Practice Problems:
Chapter 12 Aggregate Demand and Aggregate Supply

1. The aggregate supply curve shows the relationship between the aggregate price level and:
   A) aggregate output supplied.
   B) the aggregate money supply.
   C) the aggregate unemployment rate.
   D) aggregate employment.

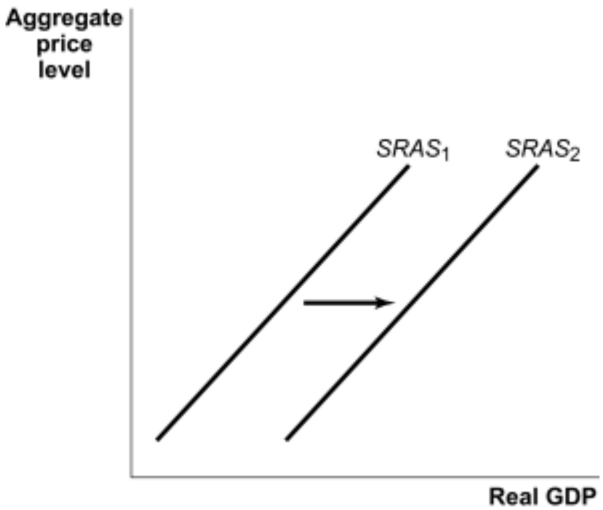
2. An increase in the aggregate price level will increase:
   A) short-run aggregate supply.
   B) the quantity of aggregate output supplied in the short run.
   C) aggregate demand.
   D) the quantity of aggregate output demanded.

3. The short-run aggregate supply curve is positively sloped because:
   A) wages and other costs of production respond immediately to changes in prices.
   B) profit is lower when prices increase, so output decreases.
   C) workers are willing to work for lower wages rather than be laid off.
   D) higher prices lead to higher profit and higher output.

4. The short-run aggregate supply curve would shift to the left for all the following reasons EXCEPT:
   A) a decrease in productivity.
   B) an increase in nominal wages.
   C) an increase in interest rates.
   D) an increase in the price of commodities used for production.

Use the following to answer question 5:

Figure: Aggregate Supply Movements



5. (Figure: Aggregate Supply Movements) Using the accompanying figure we can safely conclude that:
   A) an increase in the price level is responsible for pushing the SRAS curve to the right.
   B) a decrease in the price level is responsible for pushing the SRAS curve to the right.
   C) that there has been an increase in the short-run aggregate supply.
   D) that there has been a decrease in the short-run aggregate supply.

6. The long-run aggregate supply curve is:
   A) upward sloping.
   B) downward sloping.
   C) horizontal.
   D) vertical.

7. The long-run aggregate supply curve is vertical because in the long run:
   A) technological progress outpaces raises in nominal wages.
   B) all factors of production increase.
   C) the price of labor is flexible, while the price of physical capital is fixed.
   D) all prices are flexible.

8. The point where the long-run aggregate supply curve intercepts the horizontal axis:
   A) is the point of macroeconomic equilibrium.
   B) is the economy's potential output.
   C) is the level of real GDP the economy would produce if all prices were flexible and wages were fixed.
   D) is all of the above.

9. When the economy is on the short-run aggregate supply curve and to the left of the long-run aggregate supply curve, actual aggregate output will eventually equal potential output as:
   A) nominal wages fall and the long-run aggregate supply curve shifts to the left.
   B) the aggregate price level falls and the long-run aggregate supply curve shifts to the left.
   C) nominal wages fall and the short-run aggregate supply curve shifts to the right.
   D) the aggregate price level falls and the aggregate demand curve shifts to the right.

10. The negative relationship between the aggregate price level and aggregate output demanded gives the aggregate demand curve:
    A) an upward slope.
    B) a vertical slope.
    C) a horizontal slope.
    D) a downward slope.

11. According to the aggregate demand curve, when the aggregate price level _________, the quantity of _________.
    A) rises; aggregate output supplied falls
    B) falls; aggregate output demanded falls
    C) rises; aggregate output demanded falls
    D) rises; aggregate output demanded does not change

12. Which of the following is NOT one of the reasons that the aggregate demand curve slopes downward?
    A) the wealth effect
    B) the interest rate effect
    C) the substitution effect
    D) None of the above is correct.

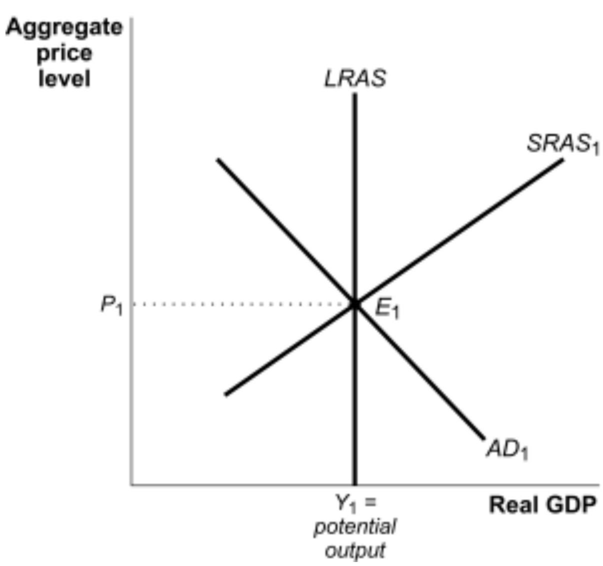
13. Which of the following is a factor which can shift the aggregate demand curve?
    A) changes in expectations
    B) changes in wealth
    C) changes in stock market indices
    D) all of the above

14. Stagflation may result from:
    A) an increase in the supply of money.
    B) a decrease in the supply of money.
    C) an increased in the price of imported oil.
    D) a decrease in the price of imported oil.

15. A positive demand shock leads to:
    A) higher prices and higher employment.
    B) higher prices and higher unemployment.
    C) higher prices and lower output.
    D) lower prices and lower output.

Use the following to answer questions 16-19:

Figure: AD-AS Model 2



16. (Figure: AD-AS Model 2) If commodity prices increase, which of the following will take place?
A) *SRAS* curve will shift to the left.
B) *SRAS* curve will shift to the right.
C) *AD* curve will shift to the left.
D) *AD* curve will shift to the right.

17. (Figure: AD-AS Model 2) As the size of the labor force increases over time, which of the following will take place?
A) *LRAS* will shift to the right.
B) *LRAS* will shift to the left.
C) *AD* curve will shift to the left.
D) *AD* curve will shift to the right.

18. (Figure: AD-AS Model 2) When consumers and firms become more optimistic, which of the following will take place in the short run?
A) *SRAS* curve will shift to the left.
B) *SRAS* curve will shift to the right.
C) *AD* curve will shift to the right.
D) None of the above.

19. (Figure: AD-AS Model 2) If there is a significant increase in government spending, which of the following will take place in the short run?
A) *SRAS* curve will shift to the left.
B) *SRAS* curve will shift to the right.
C) *AD* curve will shift to the left.
D) *AD* curve will shift to the right.

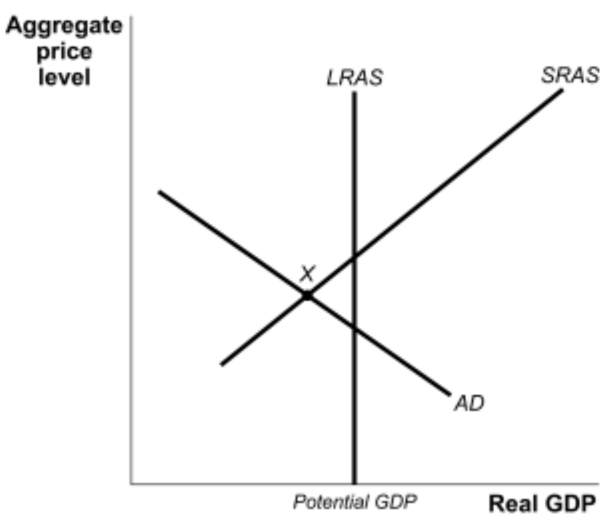
20. Suppose that the economy is in long-run macroeconomic equilibrium and aggregate demand increases. As the economy moves to short-run macroeconomic equilibrium , there is:
A) a recessionary gap with high inflation.
B) a recessionary gap with high inflation.
C) an inflationary gap with high unemployment.
D) an inflationary gap with low unemployment.

21. If there is an inflationary gap, which of the following accurately describes the adjustment to long-run equilibrium?
    A) Nominal wages decrease, and the aggregate demand curve shifts left until the economy reaches long-run equilibrium.
    B) Nominal wages increase, and the aggregate demand curve shifts right until the economy reaches long-run equilibrium.
    C) Nominal wages decrease, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
    D) Nominal wages increase, and the short-run aggregate supply curve shifts left until the economy reaches long-run equilibrium.

22. A recessionary gap is when:
    A) potential output is below aggregate output.
    B) potential output is receding.
    C) aggregate output is below potential output.
    D) aggregate output is above potential output.

Use the following to answer questions 23-25:

Figure: AD-AS Model 1



23. (Figure: AD-AS Model 1) If the economy is at point *X*, there is:
    A) an inflationary gap with low unemployment.
    B) an inflationary gap with high unemployment.
    C) a recessionary gap with low unemployment.
    D) a recessionary gap with high unemployment.

24. (Figure: AD-AS Model 1) If the economy is at point *X*, which of the following describes the likely adjustment to long-run equilibrium?
    A) Nominal wages decrease, and the aggregate demand curve shifts left until the economy reaches long-run equilibrium.
    B) Nominal wages increase, and the aggregate demand curve shifts right until the economy reaches long-run equilibrium.
    C) Nominal wages decrease, and the short-run aggregate supply curve shifts right until the economy reaches long-run equilibrium.
    D) Nominal wages decrease, and the short-run aggregate supply curve shifts left until the economy reaches long-run equilibrium.

25. (Figure: AD-AS Model 1) If the economy is at point *X*, the appropriate fiscal policy is to:
    A) increase taxes and decrease government spending.
    B) decrease taxes and increase government spending.
    C) increase the money supply and interest rates.
    D) decrease the money supply and interest rates.

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Answer Key

1. A
2. B
3. D
4. C
5. C
6. D
7. D
8. B
9. C
10. D
11. C
12. C
13. D
14. C
15. A
16. A
17. A
18. C
19. D
20. D
21. D
22. C
23. D
24. C
25. B