose the economy is initially at point A when firms come to expect that future tax rate changes will reduce the profitability of investment. In the Keynesian theory, which of the following occur?

- I. Investment will decrease. ✓
  - II. There will be a movement to point D. ✓
  - III. Money wages will not fall. ✓
- A) I only.
  - B) II and III.
  - C) I and III.
  - D) I, II and III.

All of the following, except one, would be expected to give rise to a leftward shift in the aggregate demand curve in the United States. Which is the odd one out?

- a. an economic downturn in Europe ✓
- b. a decline in new business investment ✓
- c. a reduction in exports ✓

Suppose the only revenue taken in by the government is in the form of income tax, and the tax rate is 10 percent. If aggregate income is \$800 billion, and government expenditures are \$100 billion then

- A) the government budget shows a deficit of \$20 billion.
- B) the government budget shows a surplus of \$20 billion.
- C) the government budget shows neither a surplus nor a deficit.
- D) the government budget shows a deficit of \$80 billion.

Suppose that in a particular economy, the multiplier is equal to 5. In terms of aggregate demand and aggregate supply, this value for the multiplier means that after a change in investment

- A) at each level of real GDP, the aggregate demand curve shifts upward by an amount equal to 5 times the change in investment.
- B) at each level of real GDP, the aggregate supply curve shifts upward by an amount equal to 5 times the change in investment.
- C) at each price level, the aggregate supply curve shifts rightward by an amount equal to 5 times the change in investment.
- D) at each price level, the aggregate demand curve shifts rightward by an amount equal to 5 times the change in investment.

Assume a closed economy in which households spend 80 percent of any increase in disposable income they receive. In income-expenditure analysis, an increase in government spending of \$100 million, accompanied by an increase in taxes of \$100 million that is put into effect by increasing the taxes of everyone in the population by the same amount, will cause the equilibrium level of national output to change by:

- a. \$80 million.
- b. \$100 million.
- c. \$400 million.
- d. \$500 million.
- e. \$800 million.

Suppose that in a particular economy, the multiplier is equal to 5. In terms of aggregate demand and aggregate supply, this value for the multiplier means that after a change in investment

- A) at each level of real GDP, the aggregate demand curve shifts upward by an amount equal to 5 times the change in investment.
- B) at each level of real GDP, the aggregate supply curve shifts upward by an amount equal to 5 times the change in investment.
- C) at each price level, the aggregate supply curve shifts rightward by an amount equal to 5 times the change in investment.
- D) at each price level, the aggregate demand curve shifts rightward by an amount equal to 5 times the change in investment.

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Suppose the current situation is such that the price level is 120, real GDP is \$4 trillion, and GDP along the long-run aggregate supply is \$3.6 trillion. What will take place to restore the long-run equilibrium?

- A) The price level will fall until long-run aggregate supply increases to \$4 trillion.
- B) The price level will fall and money wages will rise until real GDP along the long-run aggregate supply curve is \$4 trillion.
- C) Money wages will rise until real GDP is \$3.6 trillion.
- D) Aggregate demand will increase until both short-run and long-run aggregate supply equal \$4 trillion.

Suppose that real GDP equals \$2 trillion while potential GDP is \$3 trillion. There no imports or taxes and prices are constant. If the government wants to increase aggregate demand to fill the gap, it should increase government spending by \_\_\_\_\_ if the MPC equals \_\_\_\_\_.

- A) \$200 billion; 0.80
- B) \$1 trillion; 0.80
- C) \$250 billion; 0.75
- D) Both answers A and C are correct.

The most expansionary fiscal policy would be one that

- A) decreases government purchases and lowers taxes.
- B) increases the nation's money supply.
- C) increases government purchases and lowers taxes.
- D) raises tax rates.

If the economy is at a level of GDP less than potential GDP, which of the following fiscal policies would lead to a higher equilibrium level of real GDP in the short run?

- A) only decrease government spending.
- B) only increase taxes.
- C) increase government spending and/or decrease taxes.
- D) decrease government spending and/or increase taxes.

An increase in the tax rate in the model of income-expenditure analysis:

- a. increases the multiplier and makes the aggregate expenditures schedule flatter. ✓
- b. decreases the multiplier and makes the aggregate expenditures schedule steeper.
- c. has no effect on the multiplier or the aggregate expenditures schedule. ✓
- d. decreases the multiplier and makes the aggregate expenditures schedule flatter.
- e. increases the multiplier and makes the aggregate

Expanded

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According to a Keynesian economist, an increase in aggregate demand that increases real GDP so that it exceeds potential GDP should be met with a(n) \_\_\_\_\_ in tax rates or a(n) \_\_\_\_\_ in government spending.

- A) increase; increase
- B) increase; decrease
- C) decrease; increase
- D) decrease; decrease

If exports depend on foreigners' incomes, and these incomes do not depend on incomes in the United States, U.S. exports can be assumed to be:

- a. positively related to U.S. national income.
- b. related only to the level of imports.
- c. negatively related to U.S. national income.
- d. related only to the level of consumption.
- e. invariant to changes in U.S. national income.

If the real wage were downwardly rigid, then in a recession, when there is reduced demand for labor, we would expect to observe:

- a. higher employment and a lower real wage.
- b. higher employment without an increase in the real wage.
- c. no change in employment or the real wage.
- d. lower employment without a reduction in the real wage.
- e. lower employment and a lower real wage.

Suppose the only revenue taken in by the government is in the form of income tax, and the tax rate is 10 percent. If aggregate income is \$800 billion, and government expenditures are \$100 billion then

- repeated
- A) the government budget shows a deficit of \$20 billion.
  - B) the government budget shows a surplus of \$20 billion.
  - C) the government budget shows neither a surplus nor a deficit.
  - D) the government budget shows a deficit of \$80 billion.

The introduction of trade into the model of income-expenditure analysis:

- a. increases the multiplier and makes the aggregate expenditures function flatter.
- b. decreases the multiplier and makes the aggregate expenditures function flatter.
- c. increases the multiplier and makes the aggregate expenditures function steeper.
- d. decreases the multiplier and makes the aggregate expenditures function steeper.
- e. has no effect on the multiplier of the aggregate expenditures function.

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AGGREGATE PRODUCT MARKET

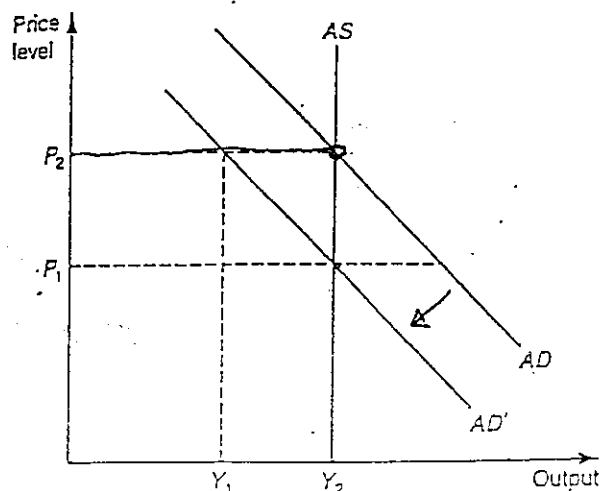
- A demand shock \_\_\_\_\_; a fiscal stimulus \_\_\_\_\_.
- a. always shifts the aggregate demand curve to the right; always shifts the curve to the left
  - b. always shifts the aggregate demand curve to the right; always shifts the curve to the right
  - c. may shift the aggregate demand curve in either direction; always shifts the curve to the right
  - d. always shifts the aggregate demand curve to the left; always shifts the curve to the left
  - e. always shifts the aggregate demand curve to the left; always shifts the curve to the right

Figure 8.3 shows the aggregate product market, which is initially in equilibrium at  $P_2$  and  $Y_2$ . If the price level is rigid, and the aggregate demand curve shifts leftward:

- a. the price level stays at  $P_2$  and output equals  $Y_1$ , which is less than the full employment level of output.
- b. the price level falls to  $P_1$  and output equals  $Y_1$ , which is less than the full employment level of output.
- c. the price level slowly falls to  $P_1$ , and as it does so full employment output slowly falls too.
- d. the price level falls to  $P_1$  and output equals  $Y_1$ , which is the new full employment level of output.
- e. the price level stays at  $P_2$  and output equals  $Y_2$ , the original full employment level of output.

Figure 8.3 shows the aggregate product market, which is initially in equilibrium at  $P_2$  and  $Y_2$ . If the price level is flexible, and the aggregate demand curve shifts leftward:

- a. the price level falls to  $P_1$ , and the quantity of output sold in the economy falls to  $Y_1$ .
- b. the price level stays at  $P_2$ , and the quantity of output sold in the economy falls to  $Y_1$ .
- c. the price level stays at  $P_2$ , and the aggregate demand shifts back to its original position.
- d. the price level stays at  $P_2$ , and the quantity of output sold in the economy stays at  $Y_2$ .
- e. the price level falls to  $P_1$ , and the quantity of output sold in the economy stays at  $Y_2$ .



- In the short run, an increase in the price level causes firms to expand production because
- A) the money wage rate remains constant so the higher prices for their product makes it profitable for firms to expand production.
  - B) each firm must keep its production level up to the level of its rivals, and some firms will expand production as the price level increases.
  - ~~C) the higher prices allow the firm to hire more workers by offering higher wages, thereby increasing productivity and profits.~~
  - D) firms can increase their profits by increasing their maintenance.

Figure 14.4 depicts short-run and long-run aggregate supply curves and different aggregate demand curves. Which shift in aggregate demand results in a small, short-run expansion of output but considerable upward pressure on price?

- a.  $AD_3$  to  $AD_4$  ✓
- b.  $AD_1$  to  $AD_2$
- c.  $AD_2$  to  $AD_3$
- d.  $AD_3$  to  $AD_4$
- ~~e.  $AD_4$  to  $AD_5$~~

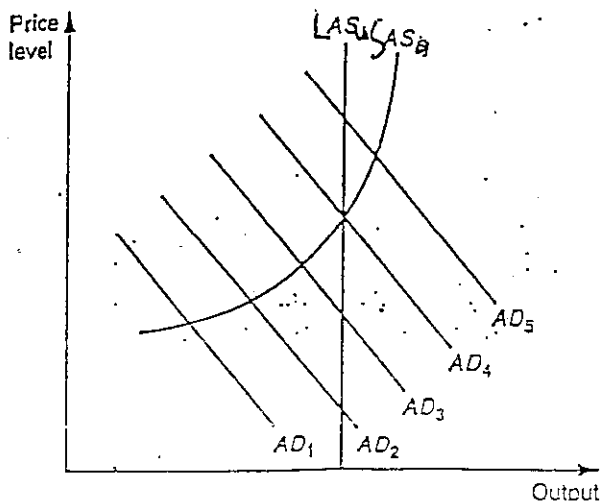
Figure 14.4 depicts short-run and long-run aggregate supply curves and different aggregate demand curves. Which shift in aggregate demand results in an expansion of output with almost no upward pressure on price?

- a.  $AD_1$  to  $AD_2$
- b.  $AD_2$  to  $AD_3$
- ~~c.  $AD_3$  to  $AD_4$~~
- d.  $AD_4$  to  $AD_5$
- e.  $AD_1$  to  $AD_3$

Figure 14.4 depicts short-run and long-run aggregate supply curves and different aggregate demand curves. The lowest aggregate demand curve beyond which further stimulus to the economy causes only inflation in the long run is:

- a.  $AD_5$
- ~~b.  $AD_4$~~
- c.  $AD_3$
- d.  $AD_2$
- e.  $AD_1$

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- An above full-employment equilibrium occurs when
- A) aggregate demand decreases while neither the short-run nor long-run aggregate supply changes.
  - B) short-run aggregate supply decreases while neither aggregate demand nor long-run aggregate supply changes.
  - ~~C) the equilibrium level of real GDP is greater than potential GDP.~~
  - D) the equilibrium level of real GDP is less than potential GDP. ✓

- Automatic stabilizers
- ~~A) so that the decrease in after-tax income when a recession occurs.~~
  - B) magnify the increase in after-tax income when a boom occurs.
  - C) require the government to balance the budget. ✓
  - D) require the government use countercyclical policy, such as increasing or decreasing government purchases. ✓

- In the Classical model, shifts in aggregate demand:
- a. lead to changes in output, because there is excess capacity in the economy and prices and wages are assumed fixed.
  - b. lead to changes in both output and the price level because there is excess capacity in the economy and prices and wages are assumed flexible.
  - c. have no effect on either output or the price level, because the economy is already at full capacity and prices and wages are assumed fixed.
  - ~~d. lead to changes in the price level, because the economy is already at full capacity and prices and wages are assumed flexible.~~
  - e. have no effect on either output or the price level, because there are offsetting effects on aggregate supply.

- Suppose aggregate demand increases by more than expected. Which of the following describes what will occur?
- A) Real GDP will be greater than potential GDP. ✓
  - B) The price level will increase. ✓
  - C) Unemployment will fall.
  - ~~D) All of the above answers are correct.~~

- An increase in the price of a resource such as oil
- I. shifts the aggregate demand curve leftward. ✓
  - II. shifts the long-run aggregate supply curve rightward.
  - III. shifts the short-run aggregate supply curve leftward. ✓
  - IV. increases the price level and decreases real GDP in the short run.
  - A) I only is correct. ✓
  - B) both I and II are correct. ✓
  - C) III only is correct.
  - ~~D) both III and IV are correct.~~

Real GDP	C	I	G	X	M
100	75	25	95	10	1
200	150	25	95	10	2
300	225	25	95	10	3
400	300	25	95	10	4
500	375	25	95	10	5
600	450	25	95	10	6
700	525	25	95	10	7
800	600	25	95	10	8
900	675	25	95	10	9
1000	750	25	95	10	10

A decrease in the tax rate in the model of income-expenditure analysis:

- a. increases the multiplier and makes the aggregate expenditures schedule flatter.
- b. decreases the multiplier and makes the aggregate expenditures schedule steeper. ✓
- c. increases the multiplier and makes the aggregate expenditures schedule steeper.
- d. decreases the multiplier and makes the aggregate expenditures schedule flatter. ✓
- e. has no effect on the multiplier or the aggregate expenditures schedule. ✓

Let MPC denote the marginal propensity to consume, MPS the marginal propensity to save, and  $t$  the tax rate. In a closed economy, the slope of the aggregate expenditure function is:

- a.  $(1 - t)MPC$ .
- b.  $(1 - t)MPS$ .
- c.  $t(1 - MPC)$ .
- d.  $t(1 - MPS)$ .
- e.  $(1 - t)(1 - MPC)$ .

Assume a closed economy in which autonomous consumption is \$25 million, investment is \$50 million, government spending is \$125 million, the tax rate is 0.25, and the marginal propensity to consume out of disposable income is 0.80. In income-expenditure analysis, the equilibrium level of national income is:

- a. \$200 million.
- b. \$400 million.
- c. \$500 million.
- d. \$600 million.
- e. \$800 million.

Assume a closed economy in which the marginal propensity to consume out of disposable income is 0.80. In income-expenditure analysis, the introduction of a tax rate of 0.25 will reduce the multiplier to of what it was before the introduction of the tax.

- a. 80 percent
- b. 75 percent
- c. 60 percent
- d. 50 percent
- e. 25 percent

An increase in the marginal propensity to import in the model of income-expenditure analysis:

- a. increases the multiplier at all levels of national income. ✓
- b. increases the multiplier at low levels of national income and reduces it at high levels of national income. ✓
- c. has no effect on the multiplier. ✓
- d. reduces the multiplier at low levels of national income and increases it at high levels of national income.
- e. reduces the multiplier at all levels of national income.

In the above table, C is consumption expenditure, I is investment, G is government purchases, X is exports, and M is imports. All entries are in dollars. If investment were to increase by \$26 to a level of \$51 then equilibrium expenditure will

- A) increase by \$25.
- B) decrease by \$50. ✓
- C) increase by \$100.
- D) decrease by \$100. ✓

In the above table, C is consumption expenditure, I is investment, G is government purchases, X is exports, and M is imports. All entries are in dollars. What is the equilibrium expenditure?

- A) \$200.
- B) \$500.
- C) \$700.
- D) \$1,000.

If the exchange rate between the dollar and the French franc changes from 5 francs per dollar to 4 francs per dollar:

- a. French goods become relatively more expensive in the United States, increasing U.S. demand for francs.
- b. U.S. goods become relatively cheaper in France, reducing French demand for U.S. dollars. ✓
- c. French goods become relatively cheaper in the United States, increasing U.S. demand for francs. ✓
- d. U.S. goods become relatively more expensive in France, increasing French demand for U.S. dollars.
- e. French goods become relatively more expensive in the United States, reducing U.S. demand for francs.

In income-expenditure analysis, if an economy is in equilibrium and aggregate expenditures increase by \$100 million, equilibrium output will increase by:

- a. less if the aggregate expenditures schedule is relatively steep than if it is relatively flat.
- b. less if unplanned inventories are positive at the old equilibrium.
- c. more if the aggregate expenditures schedule is relatively steep than if it is relatively flat. ✓
- d. more if unplanned inventories are negative at the old equilibrium. ✓
- e. the same amount regardless of the slope of the aggregate expenditures schedule. ✓

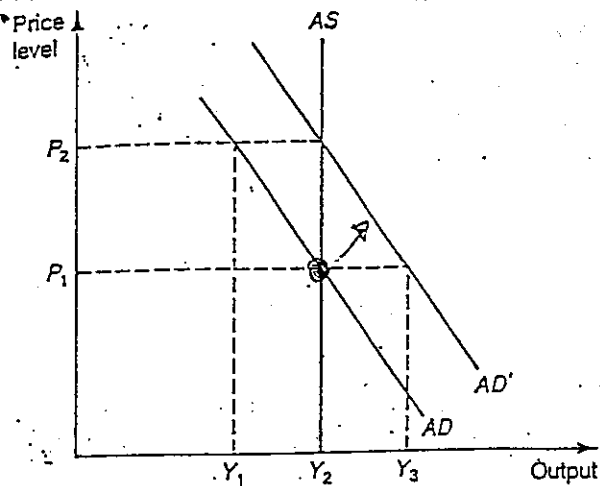


Figure 8.4

Figure 8.4 shows the aggregate product market, which is initially in equilibrium at  $P_1$  and  $Y_2$ . If the price level is downwardly rigid, and the aggregate demand curve shifts rightward:

- the price level stays at  $P_1$ , and the quantity of output sold in the economy stays at  $Y_2$ .
- the price level rises to  $P_2$ , and the quantity of output sold in the economy stays at  $Y_2$ .
- the price level stays at  $P_1$ , and the quantity of output sold in the economy rises to  $Y_3$ .
- the price level rises to  $P_2$ , and the quantity of output sold in the economy falls to  $Y_1$ .
- the price level stays at  $P_1$ , and the quantity of output sold in the economy falls to  $Y_1$ .

A lower price level combined with a decrease in real GDP occurs when the

- short-run aggregate supply curve shifts rightward.
- short-run aggregate supply curve shifts leftward.
- aggregate demand curve shifts rightward.
- aggregate demand curve shifts leftward.

An increase in both government spending and taxes, keeping the overall budget balanced, will:

- shift the aggregate expenditures schedule up.
- leave the aggregate expenditures schedule unchanged.
- shift the aggregate expenditures schedule down.
- rotate the aggregate expenditures schedule to the left.
- rotate the aggregate expenditures schedule to the right.

At low levels of output the aggregate supply curve will be almost \_\_\_\_\_, and at high levels of output the aggregate supply curve will be \_\_\_\_\_.

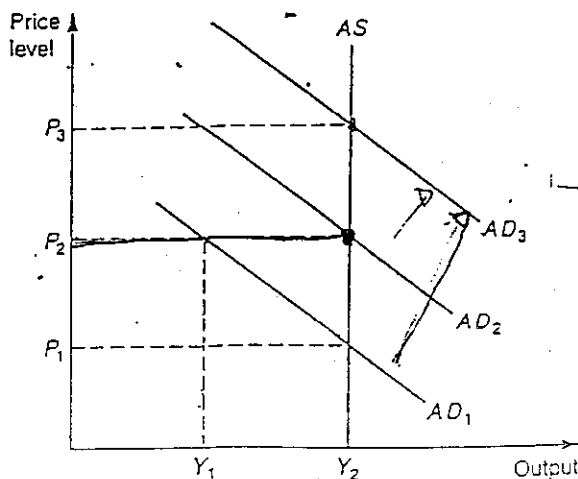
- vertical; horizontal
- horizontal; vertical
- vertical; vertical
- horizontal; upward sloping
- vertical; upward sloping

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- Figure 14.1 depicts the product market. If the price level is downwardly rigid, and is currently at  $P_2$ , and if the aggregate demand schedule is  $AD_3$ :
- there is excess demand, which would lead to an increase in the price level were the price level not downwardly rigid.
  - there is excess supply, which will lead to a fall in the price level.
  - the product market is in equilibrium.
  - there is excess demand, which will lead to an increase in the price level.
  - there is excess supply, which would lead to a fall in the price level were the price level not downwardly rigid.

- Figure 14.1 depicts the product market. If the price level is downwardly rigid, and is currently at  $P_2$ , and if the aggregate demand schedule is  $AD_2$ :
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  - there is excess supply, which will lead to a fall in the price level.
  - the product market is in equilibrium.
  - there is excess demand, which will lead to an increase in the price level.
  - there is excess supply, which would lead to a fall in the price level were the price level not downwardly rigid.

- Figure 14.1 depicts the product market. If the price level is downwardly rigid, and is currently at  $P_2$ , a shift in aggregate demand from  $AD_1$  to  $AD_3$ :
- increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_1$  to  $P_2$ .
  - increases the price level from  $P_2$  to  $P_3$  but leaves output unchanged.
  - increases output from  $Y_1$  to  $Y_2$  but leaves the price level unchanged.
  - increases the price level from  $P_1$  to  $P_2$  but leaves output unchanged.
  - increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_2$  to  $P_3$ .



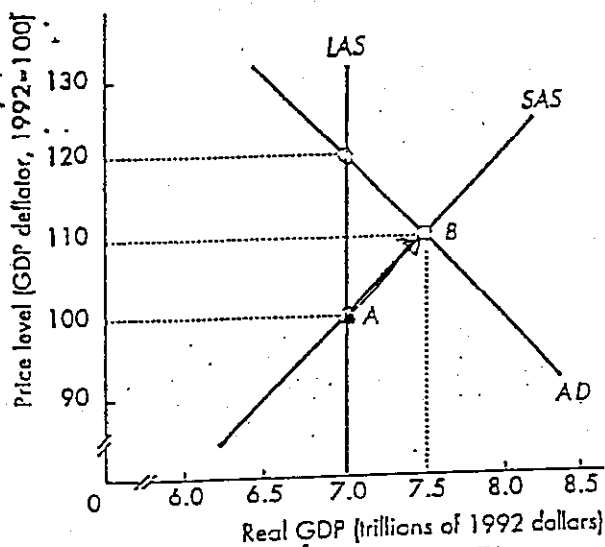
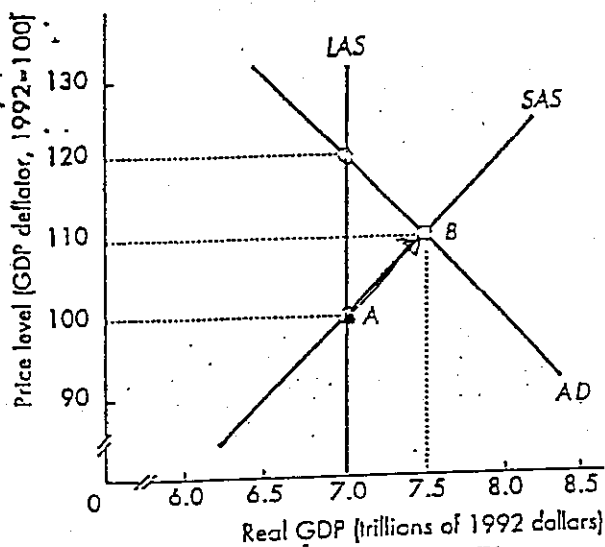


Figure 14.1



In the above figure, suppose the economy had been at point *A* and now is at *B*. Without any economic growth, what will the new long-run equilibrium be?

- A) Aggregate demand will decrease until real GDP is \$7 trillion and the price level is 110.
- B) Money wages will fall and the aggregate demand curve will shift leftward until the price level is 100 and real GDP is \$7.0 trillion.
- C) The population will increase, causing the long-run aggregate supply to increase to \$7.5 trillion and the price level to fall to 100.
- ~~D) Money wages will increase and the short-run aggregate supply curve will shift leftward until the price level is 120 and real GDP is \$7 trillion.~~

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Figure 14.1 depicts the product market. If the price level is flexible, a shift in aggregate demand from  $AD_1$  to  $AD_3$ :

- a. increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_1$  to  $P_2$ .
- ~~b. increases the price level from  $P_2$  to  $P_3$  but leaves output unchanged.~~
- c. increases output from  $Y_1$  to  $Y_2$  but leaves the price level unchanged.
- d. increases the price level from  $P_1$  to  $P_2$  but leaves output unchanged.
- e. increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_2$  to  $P_3$ .

Figure 14.1 depicts the product market. If the price level is fixed at  $P_2$ , a shift in aggregate demand from  $AD_1$  to  $AD_3$ :

- a. increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_1$  to  $P_2$ .
- b. increases the price level from  $P_2$  to  $P_3$  but leaves output unchanged.
- ~~c. increases output from  $Y_1$  to  $Y_2$  but leaves the price level unchanged.~~
- d. increases the price level from  $P_1$  to  $P_2$  but leaves output unchanged.
- e. increases output from  $Y_1$  to  $Y_2$  and increases the price level from  $P_2$  to  $P_3$ .