Multiple Choice Questions

1. The extended AD-AS model:
   A. distinguishes between short-run and long-run aggregate demand.
   B. explains inflation but not recession.
   C. includes $G$ and $X_n$ whereas the simple AD-AD model does not.
   D. distinguishes between short-run and long-run aggregate supply.

2. The Laffer Curve is a central concept in:
   A. monetarism.
   B. Keynesianism.
   C. welfare economics.
   D. supply-side economics.

3. Refer to the above diagram. If drawn, the long-run aggregate supply curve would include points:
   A. $v$, $w$, and $u$.
   B. $w$, $u$ and $y$.
   C. $t$, $w$, and $z$.
   D. $y$, $w$, and $x$. 
Suppose the natural level of real output \((Q)\) for a hypothetical economy is $500, the price level \((P)\) initially is 100, and that prices and wages are flexible both upward and downward. Use the following short-run aggregate supply schedules to answer the next question(s).

<table>
<thead>
<tr>
<th>(a) (\text{AS}(P_{100}))</th>
<th>(b) (\text{AS}(P_{125}))</th>
<th>(c) (\text{AS}(P_{25}))</th>
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<td>75</td>
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4. Refer to the information above. In the long run, a fall in the price level from 100 to 75 will:
A. decrease real output from $500 to $440.
B. increase real output from $500 to $620.
C. change the aggregate supply schedule from (a) to (c) and produce an equilibrium level of real output of $500.
D. change the aggregate supply schedule from (a) to (b) and produce an equilibrium level of real output of $500.

5. Refer to the above diagram and assume the economy is initially at point \(b_1\). The long-run relationship between the unemployment rate and the rate of inflation is represented by:
A. the line connecting \(b_1\) and \(c_1\).
B. the line through \(b_1\), \(b_2\), \(b_3\), and \(b_4\).
C. the line connecting \(c_1\) and \(b_2\).
D. any line parallel to the horizontal axis.

6. Refer to the information above. If the price level unexpectedly declines from 100 to 75, the level of real output in the short run will:
A. rise from $500 to $560.
B. fall from $500 to $440.
C. fall from $560 to $500.
D. rise from $440 to $500.
7. In the extended aggregate demand-aggregate supply model:
   A. long-run equilibrium occurs wherever the aggregate demand curve intersects the short-run aggregate supply curve.
   B. the long-run aggregate supply curve is horizontal.
   C. the level of real output is the same in the long run regardless of the location of the aggregate demand curve.
   D. the short-run aggregate supply curve is downsloping.

8. Refer to the above diagram and assume the economy is operating at equilibrium point w. In the long run, an increase in the price level from $P_2$ to $P_3$ would move the economy from point w to point:
   A. v.
   B. x.
   C. u.
   D. y.

9. The above diagram is the basis for explaining:
   A. the traditional Phillips Curve.
   B. the long-run Phillips Curve.
   C. how central planning can make full employment and price level stability compatible goals.
   D. new policies for eliminating unemployment.

10. Refer to the above diagram. If the price level rises above $P_1$ because of an increase in aggregate demand, the:
    A. economy will move up along curve B and output will temporarily increase.
    B. long-run aggregate supply curve C will shift upward.
    C. short-run aggregate supply curve B will automatically shift to the right.
    D. economy's output first will decline, then increase, and finally return to $Q_1$.

11. Which of the following is a true statement?
    A. There is a long-run tradeoff between inflation and unemployment.
    B. The short-run Phillips Curve is vertical.
    C. The long-run Phillips Curve is horizontal.
    D. Adverse aggregate supply shocks can simultaneously worsen unemployment and inflation.
12. Government can push the unemployment rate below the natural rate only by:
A. instituting supply-side economic policies.
B. producing a higher rate of inflation than people expect.
C. balancing the federal budget.
D. achieving zero inflation.

![Graph](image)

13. Refer to the above diagram for a specific economy. An increase in aggregate demand will:
A. shift this curve to the right.
B. shift this curve to the left.
C. move this economy southeast along the curve.
D. move this economy northwest along the curve.

14. If government uses fiscal policy to restrain cost-push inflation, we can expect:
A. the unemployment rate to rise.
B. the unemployment rate to fall.
C. the aggregate demand curve to shift rightward.
D. tax-rate declines and increases in government spending.
15. Refer to the above diagram. Assume that the natural rate of unemployment is 5 percent and that the economy is initially operating at point $a$ where the expected and actual rates of inflation are each 6 percent. In the long run, the decline in the actual rate of inflation from 6 percent to 4 percent will:
A. reduce the unemployment rate.
B. reduce corporate profits in real terms.
C. have no effect on the unemployment rate.
D. reduce real domestic output.

16. Disinflation occurs when:
A. the price level is falling.
B. investment plans exceed saving.
C. a speculative investment “bubble” is bursting.
D. the inflation rate is declining.

17. The:
A. short-run aggregate supply curve is downward sloping.
B. short-run aggregate supply curve is vertical.
C. long-run aggregate supply curve is vertical.
D. long-run aggregate supply curve is upsloping.

18. Refer to the above diagram and assume the economy is initially at point $b$. Point $c$ represents:
A. a stable position because reality and expectations are consistent.
B. a stable position because full employment and a constant annual inflation rate are represented.
C. an unstable situation because government will undertake contractionary policies
D. an unstable situation because nominal wage rates will increase.
19. The basic problem portrayed by the traditional Phillips Curve is:
A. that a level of aggregate demand sufficiently high to result in full employment may also cause inflation.
B. that changes in the composition of total labor demand tend to be deflationary.
C. that unemployment rises at the same time the general price level is rising.
D. the possibility that automation will increase the level of noncyclical unemployment.

20. Refer to the above diagram. The initial aggregate demand curve is AD\(_1\) and the initial aggregate supply curve is AS\(_1\). Assuming no change in aggregate demand, the long-run response to a recession caused by cost-push inflation is best depicted as a:
A. move from \(a\) to \(d\) along the long-run aggregate supply curve.
B. rightward shift of the aggregate supply curve from AS\(_2\) to AS\(_1\).
C. move from \(a\) to \(c\) to \(d\).
D. leftward shift of the aggregate supply curve from AS\(_1\) to AS\(_2\).

21. (Last Word) One of the implications of the supply-side anecdote is that:
A. tax cuts distributed equally across all workers would result in some people being paid by the government to work.
B. it is unwise to dine with supply-side economists if you are the wealthiest person at the table.
C. tax cuts are generally distributed unfairly.
D. the U.S. tax system is proportional.
22. Refer to the above diagram. Assume that nominal wages initially are set on the basis of the price level $P_2$ and that the economy initially is operating at its full-employment level of output $Q_f$. In terms of this diagram, the long-run aggregate supply curve:
   A. is $AS_2$.
   B. is a vertical line extending from $Q_f$ upward through $e$, $b$, and $d$.
   C. may be either $AS_1$, $AS_2$, or $AS_3$ depending on whether the price level is $P_1$, $P_2$, or $P_3$.
   D. is a horizontal line extending from $P_2$ rightward through $f$, $b$, and $g$.

23. Refer to the above diagram relating to short-run and long-run aggregate supply. The
   A. short-run aggregate supply curve is $A$.
   B. short-run aggregate supply curve is $B$.
   C. long-run aggregate supply curve is $B$.
   D. long-run aggregate supply curve is $D$.

24. When the actual rate of inflation exceeds the expected rate:
   A. the unemployment rate will temporarily rise.
   B. firms will experience rising profits and thus increase their employment.
   C. the actual rate of inflation will fall.
   D. nominal wages will decline.
25. Refer to the above diagram and assume the economy is initially at point $b_1$. Which of the following movements is consistent with the traditional Phillips Curve?
   A. the movement from $b_1$ to $b_2$
   B. the movement from $b_1$ to $c_1$
   C. the movement from $c_1$ to $b_2$
   D. the movement from $b_2$ to $b_1$

26. Refer to the above diagram for a specific economy. The curve on this graph is known as a:
   A. Laffer Curve.
   B. Phillips Curve.
   C. labor demand curve.
   D. production possibilities curve.

27. In the last half of the 1990s, the usual short-run tradeoff between inflation and unemployment did not arise because:
   A. the Fed held interest rates constant.
   B. the Federal government balanced its budget.
   C. the U.S. personal savings rate rose.
   D. productivity (and thus aggregate supply) grew faster than previously.

28. In the extended analysis of aggregate supply, the short-run aggregate supply curve is:
   A. vertical and the long-run aggregate supply curve is horizontal.
   B. horizontal and the long-run aggregate supply curve is vertical.
   C. upward sloping and the long-run aggregate supply curve is vertical.
   D. horizontal and the long-run aggregate supply curve is upward sloping.
29. Refer to the above diagram and assume that prices and wages are flexible both upward and downward in the economy. In the extended AD-AS model:
A. demand-pull inflation would involve a rightward shift of curve A, followed by a rightward shift of curve C.
B. cost-push inflation would involve a rightward shift of curve A, followed by a leftward shift of curve C.
C. recession would involve a leftward shift of curve A followed by a rightward shift of curve C.
D. recession would involve a rightward shift of curve D, followed by leftward shifts of curves A and C.

30. Refer to the above diagram for a specific economy. The shape of this curve suggests that:
A. the price level rises at a diminishing rate as the level of aggregate demand increases.
B. full employment and price stability are compatible goals only when aggregate demand is falling.
C. each successive unit of decline in the unemployment rate is accompanied by a smaller increase in the rate of inflation.
D. each successive unit of decline in the unemployment rate is accompanied by a larger increase in the rate of inflation.

Pre-Test Chapter 15 ed17 Key

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