Chapter 14 Assignment

A 1. The decrease in real GDP during a recession is mostly the result of which of the following?
   a. a decrease in investment spending
   b. a decrease in consumption spending
   c. a decrease in net exports
   d. a decrease in net imports

D 2. According to most economists, classical economic theory (from chapter 11) applies in which of the following situations?
   a. in NEITHER the short run NOR in the long run
   b. in the short run AND in the long run
   c. in the short run but NOT in the long run
   d. in the long run but NOT in the short run

C 3. To increase aggregate demand, a government could do which of the following?
   a. raise personal income taxes
   b. decrease the money supply
   c. begin a new tax credit for business investment
   d. increase the money supply

C 4. A recession caused by a reduction in aggregate demand corrects itself over time as the expected price level does which of the following?
   a. It rises, moving the SRAS curve to the right.
   b. It rises, moving the SRAS curve to the left.
   c. It falls, moving the SRAS curve to the right.
   d. It falls, moving the SRAS curve to the left.

D 5. Changes in the price of oil are responsible for which of the following effects?
   a. They lead to recessions.
   b. They have little effect on the business cycle in Canada.
   c. They change the economy principally by changing aggregate demand.
   d. They created both inflation and recession in Canada in the 1970s.

C 6. A fall in oil prices (for a non oil exporting country) has which of the following effects?
   a. Aggregate demand shifts left, the price level falls, and real output falls.
   b. Aggregate demand shifts right, the price level rises, and real output rises.
   c. Aggregate supply shifts right, the price level falls, and real output rises.
   d. Aggregate supply shifts left, the price level rises, and real output falls.

A 7. Which of the following occurs during a recession?

a. an increase in unemployment, a decrease in real output and real income
b. an increase in unemployment, an increase in real output and real income
c. a decrease in unemployment, an increase in real output and real income
d. a decrease in unemployment, a decrease in real output and real income

D 8. An improvement in technology shifts which of the following curves?

a. only the aggregate demand
b. the aggregate demand and the aggregate supply
c. only the short-run aggregate supply
d. the short-run aggregate supply and the long-run aggregate supply

A 9. Which of the following is most likely to cause a decrease in aggregate supply?

a. a decline in the productivity of labour
b. a decrease in resource prices
c. an increase in capital formation
d. an increase in the price level

D 10. Which of the following will lead to a reduction in aggregate demand in Canada?

a. a higher price level
b. rapid growth of real income in Japan and Western Europe
c. an increase in consumer confidence
d. an increase in real interest rates

A 11. Which of the following terms best describes an increase in the wealth of households and businesses resulting from the increased purchasing power of a constant supply of money as the price level declines?

a. the wealth effect
b. the inflationary tradeoff
c. the nominal-income effect
d. the multiplier

D 12. The aggregate demand for goods and services is composed of purchases of which of the following?

a. households and businesses
b. governments and net exports
c. households, governments, and net exports
d. households, businesses, governments, and net exports

C 13. Starting with initial long-run equilibrium, a sudden decrease in optimism about future business conditions will have which of the following effects (in the short run)?
   a. an increase in output and a reduction in the price level
   b. an increase in both output and the price level
   c. a reduction in both output and the price level
   d. a reduction in output and an increase in the price level

B 14. Which of the following basic economic concepts most clearly provides the foundation for the long-run aggregate-supply curve?
   a. the law of demand
   b. the classical dichotomy and monetary neutrality
   c. the law of increasing marginal returns
   d. the law of diminishing marginal utility

D 15. A decrease in the price level will lead to which of the following effects?
   a. a decrease in the quantity of goods and services demanded
   b. a reduction in net exports to foreigners
   c. a decrease in the wealth of persons holding the fixed supply of money
   d. an increase in the value of the money that is in circulation

True or False?

T 16. A recession is a period of two or more consecutive quarters of negative real gross domestic product growth and rising unemployment.

T 17. Gross domestic product is the same as the sum of consumption, investment, government purchases, and net exports.

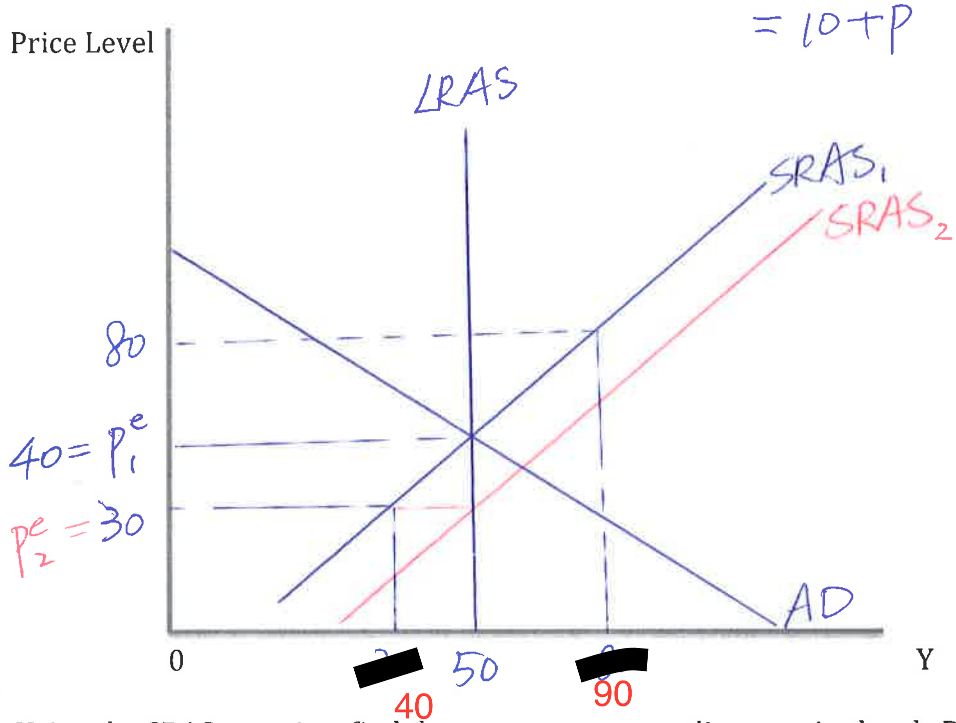
F 18. Aggregate supply is a curve that shows the quantity of goods and services that households, firms, and government want to buy at each price level.

F 19. The short-run aggregate-supply curve slopes upward showing a negative relation between the quantities supplied and the various price levels.

20. A short-run aggregate supply (SRAS) curve is described by the equation $Y = Y^* + b(P - P^e)$. Suppose $Y^* = 50$, $b = 1$, and $P^e = 40$.

a. Draw the LRAS curve in an AD - AS diagram.

$Y = 50 + (P - 40)$
$= 10 + P$



b. Using the SRAS equation, find the output corresponding to price levels $P = 30$ and $P = 80$ and place the 2 points on your diagram. Draw the SRAS curve that passes through the two points.

$Y = 10 + 30 = 40$ when $P = 30$
$Y = 10 + 80 = 90$ when $P = 80$

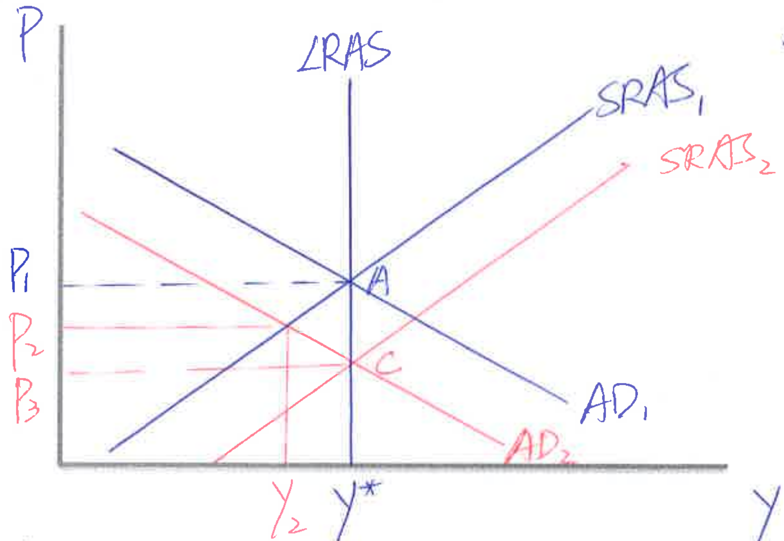
c. Identify the expected price level on your graph (the equilibrium price level where LRAS = SRAS).

see graph above

d. Suppose the expected price level decreases to $P^e = 30$. For the current price levels $P = 20$ and $P = 70$, recalculate the output levels using the SRAS formula. Draw the new SRAS curve and identify the new expected price level.

when $P^e = 30$, $Y = 50 + (P - 30) = 20 + P$
when $P = 20$ $Y = 40$
when $P = 70$ $Y = 90$

21. Draw an economy in the long run equilibrium (point A). Label all axis and curves. Show what will happen in the *short run* if there is a *decrease in consumer confidence*. Label this point B. Then show what will happen in the *long run*. Label this point C.



consumer confidence ↓
AD ↓ to AD_2 b/c C ↓

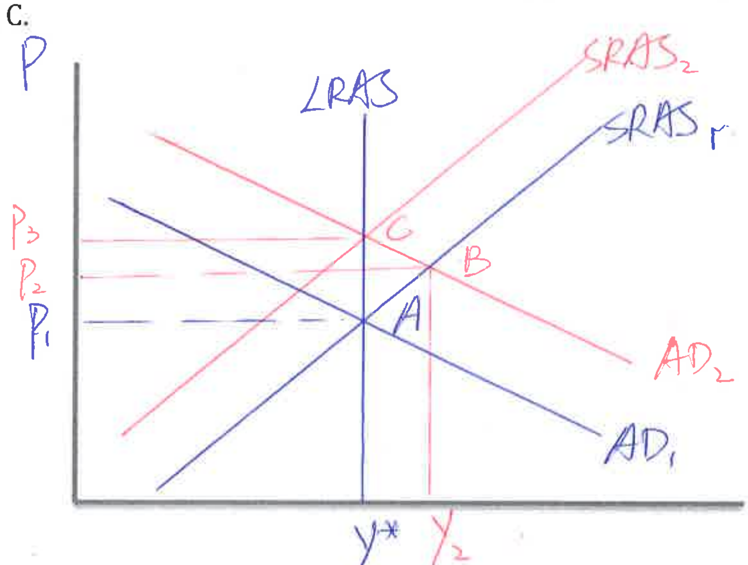
What had to happen to wages in order for the economy to return to Y*?

wage ↓ b/c P^e ↓ w/ a recessionary output gap

What had to happen to the expected price level in order for the economy to return to Y*?

$P^e \downarrow$ b/c $Y_2 < Y^*$

22. Draw an economy in the long run equilibrium (point A). Label all axis and curves. Show what will happen in the *short run* if the *U.S. enters an economic boom*. Label this point B. Then show what will happen in the *long run*. Label this point C.



US is booming
EX ↑ NX ↑ → AD ↑

What had to happen to wages in order for the economy to return to Y*?

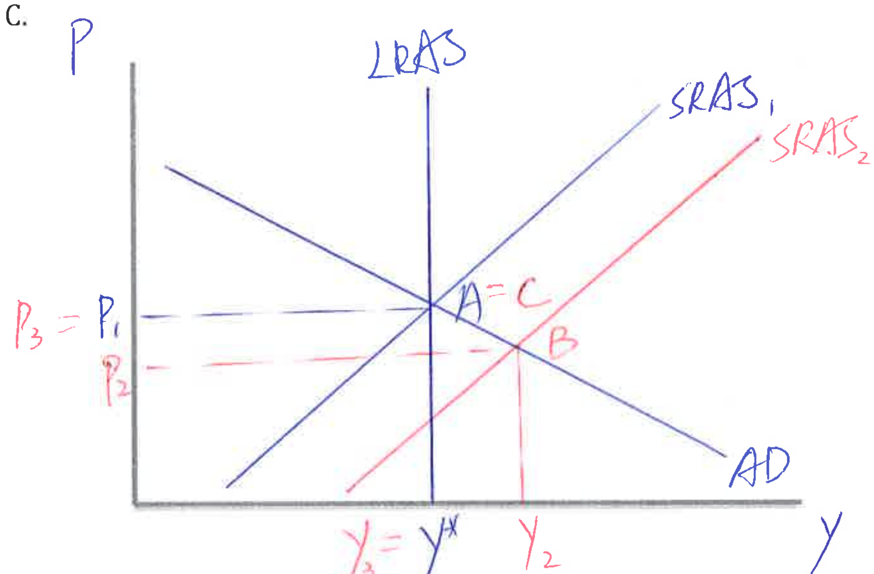
wage ↑ b/c P^e ↑ w/ an inflationary output gap

What had to happen to the expected price level in order for the economy to return to Y*?

$P^e \uparrow$ b/c $Y_2 > Y^*$

23. Draw an economy in the long run equilibrium (point A). Label all axis and curves. Show what will happen in the *short run* if *oil and gas prices decrease*. Label this point B. Then show what will happen in the *long run*. Label this point C.

oil price ↓, AS ↑



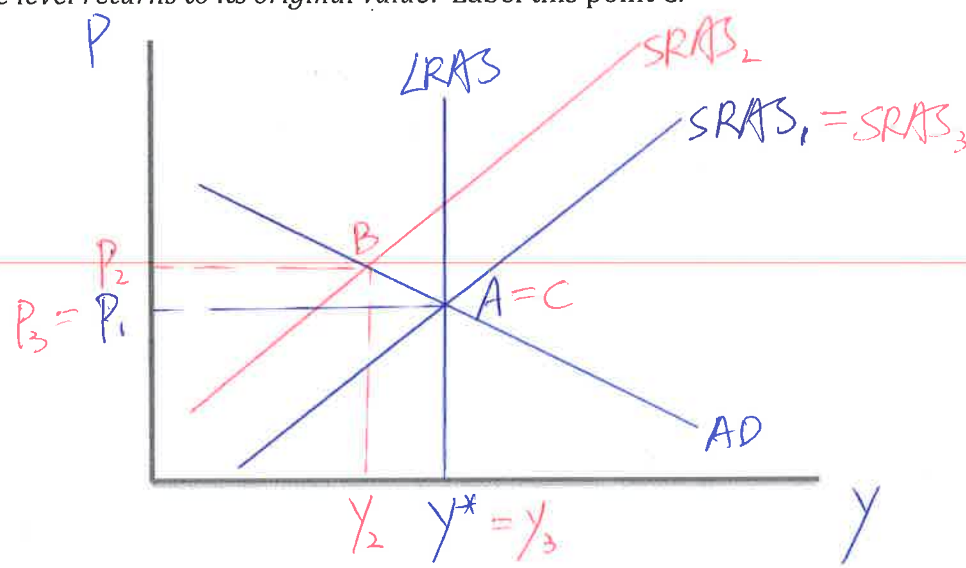
What had to happen to wages in order for the economy to return to Y*?

wage ↑ b/c P^e ↑ w/ an inflationary output gap

What had to happen to the expected price level in order for the economy to return to Y*?

P^e ↑ b/c $Y_2 > Y^*$

24. Draw an economy in the long run equilibrium (point A). Label all axis and curves. Show what will happen in the *short run* if there is an increase in the expected price level (firms and workers expect higher inflation). Label this point B. Then show what will happen in the *long run assuming the expected price level returns to its original value.* Label this point C.



What had to happen to wages in order for the economy to return to Y*?

P^e ↓ b/c $Y_2 < Y^*$ → wage ↓ → cost of production ↓ → potential profit ↑ → AS ↑