ECN 204
Introductory Macroeconomics
Instructor: Sharif F. Khan

Department of Economics
Ryerson University
Fall 2005

Assignment 6

Part A — Multiple-Choice Questions — [30 marks]

Each question is worth 1.5 marks. There is no negative marking for wrong answers

To answer each question correctly, you have to choose the best answer from the given four choices.

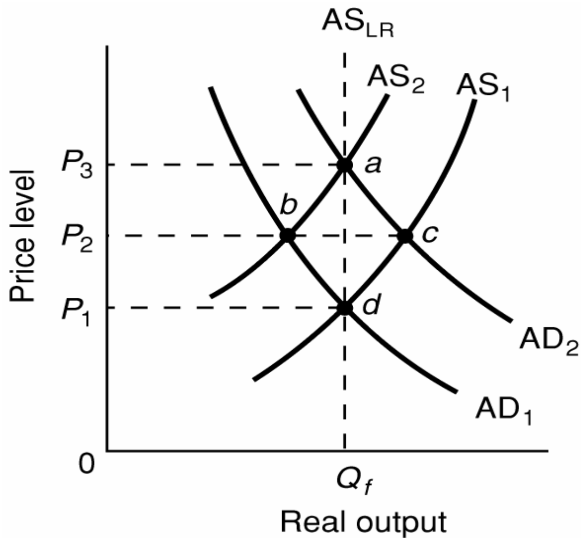
1. Demand-pull inflation in the short-run increases the price level and:
   A) real wages.
   B) real output.
   C) unemployment.
   D) nominal wages.

2. The economy enters the long-run once:
   A) nominal wages become real wages.
   B) real wages become nominal wages.
   C) sufficient time has elapsed for wage contracts to expire and nominal wage adjustments to occur.
   D) sufficient time has elapsed for real GDP to increase and unemployment to decrease.

3. In the long run, demand-pull inflation:
   A) increases unemployment.
   B) decreases nominal wages.
   C) decreases real output.
   D) increases the price level.

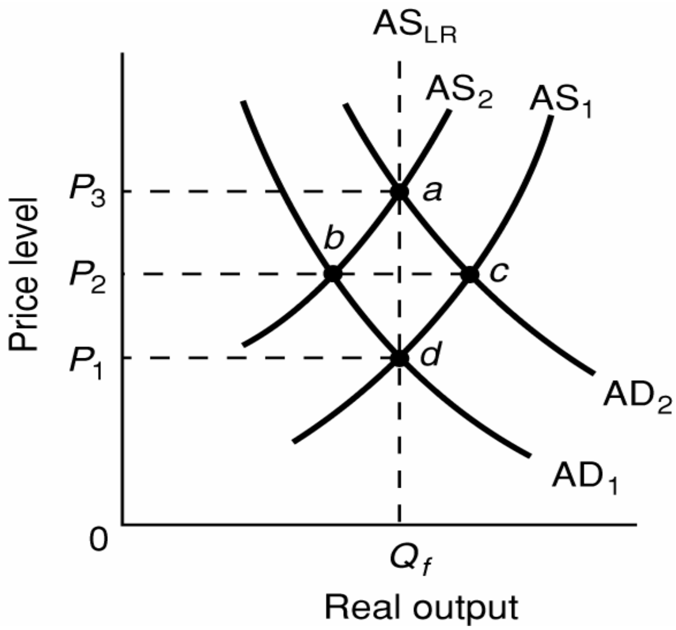
4. In long run aggregate demand-aggregate supply model:
   A) long-run equilibrium occurs wherever the aggregate demand curve intersects the short-run aggregate supply curve.
   B) the long-run aggregate supply curve is horizontal.
   C) the price level is the same regardless of the location of the aggregate demand curve.
   D) long-run equilibrium occurs at the intersection of the aggregate demand curve, the short-run aggregate supply curve, and the long run aggregate supply curve.

Use the following to answer question 5:



5. Refer to the above diagram. The initial aggregate demand curve is AD_1 and the initial aggregate supply curve is AS_1. In the long run, demand-pull inflation is best shown as:
   A) a shift of aggregate demand from AD_1 to AD_2 followed by a shift of aggregate supply from AS_1 to AS_2.
   B) a move from d to b to a.
   C) a shift of aggregate supply from AS_1 to AS_2 followed by a shift of aggregate demand from AD_1 to AD_2.
   D) a move from a to d.

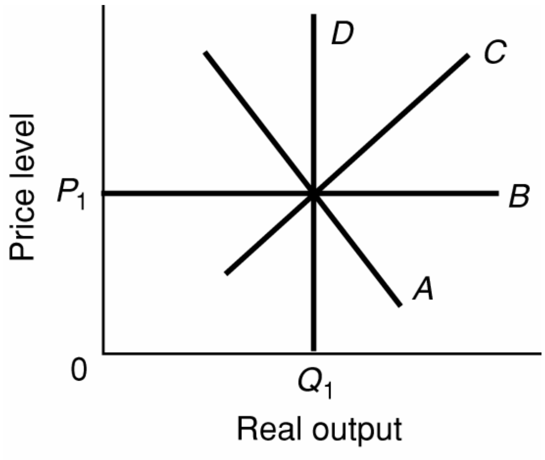
Use the following to answer questions 6-7:



6. Refer to the above diagram. The initial aggregate demand curve is AD_1 and the initial aggregate supply curve is AS_1. Cost-push inflation in the short run is best represented as a:
   A) leftward shift of the aggregate supply curve from AS_1 to AS_2.
   B) rightward shift of the aggregate demand curve from AD_1 to AD_2.
   C) move from d to b to a.
   D) move from d directly to a.

7. Refer to the above diagram. The initial aggregate demand curve is AD_1 and the initial aggregate supply curve is AS_1. If government offsets the decline in real output resulting from short-run cost-push inflation by increasing aggregate demand from AD_1 to AD_2:
   A) real output will rise above Q_f.
   B) the price level will rise from P_1 to P_2.
   C) it is possible that aggregate supply will shift rightward from AS_2 because nominal wage demands will rise.
   D) the price level will rise from P_2 to P_3.

Use the following to answer question 8-9:



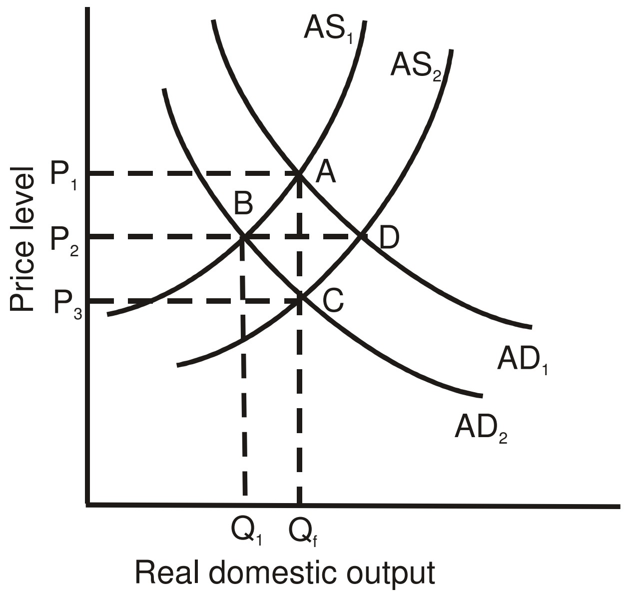
8. Refer to the above diagram and assume that prices and wages are flexible both upward and downward in the economy. In the long-run AD-AS model:

   A) demand-pull inflation would involve a rightward shift of curve A, followed by a rightward shift of curve C.
   B) cost-push inflation would involve first a leftward shift of curve C, then a rightward shift of curve C.
   C) recession would involve a leftward shift of curve A followed by a leftward shift of curve C.
   D) recession would involve a rightward shift of curve D, followed by leftward shifts of curves A and C.

9. Refer to the above diagram and assume that prices and wages are flexible both upward and downward in the economy. In the long run AD-AS model:

   A) demand-pull inflation would involve a rightward shift of curve A, followed by a rightward shift of curve C.
   B) cost-push inflation would involve a rightward shift of curve A, followed by a leftward shift of curve C.
   C) recession would involve a leftward shift of curve A followed by a rightward shift of curve C.
   D) recession would involve a rightward shift of curve D, followed by leftward shifts of curves A and C.

Use the following to answer question 10:

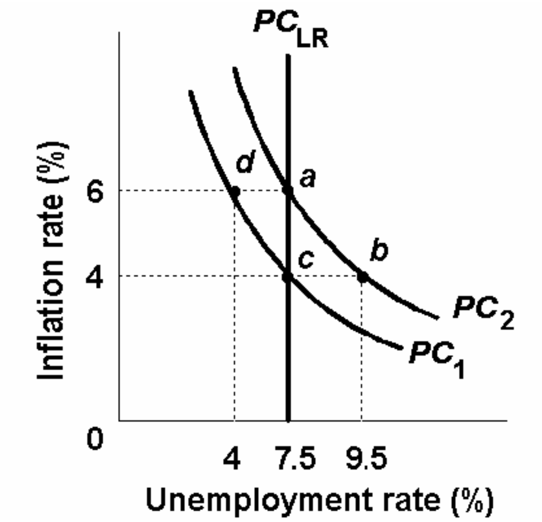


10. Refer to the above graph. Assume that the economy is initially at equilibrium at point A. If there is a recession in the economy such that AD_1 shifts to AD_2, and wages and prices are flexible, then in the long run the price level will be:

    A) P_2, and real output will be Q_f.
    B) P_3, and real output will be Q_f.
    C) P_1, and real output will be Q_f.
    D) P_2, and real output will be Q_1.

11. Aggregate supply shocks will:
    A) move the economy along the Phillips Curve toward less unemployment.
    B) move the economy along the Phillips Curve toward less inflation.
    C) shift the Phillips Curve to the left.
    D) shift the Phillips Curve to the right.

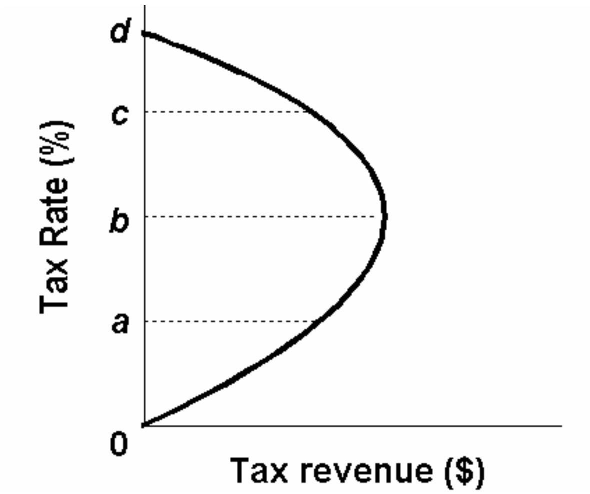
Use the following to answer questions 12-13:



12. Refer to the above diagram. Assume that the natural rate of unemployment is 7.5 percent and that the economy is initially operating at point a where the expected and actual rates of inflation are each 6 percent. If the actual rate of inflation unexpectedly falls from 6 percent to 4 percent, then the unemployment rate will:
    A) temporarily fall from 7.5 percent to 4 percent.
    B) permanently fall from 7.5 percent to 4 percent.
    C) temporarily rise from 7.5 percent to 9.5 percent.
    D) permanently rise from 7.5 percent to 9.5 percent.

13. Refer to the above diagram. Assume that the natural rate of unemployment is 7.5 percent and that the economy is initially operating at point a where the expected and actual rates of inflation are each 6 percent. In the long run, the decline in the actual rate of inflation from 6 percent to 4 percent will:
    A) reduce the unemployment rate.
    B) reduce corporate profits in real terms.
    C) have no effect on the unemployment rate.
    D) reduce real domestic output.

Use the following to answer question 14:



14. The above diagram describes the notion that as tax:
    A) revenues increase from zero to 100 percent, tax rates will increase from zero to some maximum level and then decline to zero.
    B) rates increase from zero to 100 percent, tax revenue will increase from zero to some maximum level and decline to zero.
    C) rates decrease from 100 to zero percent, tax revenue will decrease from 100 percent to a maximum level.
    D) rates increase from zero to 100 percent, tax revenue will increase from zero to a maximum level.

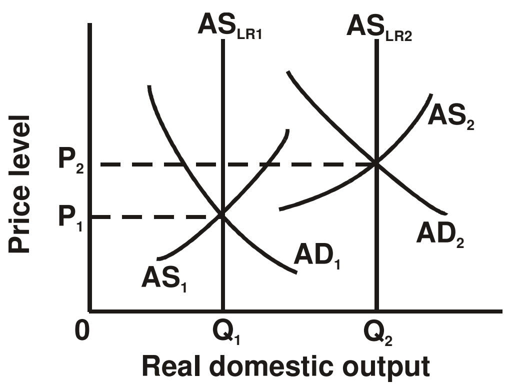
15. Which of the following is not a supply factor in economic growth?
    A) the stock of capital
    B) technological advance
    C) the size and quality of the labor force
    D) full employment

16. Which is a demand factor in economic growth?
    A) more human and natural resources
    B) technological progress and innovation
    C) an increase in the economy's stock of capital goods
    D) an increase in total spending in the economy

17. Which is an efficiency factor in economic growth?
    A) an efficient allocation of resources
    B) natural resources
    C) the quantity and quality of labor
    D) technological knowledge

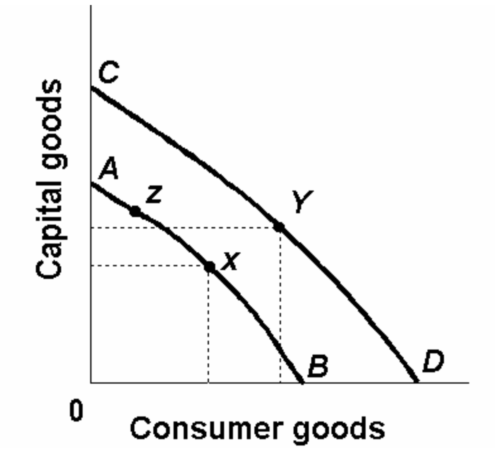
18. Suppose total output (real GDP) is $10,000 and worker-hours are 20,000. We can conclude that:
    A) real GDP per capita must be $200,000.
    B) the price-level index must be less than 100.
    C) labor productivity must be 0.5.
    D) nominal GDP must be between $10,000 and $20,000.

19. Refer to the graph below. The change from Q_1 to Q_2 represents a shift in the:



    A) level of prices.
    B) aggregate demand curve.
    C) short-run aggregate supply curve.
    D) long-run aggregate supply curve.

Use the following to answer question 20:



20. Refer to the above diagram. Realized economic growth is best represented by a:
    A) shift in the production possibilities curve from AB to CD.
    B) move from x on AB to y on CD.
    C) shift in the production possibilities curve from CD to AB.
    D) move from x to z along AB.

Part B True/ False/ Uncertain Questions [10 marks]

Each question is worth 5 marks.

Explain why the following statement is True, False, or Uncertain according to economic principles. Use diagrams and / or numerical examples where appropriate. Unsupported answers will receive no marks. It is the explanation that is important.

B-1 The long-run Phillips curve is downward sloping.

B-2 The Laffer curve suggests a positive relationship between tax rates and tax revenues.