

Economics 1012A: Introduction to Macroeconomics
FALL 2007
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Third Midterm Examination
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Answer **all** of the following questions by selecting the most appropriate answer on your bubble sheet. Be sure to read each question carefully. Each question is worth 2 points (100 points total) and will count as 20 per cent of your final course grade.

1. The marginal propensity to consume (*mpc*) tells us
 - A) the fraction of income consumed.
 - B) the percentage of income consumed.
 - C) the level of induced expenditures.
 - D) the fraction of an additional dollar of income that is spent.

2. If the marginal propensity to consume is 0.9 and a decline in household wealth reduces autonomous expenditures by \$75 billion, equilibrium real GDP will
 - A) increase by \$300 billion.
 - B) increase by \$750 billion.
 - C) decrease by \$750 billion.
 - D) decrease by \$500 billion.

3. The multiplier equation can be used to determine how changes in
 - A) autonomous expenditures affect consumption.
 - B) autonomous expenditures affect income.
 - C) output affect consumption.
 - D) output affect autonomous expenditures.

4. The multiplier equation shows the relationship between
 - A) autonomous expenditures and savings.
 - B) autonomous expenditures and government spending.
 - C) autonomous expenditures and the equilibrium income level.
 - D) investment spending and savings.

Use the following to answer question 5:

Income	Expenditures
\$ 0	\$ 500
1,000	1,167
1,500	1,500
2,000	1,833
2,500	2,167

5. In the table above, the marginal propensity to consume is
 - A) \$500.
 - B) \$1,500.
 - C) 0.167.
 - D) 0.667.

6. Say foreign income increases and this pushes U.S. exports up. The U.S. AE curve will likely
 - A) become steeper.
 - B) become flatter.
 - C) shift up.
 - D) shift down.

7. If saving increases at a particular income level, it follows that
 - A) consumption and total expenditures must decrease.
 - B) consumption must decrease but total expenditure need not.
 - C) total expenditure must decrease but consumption need not.
 - D) neither consumption nor total expenditure need decrease.

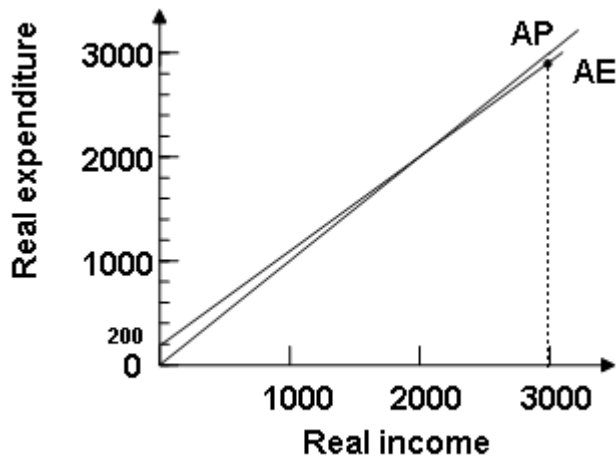
8. In the aggregate expenditure model, if the *mpc* is 0.75, then the multiplier is
 - A) 1.25.
 - B) 1.75.
 - C) 3.
 - D) 4.

9. According to the multiplier equation, an increase in the marginal propensity to consume
 - A) raises output because it leads to an increase in autonomous expenditure.
 - B) reduces aggregate expenditure because it reduces the multiplier.
 - C) increases output because it increases the multiplier.
 - D) increases aggregate expenditure because it increases autonomous expenditure.

10. If the permanent income hypothesis is true, i.e., if people spend their income based on their lifetime income,
 - A) the *mpc* would be relatively small.
 - B) the *mpc* would be relatively large.
 - C) the *mpc* would fluctuate.
 - D) nothing can be concluded about the *mpc*.

11. According to the aggregate expenditure model, if firms cannot sell all their output at existing prices, they will
 - A) cut production until the excess supply is eliminated.
 - B) raise production until the excess demand is eliminated.
 - C) cut prices until excess supply is eliminated.
 - D) advertise more.

Use the following to answer question 12:



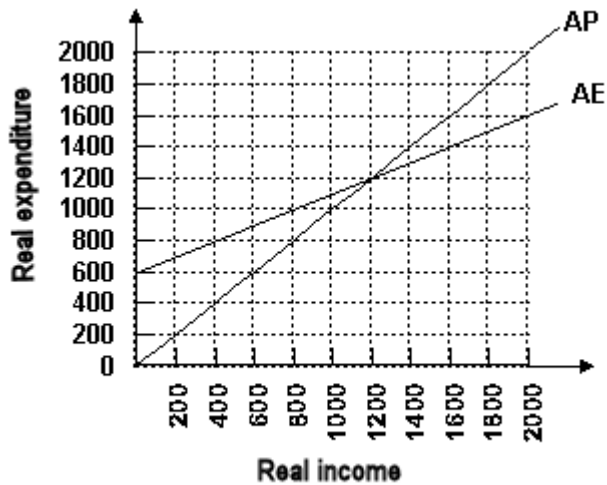
12. Refer to the graph above. What are expenditures if income is \$3,000 billion?
- A) \$2,000 billion.
 - B) Greater than \$3,000 billion.
 - C) Less than \$3,000 billion.
 - D) \$3,000 billion.
13. Which of the following statements is TRUE?
- A) The greater is the marginal propensity to save, the smaller is the multiplier.
 - B) The greater is the marginal propensity to consume, the smaller is the multiplier.
 - C) The greater is the marginal propensity to save, the greater is the marginal propensity to consume.
 - D) The greater is the marginal propensity to consume, the smaller is equilibrium income.
14. Keynes thought that the economy was
- A) not generally at potential income.
 - B) always at potential income.
 - C) always moving away from potential income.
 - D) always moving toward potential income.

Use the following to answer question 15:

Income	Expenditures
\$ 0	\$ 500
1,000	1,167
1,500	1,500
2,000	1,833
2,500	2,167

15. In the table above, if income rises from \$2,000 to \$2,500, induced expenditures
- remain equal to \$500.
 - remain equal to \$1,833.
 - rise by \$334.
 - rise to \$2,167.

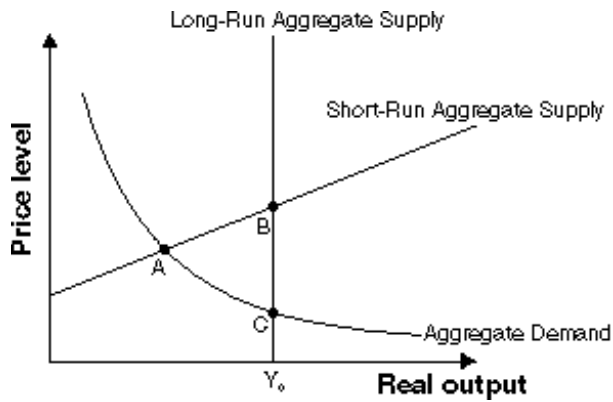
Use the following to answer question 16:



16. Refer to the graph above. Planned expenditures exceed production at
- income levels above \$1,200.
 - income levels below \$1,200.
 - income level of \$1,200.
 - no income level since planned expenditures equals production.
17. In the aggregate expenditure model, if the *mpc* is 0.2, then the multiplier is
- 1.25.
 - 2.
 - 5.
 - 20.
18. Aggregate expenditures consist of
- only consumption and investment.
 - consumption, investment, and government spending.
 - consumption, investment, government spending, and exports.
 - consumption, investment, government spending, and net exports.
19. If a fall in the price level made people feel richer and initially increased aggregate expenditures by 20, the AD curve would
- shift by more than 20.
 - shift by less than 20.
 - shift by exactly 20.
 - not shift at all.

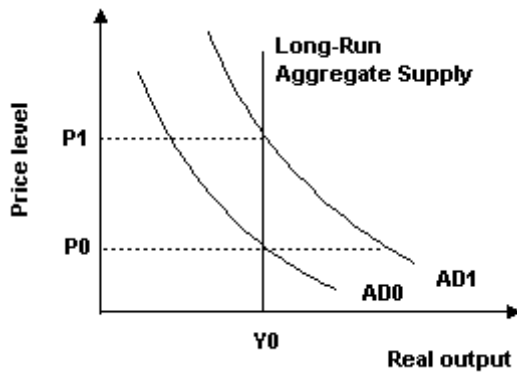
20. In 1999, the Brazilian currency, the *Real*, depreciated by 40%. This most likely
- A) created a trade deficit for Brazil and shifted its AD curve left
 - B) created a trade surplus for Brazil and shifted its AD curve left.
 - C) created a trade deficit for Brazil and shifted its AD curve right.
 - D) created a trade surplus for Brazil and shifted its AD curve right.
21. In the mid 1990s Japan had the lowest unemployment and inflation rates of all major industrial countries. The Japanese economy also experienced a recession in the mid 1990s. Under these circumstances, it is likely that the Japanese economy
- A) was in the Classical range.
 - B) was in the Keynesian range.
 - C) was in the intermediate range.
 - D) was at potential output.
22. An increase in the price level might cause
- A) a decrease in the quantity of aggregate demand because of the substitution effect.
 - B) an increase in the quantity of aggregate demand because of the wealth effect.
 - C) a decrease in the quantity of aggregate demand because of the interest rate effect.
 - D) an increase in the quantity of aggregate demand because of the multiplier effect.
23. The long-run aggregate supply curve is
- A) another name for the AD curve.
 - B) upward-sloping.
 - C) a vertical line.
 - D) a horizontal line.
24. A recessionary gap exists when
- A) aggregate demand exceeds short-run aggregate supply.
 - B) aggregate demand exceeds potential output.
 - C) short-run aggregate supply exceeds aggregate demand.
 - D) potential output exceeds aggregate demand.

Use the following to answer question 25:



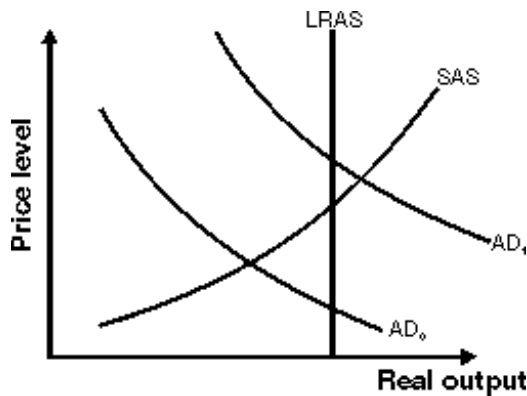
25. Refer to the graph above. The economy is in a long-run equilibrium at
- A) point A.
 - B) point B.
 - C) point C.
 - D) no point in the graph.
26. If the government increased taxes without changing spending, the AD curve would
- A) shift to the left.
 - B) shift to the right.
 - C) become flatter.
 - D) become steeper.

Use the following to answer question 27:



27. Refer to the graph above. In the graph, an inflationary gap exists if
- A) the price level is P_0 and the aggregate demand curve is AD_0 .
 - B) the price level is P_0 and the aggregate demand curve is AD_1 .
 - C) the price level is P_1 and the aggregate demand curve is AD_0 .
 - D) the price level is P_1 and the aggregate demand curve is AD_1 .

Use the following to answer question 28:



28. Refer to the graph above. If wage and price controls had not been introduced during the Second World War, the massive increase in military spending would have eventually
- A) shifted the SAS curve to the right.
 - B) shifted the AD curve to the left.
 - C) shifted the SAS curve to the left.
 - D) had no effect on AD and SAS.
29. Fiscal policy is
- A) an effective tool for fine tuning the economy.
 - B) most useful in a serious economic crisis.
 - C) always ineffective because of crowding out.
 - D) effective only when potential output is known.
30. The aggregate expenditure model assumes all of the following EXCEPT
- A) financing the deficit has offsetting effects.
 - B) the government knows what the mpc is.
 - C) the government knows the level of potential income.
 - D) the government can quickly change its spending and taxes.
31. Property taxes are
- A) not an automatic stabilizer because they don't vary with income.
 - B) not an automatic stabilizer because they vary with income.
 - C) an automatic stabilizer because they don't vary with income.
 - D) an automatic stabilizer because they vary with income.

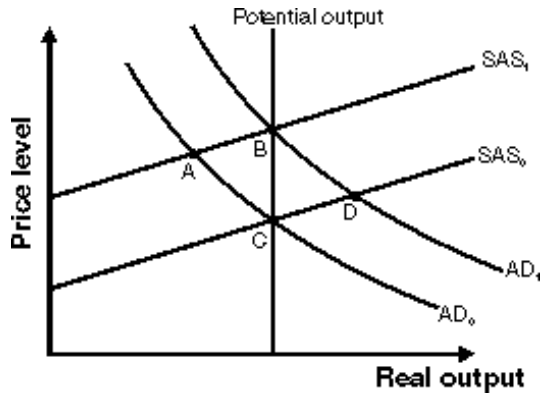
32. According to the aggregate expenditure model, government has a role in getting an economy out of recession because
- A) individuals collectively don't have the spending power to make a difference.
 - B) government spending will increase income and induce individuals to spend more.
 - C) the economy could never be expected to return to potential output on its own.
 - D) only the government knows when the economy is in a recession.
33. An increase in the budget deficit will have a
- A) more negative effect on income, the weaker the crowding out.
 - B) more positive effect on income, the greater the crowding out.
 - C) less negative effect on income, the weaker the crowding out.
 - D) less positive effect on income, the greater the crowding out.
34. Which of the following is an example of countercyclical fiscal policy?
- A) A reduction in taxes when the economy is booming.
 - B) An increase in government spending when the economy is booming.
 - C) An increase in taxes when the economy is in a recession.
 - D) An increase in government spending when the economy is in a recession.
35. Suppose that the price level is constant, that the *mpc* is $\frac{3}{4}$, and that government spending increases by 50. Now suppose the AD curve shifts out by 150 in response to the change in government spending. From this information, we can conclude that the increase in spending
- A) did not raise interest rates or crowd out investment.
 - B) raised interest rates and reduced investment by less than 50.
 - C) raised interest rates and reduced investment by 50.
 - D) raised interest rates and reduced investment by more than 50.
36. The budget surpluses of the late 1990s and early 2000s
- A) harmed the economy by producing a recession.
 - B) harmed the economy by increasing inflationary pressures.
 - C) helped the economy by producing an economic expansion.
 - D) helped the economy by reducing inflationary pressures.
37. Export-led growth policies
- A) benefit all countries.
 - B) benefit the countries that adopt them at the expense of other countries.
 - C) harm the countries that adopt them but benefit other countries.
 - D) harm all countries.

38. If an economy has an inflationary gap and the government does nothing, the aggregate expenditure model predicts that
- A) the AS curve will shift up as input prices increase and output will decline.
 - B) the AS curve will shift down as input prices decline and output will rise.
 - C) the AD curve will shift out to the right as individuals collectively decide to increase expenditures and output will rise.
 - D) the AD curve will shift in to the left as individuals collectively decide to reduce expenditures and output will decline.
39. If an economy has an inflationary gap, the government should use fiscal policy to
- A) shift the AS curve up.
 - B) shift the AS curve down.
 - C) shift the AD curve out to the right.
 - D) shift the AD curve in to the left.
40. If income increases more rapidly than expected, as it did in the early 2000s, then
- A) the budget is more likely to be in surplus.
 - B) tax revenues will be lower than expected.
 - C) spending on income-support programs will be higher than expected.
 - D) estimates of potential output are likely to be reduced.
41. Suppose changes in autonomous net exports do not affect investment while changes in autonomous government spending do affect investment. In this case, identical changes in autonomous net exports and autonomous government spending
- A) have identical effects on equilibrium income.
 - B) have different effects on equilibrium income.
 - C) may have identical effects on equilibrium income, depending on the multiplier.
 - D) may have identical effects on equilibrium income, depending on the size of the change in autonomous net exports and autonomous government spending.
42. Automatic stabilizers tend to create
- A) budget deficits throughout the business cycle.
 - B) budget surpluses throughout the business cycle.
 - C) budget deficits during the recovery phase of the business cycle and budget surpluses during the recession phase.
 - D) budget deficits during the recession phase of the business cycle and budget surpluses during the recovery phase.

43. If the $mpc = 0.8$ and government spending decreases by 40, then the AE curve shifts _____ while the AD curve shifts _____.
- A) down by 40; in by 40
 - B) down by 40; in by 200
 - C) down by 200; in by 200
 - D) up by 40; out by 200
44. Policies that affect autonomous consumption, autonomous investment, or autonomous net exports
- A) can have the same effect on equilibrium income as fiscal policy assuming there are no offsetting effects.
 - B) cannot have the same effect on equilibrium income as fiscal policy.
 - C) can have the same effect on equilibrium income as fiscal policy, but only for certain values of the multiplier.
 - D) can have the same effect on equilibrium income as fiscal policy, but only for certain types of fiscal policies.
45. If government spending increases by 40, the AD curve will shift to the
- A) right by 40.
 - B) left by 40.
 - C) right by more than 40.
 - D) right by less than 40.
46. In the late 1990s, U.S. fiscal policy was largely contractionary, while U.S. monetary policy was largely expansionary. In the long run, this combination will
- A) increase output above its potential.
 - B) reduce output beneath its potential.
 - C) have an indeterminate effect on output.
 - D) not cause output to deviate from its potential.
47. If you knew from the aggregate expenditure model that a change in autonomous expenditures of 10 increased equilibrium income by 40, you would know
- A) the slope of the AD curve.
 - B) the position of the AD curve.
 - C) the shift in the AD curve.
 - D) the rotation of the AD curve.
48. Which of the following would shift the aggregate demand curve to the left?
- A) An increase in foreign income.
 - B) A depreciation in the value of the country's currency.
 - C) A higher future expected price level.
 - D) A decrease in exports.

49. The long-run aggregate supply curve plays an important role in determining
- the price level in the short run.
 - output in the short run.
 - the price level in the long run.
 - output in the long run.

Use the following to answer question 50:



50. Refer to the graph above. If the economy is experiencing a recessionary gap, in the long run, production costs will
- increase, causing the economy to move from A to B.
 - decrease, causing the economy to move from A to C.
 - increase, causing the economy to move from C to B.
 - decrease, causing the economy to move from B to C.

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Fall 2007 – Econ 1012 – Midterm #3 - **Answer Key**

1. D
2. C
3. B
4. C
5. D
6. C
7. B
8. D
9. C
10. A
11. A
12. C
13. A
14. A
15. C
16. B
17. A
18. D
19. D
20. D
21. B
22. C
23. C
24. D
25. C
26. A
27. B
28. C
29. B
30. A
31. A
32. B
33. D
34. D
35. C
36. D
37. B
38. A
39. D
40. A
41. B
42. D
43. B
44. A

- 45. C
- 46. D
- 47. C
- 48. D
- 49. D
- 50. B