**These are some practice questions for CHAPTER 25. Each question should have a single answer. But be careful. There may be errors in the answer key!**

106. Which of the following is NOT associated with a deflationary output gap?
    a. Unit costs rise slower than the increase in productivity.
    b. The *SRAS* curve shifts leftward.
    c. The shift in the *SRAS* curve raises the price level.
    d. The *AD* curve shifts rightward more than the *SRAS* curve.
    e. There is upward pressure on wages.

107. Which of the following would serve as an automatic adjustment mechanism of the economy with a recessionary gap?
    a. increasing prices
    b. increasing imports
    c. declining government spending
    d. declining wages
    e. increasing taxes.

108. If the equilibrium output occurs at the point where the *SRAS* curve intersects the *AD* curve to the right of potential national income, the economy is
    a. at full-employment level of output.
    b. in a recessionary output gap.
    c. in an inflationary output gap.
    d. threatened with an acceleration of inflation.
    e. operating at full capacity.

109. When wages are rising faster than the increase in labour productivity, then unit labour costs will
    a. fall and the *SRAS* curve will shift left.
    b. fall and the *SRAS* curve will shift right.
    c. rise and the *SRAS* curve will shift left.
    d. rise and the *SRAS* curve will shift right.
    e. not change because only total labour costs change.

110. An output gap, caused by a leftward shift of the *AD* curve, would be eliminated if
    a. wages rose quickly.
    b. the *SRAS* shifted upward.
    c. wages fell quickly.
    d. real national income decreased.
    e. prices rose quickly.

111. Demand-shock inflation is usually associated with major wars because the

a. government must raise taxes to finance the war.
b. large increase in government spending is not matched by an equivalent drop in private consumption expenditure.
c. drop in the labour force because of the manpower needs of the armed forces causes shortages of labour.
d. government spending for social programs must be reduced to finance the increase in military spending.
e. prices always rise during a crisis.

112. The process of automatic adjustment of an economy, from an inflationary output gap, is best described by saying that wages

a. do not adjust, but the *AD* curve shifts to the right
b. fall, unit costs fall and the *AD* curve shifts rightward
c. rise, unit costs rise and the *SRAS* curve shifts leftward
d. fall, unit costs rise and the *SRAS* curve shifts leftward
e. fall, unit costs fall, and the *SRAS* curve shifts rightward

113. Some economists argue that a recessionary gap may NOT be automatically eliminated, because wages

a. never change in response to changes in demand for labour.
b. have a tendency to be sticky downward.
c. have a tendency to fall too quickly.
d. have a tendency to rise too quickly.
e. are flexible but prices have a tendency to be sticky downward.

114. If the economy in Figure 25-1 is currently producing $Y_0$ level of output, then to attain full-employment level of production $Y^*$, the

a. *SRAS* curve will shift to the right and intersect the *AD* curve at A.
b. *LRAS* curve will shift to the left until it intersects the *SRAS* curve and *AD* curve at $Y_0$ output level.
c. *AD* curve will shift to the right and intersect the *SRAS* curve at point B.
d. economy will stay at $Y_0$ level of production.
e. economy is in equilibrium and will not adjust further.

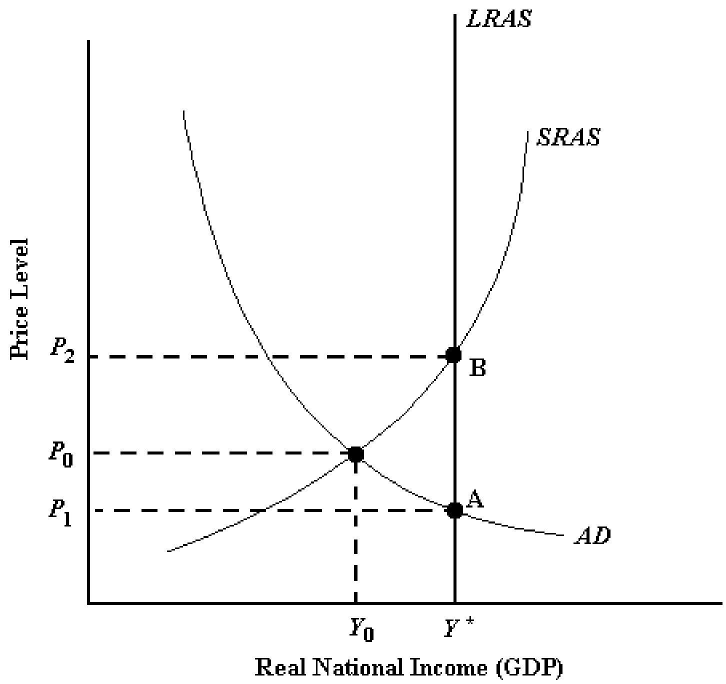


FIGURE 25-1

115. Referring to Figure 25-1, where the economy is currently in equilibrium at $Y_0$, the appropriate fiscal policy response, to attain full employment output ($Y^*$), is
a. an increase in personal income taxes.
b. a reduction in government spending on goods and services.
c. an increase in corporate income taxes.
d. an increase in government spending or reduction in personal income taxes or a combination of both.
e. an increase in interest rates to encourage increased savings.

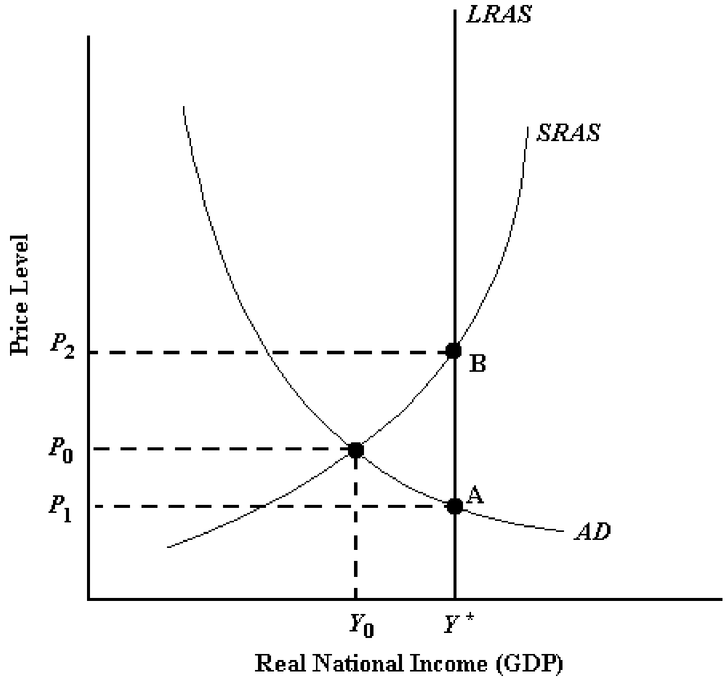


**FIGURE 25-1**

116. The effect of a temporary increase in short run aggregate supply on real GDP, starting from potential output, will be reversed in the long run with a _____ shift in _____.
   a. rightward; *SRAS*
   b. rightward; *AD*
   c. leftward; *SRAS*
   d. leftward; *AD*
   e. none of the above.

117. Referring to Figure 25-2, where the economy is in equilibrium at $Y_1$, a contractionary fiscal policy restores potential output ($Y^*$) by shifting the
   a. *SRAS* curve to the left to intersect *AD* at B.
   b. *LRAS* curve to the right to intersect both *AD* and *SRAS* curves at A.
   c. *LRAS* and *SRAS* curves to the left.
   d. *AD* curve to the right.
   e. *AD* to the left to intersect both the *LRAS* and *SRAS* curves at C.

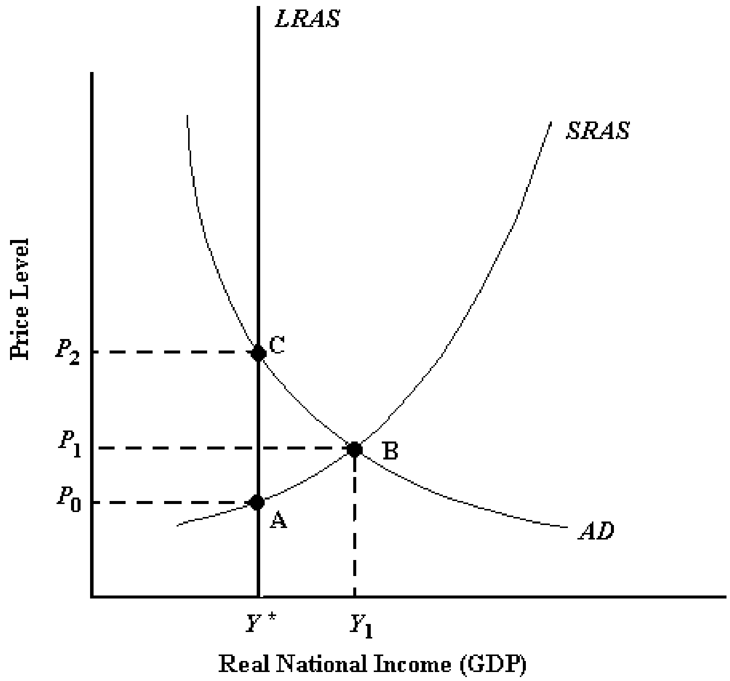


**FIGURE 25-2**

118. When economists argue that fiscal policy may NOT be effective in stabilizing the economy, the reasons they adduce are that
   a. households will tend to save the extra income brought by a tax cut rather than spend it.
   b. private investment will be crowded out by government's borrowing in the money market.
   c. there are considerable time lags in implementing fiscal policy.
   d. all of the above.
   e. none of the above.

119. The "paradox of thrift" is that in a recession the understandable tendency of worried people to increase their saving causes the resulting _____ in consumption expenditure to _____ the recession.
   a. decrease, deepen
   b. decrease; eliminate
   c. rise; deepen
   d. rise; eliminate

120. In a boom, progressive income taxes act as an automatic stabilizer by _____ the marginal propensity to spend, and thereby _____ the multiplier.
   a. raising; raising
   b. raising; lowering
   c. lowering; raising
   d. lowering; lowering

121. In Figure 25-3, with the economy starting at point $E_0$, suppose the government embarks on a widespread infrastructure program as a means to increase *AD* to $AD_1$. If this policy has been fully and widely anticipated, the likely result will be that the

a. economy would move from $E_0$ to $E_1$ and eventually adjust to $E_2$.
b. *SRAS* curve would move quickly to $SRAS_1$ and the effect of the *AD* shock would be to move the economy directly to $E_2$.
c. *SRAS* curve would quickly shift to $SRAS_1$, and the *AD* curve would remain stationary, resulting in a new equilibrium at $E_3$.
d. economy would immediately move from $E_0$ to $E_1$ as the *AD* curve shifts rightward, and remain there with a persistent inflationary gap.

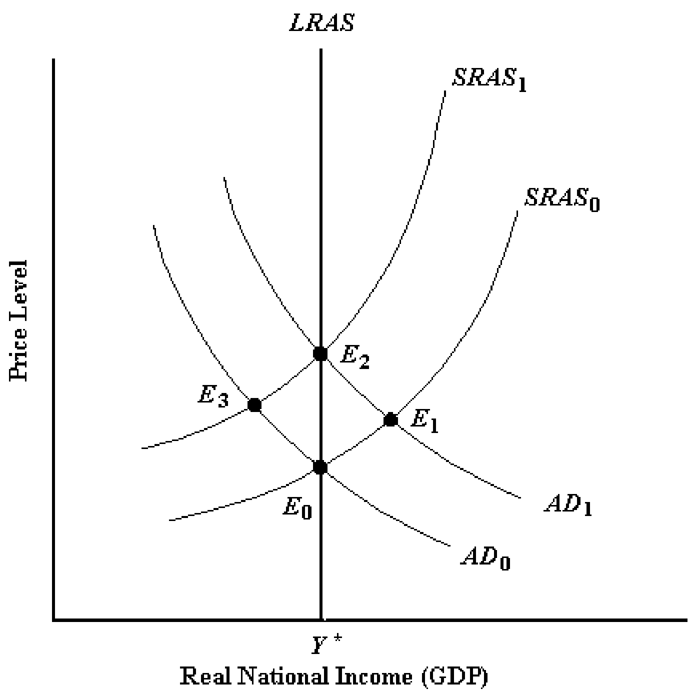


**FIGURE 25-3**

122. The Phillips curve describes the relationship between

a. aggregate expenditure and aggregate demand.
b. the money supply and interest rates.
c. the rate of change of wages and output.
d. aggregate demand and the price level.
e. unemployment and the interest rate.

123. An important policy conclusion of the Phillips curve is that
   a. the real GDP can be maintained above the potential output without causing inflation.
   b. the unemployment rate can be maintained at less than the natural rate in the long run.
   c. an attempt to maintain real GDP higher than the potential output will result in accelerating inflation.
   d. fiscal policy is most effective in controlling inflation.
   e. none of the above.

**Answer Key**

106. e
107. d
108. c
109. c
110. c
111. b
112. c
113. b
114. a
115. d
116. c
117. e
118. d
119. a
120. d
121. b
122. c
123. c