1. Which of the following equations is correct?
   A) \( AE = C - I + G + (X + M) \)
   B) \( AE = C + I + G + (X - M) \)
   C) \( AE = C + I - G + (X - M) \)
   D) \( AE = C - I + G - (X + M) \)

2. If disposable income is $3,000 and saving is $1,200, how much is the average propensity to consume?
   A) 0.4
   B) 0.6
   C) 1.2
   D) 2.5

Use the following to answer question 3:

<table>
<thead>
<tr>
<th>Disposable Income</th>
<th>Consumption</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,000</td>
<td>$1,200</td>
</tr>
<tr>
<td>$1,200</td>
<td>$1,300</td>
</tr>
<tr>
<td>$1,400</td>
<td>$1,400</td>
</tr>
<tr>
<td>$1,600</td>
<td>$1,500</td>
</tr>
<tr>
<td>$1,800</td>
<td>$1,600</td>
</tr>
</tbody>
</table>

3. (Table) When disposable income is $1,200, what is the value of the average propensity to save?
   A) −0.5
   B) −1.5
   C) −1.083
   D) −0.083

4. The 45-degree line in the Keynesian model represents:
   A) \( AE = C \)
   B) \( AE = G \)
   C) \( AE = I \)
   D) \( AE = Y \)
5. If AE = $6,200 and Y = $5,800, businesses will produce:
   A) more, raising both employment and income.
   B) less, lowering both employment and income.
   C) more, raising employment and lowering income.
   D) less, lowering employment and raising income.

6. If the marginal propensity to consume is 0.85, how much is the spending multiplier?
   A) 0.15
   B) 1.17
   C) 5.1
   D) 6.67

7. Increases in government spending ____ equilibrium income, and increases in taxes ____
equilibrium income.
   A) increase; increase
   B) increase; decrease
   C) decrease; increase
   D) decrease; decrease

8. In the full aggregate expenditure model with net exports included:
   A) \( C + G + X = S + T + M \).
   B) \( C + G + M = S + T + X \).
   C) \( I + G + M = S + T + X \).
   D) \( I + G + X = S + T + M \).

9. In an economy with three sectors (household, business, and government), government
   spending is $5 billion, taxes are $4 billion, and investment is $4 billion. If the economy
   is in equilibrium, then saving is:
   A) $1 billion.
   B) $4 billion.
   C) $5 billion.
   D) $9 billion.

10. If the government spends $1 billion to create a wetlands preserve, taxes increase $1
    billion to pay for it, and the marginal propensity to consume is 0.75, GDP:
    A) remains unchanged.
    B) increases by $1 billion.
    C) increases by $4 billion.
    D) decreases by $1 billion.
11. According to Keynes, what determines the level of employment and income?
   A) aggregate expenditures
   B) aggregate savings
   C) government spending
   D) aggregate supply

12. Because of the wealth effect, a rising aggregate price level ____ the purchasing power of wealth and therefore _____ output demanded.
   A) increases; increases
   B) increases; reduces
   C) reduces; increases
   D) reduces; reduces

13. The ______ effect is a reason for the negative slope of the aggregate demand curve.
   A) income
   B) substitution
   C) interest rate
   D) multiplier

14. In the short run, the aggregate supply curve is ____ because input prices are _____.
   A) positively sloped; not completely flexible
   B) positively sloped; completely flexible
   C) vertical; not completely flexible
   D) vertical; completely flexible

15. The ____ shows the amount of output that firms are willing to produce at various price levels.
   A) aggregate expenditure curve
   B) aggregate supply curve
   C) aggregate demand curve
   D) aggregate spending curve
16. (Figure: Determining SRAS Shifts 2)

Which of the following might be a cause of the change in short-run aggregate supply?

A) Unions successfully negotiated higher wages.
B) Businesses are increasingly optimistic about the future.
C) Consumer incomes dropped.
D) Taxes on businesses are raised.
17. (Figure: Determining Aggregate Equilibrium Levels)

Equilibrium output is ________ and the equilibrium price level is ________.
A) 2,000; 130
B) 5,000; 160
C) 3,000; 100
D) 100; 3,000
What economic event is represented?
A) a recession
B) demand-pull inflation
C) cost-push inflation
D) deflation
19. (Figure: Understanding Aggregate Graphs 2)

This economy is at point $a$. This figure depicts an economy:
A) in neither short-run nor long-run equilibrium.
B) in short-run equilibrium only.
C) in both short-run and long-run equilibrium
D) in long-run equilibrium only.

20. What would cause the price level to decrease and employment to increase?
A) a shift to the left of the AD curve
B) a shift to the right of the AD curve
C) a shift to the left of the SRAS curve
D) a shift to the right of the SRAS curve

21. __________ government spending, _____ transfer payments, and ____ taxes are all examples of contractionary fiscal policy.
A) Reducing; increasing; raising
B) Reducing; reducing; raising
C) Reducing; reducing; reducing
D) Raising; increasing; raising
22. When the economy is at equilibrium:
   A) GDP = C + I.
   B) GDP = C + I + G + (X – M).
   C) Y + C = I.
   D) Y = C / I.

Use the following to answer question 23:

**Figure: Effects of Policy Shifts**

23. (Figure: Effects of Policy Shifts) If government spending increases, shifting aggregate demand from _____ to _____, aggregate output will increase from _____ to _____.
   A) AD₁; AD₀; Qₙ; Q₀
   B) AD₁; AD₀; Q₀; Qₙ
   C) AD₀; AD₁; Q₀; Qₙ
   D) AD₀; AD₁; Qₙ; Q₀

24. __________ marginal tax rates and _______________ are commonly used to increase aggregate supply.
   A) Lowering; increasing government transfer payments
   B) Lowering; offering investment tax credits
   C) Raising; increasing government transfer payments
   D) Raising; reducing government spending
25. If an advance in technology shifts the long-run aggregate supply curve out:
   A) prices drop and output increases.
   B) prices increase and output decreases.
   C) prices remain stable and output decreases.
   D) None of the answers is correct.

26. **Figure: Laffer Curve 2**

(Figure: Laffer Curve 2) The figure shows the Laffer curve for an economy whose tax rate is 80%. Supply-side economists would argue that the government should:
   A) reduce the tax rate to 40%.
   B) reduce the tax rate to 20%.
   C) keep the tax rate at 80%.
   D) reduce the tax rate to 60%.

27. Automatic stabilizers are designed so that as income falls:
   A) government spending falls so that budget is always balanced.
   B) spending rises to a degree that the recession automatically ends.
   C) the rate of spending decrease accelerates.
   D) spending does not fall as much as income.
28. Automatic stabilizers are:
   A) aspects of the tax code that stabilize tax revenue over the course of a business cycle.
   B) laws passed by Congress that stabilize interest rates.
   C) policies intended to stabilize the price level.
   D) components of the federal budget that counter the effects of the business cycle without explicit intervention by the president or Congress.

29. Which of the following illustrates the information lag?
   A) The economy is predicted to increase at 0.1% in July, but the numbers are revised in August to reflect an actual 2% decrease.
   B) Current data have been provided to policymakers, but they decide to wait and see what happens in the next quarter.
   C) The government responds to the 2% decrease in the economy, and private investment is crowded out of the investment market.
   D) The government decides not to respond to the 2% decrease in the economy because it is worried about the possibility of inflation.

30. Public choice theorists primarily examine the:
   A) choices consumers make when in public.
   B) ability of government to be efficient.
   C) relationship between fiscal and monetary policies.
   D) relationship between economics and political decision making.

31. If the economy is facing inflationary pressures, the Fed will:
   A) raise taxes.
   B) raise interest rates.
   C) lower interest rates.
   D) decrease government spending.

32. If the unemployment rate is 4.5% and the inflation rate is 6%, the Fed will most likely:
   A) lower the discount rate.
   B) buy bonds.
   C) lower the reserve requirement.
   D) sell bonds.

33. The short-run aggregate supply curve is ____ and the long-run aggregate supply curve is ____.
   A) vertical; upward sloping
   B) horizontal; vertical
   C) vertical; horizontal
   D) upward sloping; vertical
34. The quantity theory equation of exchange states:
   A) Supply = Demand.
   B) GDP = Q × P.
   C) M × V = P × Q.
   D) M = P × Q.

35. In the equation of exchange, if $M = 2$ trillion, $P = 1.5$, and $Q = 8$ trillion:
   A) the velocity of money ($V$) = 6.
   B) nominal GDP is $16$ trillion.
   C) the velocity of money ($V$) = 4.
   D) real GDP is $12$ trillion.

Use the following to answer question 36:

**Figure: Shifts in Aggregate Demand**

36. (Figure: Shifts in Aggregate Demand) Starting at the equilibrium point $b$, if imports increase or consumer demand decreases, the demand curve will shift to _____, thus _____ the price level and _____ real output.
   A) $AD_1$; increasing; decreasing
   B) $AD_2$; decreasing; decreasing
   C) $AD_1$; increasing; increasing
   D) $AD_2$; increasing; decreasing
37. Quantitative easing refers to the process whereby the Fed:
   A) decreases the money supply to fight inflation.
   B) raises interest rates to fight inflation.
   C) buys securities to stimulate the economy.
   D) sells securities to stimulate the economy.

38. The Fed will keep the inflation rate constant, regardless of evolving economic conditions, if it is using:
   A) Friedman's monetary rule.
   B) inflation targeting.
   C) monetary targeting.
   D) the Taylor rule.

39. According to the Taylor rule, the two most important factors influencing the Federal Reserve's changing the federal funds rate are:
   A) an inflation rate different from the Fed's target and output different from potential GDP.
   B) an inflation rate different from the Fed's target and increasing interest rates.
   C) increasing interest rates and output different from potential GDP.
   D) output different from potential GDP and unemployment rates different from full employment.

40. To say that the Fed is transparent means that the Fed:
   A) executes decisions in secrecy.
   B) has a “just trust us” approach to conducting monetary policy.
   C) is open regarding its monetary policy.
   D) uses a monetary growth rule.
ANSWER KEY – ECO 2013 Principles of Macro – Practice Test #3

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