Aggregate Output, Prices, and Economic Growth

Test ID: 7693997

Question #1 of 50

Question ID: 472409

A reduction in short-run aggregate supply is *most likely* to be accompanied by an increase in:

- ✗ **A) real interest rates.**
- ✗ **B)** real GDP.
- ✓ **C)** the price level.

Explanation

A decrease (shift to the left) in short-run aggregate supply results in lower output and a higher price level. A decrease in short-run aggregate supply will likely cause nominal and real interest rates to decrease.

Question #2 of 50

Question ID: 413757

Which of the following statements concerning aggregate demand is *most* accurate?

- ✗ **A) When price levels fall, real wealth increases, and individuals will spend less.**
- ✗ **B)** When price levels rise, real wealth increases, and individuals will spend more.
- ✓ **C)** When price levels rise, real wealth decreases, and individuals will spend less.

Explanation

When price levels rise, real wealth decreases, and we would expect individuals to spend less. If the converse were also true-if price levels were to fall-real wealth should increase, and we would expect individuals to spend more, all else being equal.

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Question ID: 413762

Because some input prices do not adjust rapidly to changes in the price level, the short-run aggregate supply curve:

- ✗ **A) may be interpreted as representing the economy's potential output.**
- ✗ **B)** exhibits a negative relationship between quantity supplied and the price level.
- ✓ **C)** is more elastic than the long-run aggregate supply curve.

Explanation

The short-run aggregate supply curve slopes upward (i.e., is not perfectly inelastic) because in the short run some input prices do not adjust fully to changes in the price level. Because firms can increase profit in the short run by increasing output in response to higher prices, there is a positive short-run relationship between the price level and quantity supplied.

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Question ID: 413759

An increase in real interest rates can be expected to:

✓ **A) decrease investment and decrease consumption.**

✗ **B)** increase government spending and decrease consumption.

✗ **C)** decrease investment and increase net exports.

Explanation

An increase in real interest rates can be expected to decrease business investment and decrease consumption. The impact on government spending and net exports is not clear-cut.

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Question ID: 460642

Which of the following amounts is *least likely* to be subtracted from gross domestic product in order to calculate national income?

✓ **A) Indirect business taxes.**

✗ **B)** Capital consumption allowance.

✗ **C)** Statistical discrepancy.

Explanation

Indirect business taxes are not subtracted because they are included in national income.

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Question ID: 413741

A shirt with a retail price of $50 is produced using cloth with a value of $40. The cloth is produced from cotton with a value of $30. Using the sum-of-value-added method, what is the total value added to gross domestic product by producing the shirt?

✗ **A) $70.**

✗ **B)** $20.

✓ **C)** $50.

Explanation

Producing the shirt adds $50 to GDP under either the sum-of-value-added approach or the value-of-final-output approach.

Stage of production	*Value*	*Value added*
Cotton	$30	$30
Cloth	$40	$10
Shirt	$50	$10
Sum of value added		$50

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Question ID: 413756

The LM curve is drawn holding which of the following factors constant?

✗ **A) Real interest rate.**

✓ **B)** Real money supply.

✗ **C)** Real GDP.

Explanation

The LM curve illustrates the relationship between real income and the real interest rate, for a given level of the real money supply.

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Question ID: 413784

Growth in total factor productivity is *best* described as driven by growth in:

✗ **A) capital.**

✓ **B)** technology.

✗ **C)** labor.

Explanation

Total factor productivity represents the productivity that cannot be directly accounted for by increases in either capital or labor, and is generally considered to be driven by changes in technology.

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Question ID: 413744

Nominal GDP for the year 20X7 is $784 billion and real GDP is $617 billion. If the base period for the GDP deflator is 20X1, the annual rate of increase in the GDP deflator since the base year is *closest to*:

✗ **A) 3.5%.**

✓ **B)** 4.0%.

✗ **C)** 4.5%.

Explanation

GDP deflator = $784 billion / $617 billion × 100 = 127.07. Annual rate of increase = $(127.07 / 100)^{1/6}$ - 1 = 0.0407 = 4.07%.

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Question ID: 413752

If a fiscal budget deficit increases, which of the following factors must also increase if all other factors are held constant?

✗ **A) Trade surplus.**

✗ **B)** Investment.

✓ **C)** Savings.

Explanation

The relationship between the fiscal balance, savings, investment, and the trade balance is (G − T) = (S − I) − (X − M). An increase in a fiscal budget deficit (G − T) must be funded by an increase in savings (S), a decrease in investment (I), or a decrease in net exports (X − M), which would decrease a trade surplus or increase a trade deficit.

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Question ID: 413781

When the sources of economic growth are stated as a production function, which factor is treated as a multiplier?

- ✗ **A)** **Size of the labor force.**
- ✓ **B)** Total factor productivity.
- ✗ **C)** Amount of capital available.

Explanation

Economic output can be stated as a production function of the form $Y = A \times f(L, K)$, where Y is economic output, L is the size of the labor force, K is the amount of capital available, and A is total factor productivity.

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Question ID: 413763

The sustainable growth rate of real GDP is *most likely* to be increased by:

- ✗ **A)** **an increase in the propensity to consume by households.**
- ✗ **B)** an increase in government spending.
- ✓ **C)** the discovery of untapped oil fields.

Explanation

Sustainable growth in real GDP is defined as the growth rate in real GDP that is sustainable over the long term. The sustainable growth rate is positively affected by increases in the supply of natural resources, the supply of physical capital, or the supply or productivity of labor. An increase in government spending does not increase an economy's sustainable growth rate.

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Question ID: 413770

Which of the following is *most likely* to occur in the short run aggregate demand decreases due to a reduction in business and consumer optimism?

- ✗ **A)** **An increase in real GDP.**
- ✓ **B)** An increase in the rate of unemployment.
- ✗ **C)** A higher rate of inflation.

Explanation

If business and consumer optimism wanes, consumers will spend less and defer current consumption and save more of their disposable income. With reduced product demand, businesses will reduce their capital expenditures and investments. These actions will lead businesses to reduce their number of employees, thereby increasing the rate of unemployment. Moreover, current output will decrease and the price level will fall.

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Question ID: 413742

Which method of calculating gross domestic product requires data from each stage of production of goods?

✗ **A)** **Value of final output method.**

✓ **B)** Sum of value added method.

✗ **C)** Income method.

Explanation

The sum-of-value-added method of calculating GDP requires data on the value added to goods at each stage of production and distribution. The value-of-final-output method only requires data on the final values of goods and services. The income approach to calculating GDP measures the total income of households and companies, rather than the value of goods and services.

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Question ID: 413748

Under the expenditure approach, gross domestic product is the sum of:

✗ **A)** **national income and transfer payments to households, less corporate and indirect business taxes and undistributed corporate profits.**

✗ **B)** wages and benefits, corporate profits, interest income, unincorporated business owners' income, rent, and indirect business taxes less subsidies.

✓ **C)** consumption spending, gross private domestic investment, government spending, and net exports.

Explanation

Under the expenditure approach, GDP is the sum of consumption, investment, government spending, and net exports. National income is the sum of wages and benefits, corporate profits, interest income, unincorporated business owners' income, rent, and indirect business taxes less subsidies. Personal income is the sum of national income and transfer payments to households, less corporate and indirect business taxes and undistributed corporate profits.

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Question ID: 472411

If both aggregate demand and short-run aggregate supply decrease, the price level:

✗ **A)** **will increase.**

✓ **B)** may increase or decrease.

✗ **C)** will decrease.

Explanation

The effect on the price level of decreases in both AD and SRAS depends on the relative size of the decreases in AD and SRAS. An increase in AD increases the price level, but an increase in SRAS tends to decrease the price level, so their combined effect could be an increase or a decrease in the price level.

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Question ID: 413738

A country's gross domestic product is:

✓ **A)** **equal to the country's aggregate income.**

✗ **B)** less than the country's aggregate income.

✗ **C)** greater than the country's aggregate income.

Explanation

Aggregate income and aggregate output (gross domestic product) must be equal for an economy as a whole.

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Question ID: 413743

If the GDP deflator is less than 100, then real GDP is:

✗ **A)** **equal to nominal GDP.**

✗ **B)** less than nominal GDP.

✓ **C)** greater than nominal GDP.

Explanation

The GDP deflator is calculated by dividing the value of nominal GDP by the value of real GDP. In most cases the GDP deflator is greater than 100; a value greater than 100 means prices have increased. A GDP deflator less than 100 shows that prices have decreased and the value of real GDP is greater than the value of nominal GDP.

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Question ID: 472410

If both aggregate demand and short-run aggregate supply increase, real GDP:

✓ **A)** **will increase.**

✗ **B)** will decrease.

✗ **C)** may increase or decrease.

Explanation

Increases in AD and SRAS both cause real GDP to increase. An increase in AD increases the price level, but an increase in SRAS tends to decrease the price level, so their combined effect could be an increase or a decrease in the price level.

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Question ID: 413777

A country's labor force is projected to decrease by 2% while its labor productivity is projected to increase by 3% per year. Based on these projections, the country's sustainable annual economic growth rate:

✗ **A)** **is negative.**

✓ **B)** is positive.

✗ **C)** depends on the proportions of labor and capital in production.

Explanation

Growth in potential GDP = growth in labor force + growth in labor productivity. In this example, -2% + 3% = 1% growth in potential GDP.

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Question ID: 413760

The long-run aggregate supply curve is:

✓ **A) inelastic because all input prices can vary.**

✗ **B)** perfectly elastic because input prices are fixed.

✗ **C)** elastic because input prices are sticky.

Explanation

The long-run aggregate supply curve is perfectly inelastic because in the long run all input prices change in proportion to the price level. Therefore the price level has no effect on long-run aggregate supply, which represents the level of potential GDP.

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Question ID: 413773

When potential real GDP is less than actual real GDP, the economy is *most likely* experiencing:

✗ **A) recession.**

✓ **B)** inflation.

✗ **C)** underemployment.

Explanation

The economy is in an inflationary phase if actual real GDP is greater than potential real GDP. When actual real GDP equals potential real GDP, the economy is said to be at full employment. The economy is in a recessionary phase if real GDP is less than potential GDP.

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Question ID: 413782

An economist wanting to determine the sources of an increase in a country's GDP using the production function approach would *most likely* investigate:

✗ **A) shifts in the aggregate supply curve.**

✗ **B)** increases in industrial production.

✓ **C)** growth in productivity, the labor force, and the capital stock.

Explanation

The production function approach relates a country's economic output to its inputs of capital and labor and its levels of productivity.

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Question ID: 413774

Stagflation refers to an environment of:

✓ **A) High unemployment and high inflation.**

✗ **B)** Low unemployment and high inflation.

✗ **C)** High unemployment and low inflation.

Explanation

Stagflation refers to an economic environment where high unemployment and high inflation exist at the same time.

Question #25 of 50

Question ID: 413778

The sustainable growth rate of an economy is *best* viewed as the sum of the growth rates of:

✓ **A) the labor force and productivity.**

✗ **B)** consumption and investment.

✗ **C)** private and government spending.

Explanation

The sustainable rate of economic growth can be estimated as the sum of the growth rate of the labor force and the growth rate of labor productivity.

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Question ID: 413767

Which of the following events is *least likely* to cause a decrease in short-run aggregate supply?

✓ **A) Inflation increases from 4% to 7%.**

✗ **B)** A labor stoppage causes the price of steel to rise.

✗ **C)** Oil exporting countries reduce their production levels.

Explanation

Changes in the price level represent movement along the short-run aggregate supply curve. The other items listed are events that are likely to shift the short-run aggregate supply curve to the left (decrease SRAS).

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Question ID: 413749

The difference between personal income and personal disposable income is:

✗ **A) fixed expenses.**

✗ **B)** savings.

✓ **C)** taxes.

Explanation

Personal disposable income equals personal income minus taxes.

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Question ID: 413764

When incomes in foreign countries increase, aggregate demand in the U.S. is *most likely* to:

✗ **A)** **decrease because foreign consumers will tend to buy fewer U.S. export goods.**

✓ **B)** increase because foreign consumers will tend to buy more U.S. export goods.

✗ **C)** decrease because U.S. interest rates will tend to increase.

Explanation

When incomes in foreign countries increase, it is unlikely to have a direct effect on interest rates in the U.S. However, increased foreign income is likely to result in greater foreign purchases of U.S. exports. Thus, aggregate demand in the U.S. is likely to increase.

Question #29 of 50

Question ID: 413783

Consider an economy in which labor's relative share of national income is 60%. For which of the following sources of economic growth will a 1% increase result in the largest increase in potential GDP?

✗ **A)** **Labor.**

✗ **B)** Capital.

✓ **C)** Technology.

Explanation

The contributions of technology, labor, and capital to potential GDP can be modeled as follows: Growth in potential GDP = growth in technology + W_L(growth in labor) + W_C(growth in capital), where W_L is labor's relative share of national income, W_C is capital's relative share of national income, and $W_L + W_C = 1$.

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Question ID: 413765

Which of the following factors is *most likely* to increase aggregate demand?

✗ **A)** **An expected decrease in future prices.**

✗ **B)** Increasing real interest rates.

✓ **C)** An increase in real wealth.

Explanation

While an increase in real wealth will shift the AD curve to the right, an increase in the real rate of interest will shift the AD curve to the left as consumers and businesses reduce their borrowing and spending. An expected decrease in prices will shift the AD curve to the left as households and businesses postpone their consumption in anticipation of lower prices in the future.

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Question ID: 413769

Which of the following choices *best* describes the effects on consumption, investment, and net exports that would result from an increase in the price level, other factors held constant?

	Consumption	Investment	Net exports
✓ **A)**	**Decrease**	**Decrease**	**Decrease**

✗ **B)**	Decrease	Increase	Increase
✗ **C)**	Increase	Increase	Increase

Explanation

At higher price levels, consumption, investment, and net exports all decrease. A rising price level decreases consumers' real wealth, so they consume less. The higher price level will increase interest rates, which causes business investment to decrease. Rising domestic prices will also reduce foreign purchases of the country's goods, decreasing net exports.

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Question ID: 413747

Components of national income include:

✗ **A)** **rent, interest income, and capital consumption allowance.**

✓ **B)** wages and benefits, corporate profits, and indirect business taxes less subsidies.

✗ **C)** government enterprise profits, unincorporated business net income, and statistical discrepancy.

Explanation

National income is the sum of employee wages and benefits, corporate and government enterprise profits before tax, interest income, unincorporated business owners' income, rental income, and indirect business taxes less subsidies. Capital consumption allowance is an estimate of depreciation during the measurement period. Statistical discrepancy is an adjustment to GDP when measured using the income approach, which accounts for differences from the data used to calculate GDP using the expenditure approach.

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Question ID: 413739

Gross domestic product includes the value of all goods:

✗ **A)** **produced and purchased during the measurement period.**

✓ **B)** produced during the measurement period.

✗ **C)** purchased during the measurement period.

Explanation

Gross domestic product (GDP) is the sum of the market values of all goods and services produced during a measurement period. Goods purchased during the measurement period that were produced earlier are not included in GDP. Goods produced during the measurement period but not purchased, such as goods produced for inventory, are included in GDP.

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Question ID: 413745

Nominal GDP is $562 billion and the GDP deflator is 119. Using base-year prices, real GDP is *closest to*:

✗ **A)** **$560 billion.**

✗ **B)** $440 billion.

✓ **C)** $470 billion.

Explanation

Real GDP = $562 billion / 1.19 = $472.27 billion.

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Question ID: 413740

Which of the following *least* accurately describes a component of gross domestic product?

✓ **A) Net imports.**

✗ **B)** Investment.

✗ **C)** Consumption.

Explanation

The components of GDP are consumption, investment, government spending, and net exports, which is exports minus imports.

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Question ID: 413761

The long-run aggregate supply curve is *best* described as:

✗ **A) perfectly elastic because input prices are sticky in the long run.**

✗ **B)** elastic because most input prices are variable in the long run.

✓ **C)** perfectly inelastic because input prices change proportionately with the price level in the long run.

Explanation

The long-run aggregate supply curve is perfectly inelastic because in the long run, wages and other input prices adjust to changes in the overall price level. Long-run aggregate supply equals potential GDP.

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Question ID: 413772

If the economy is in short-run disequilibrium below full employment, the *most likely* explanation is that:

✓ **A) aggregate demand has decreased.**

✗ **B)** money wage rates have decreased.

✗ **C)** long-run aggregate supply has decreased.

Explanation

A decrease in aggregate demand can reduce output below its full-employment level. A decline in long-run aggregate supply would mean the full-employment output level itself has decreased. Wage rates are assumed to be fixed in the short run, but the long-run effect of decreases in wage rates would be to increase (shift) short-run aggregate supply, leading to an increase in output.

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Question ID: 413780

In the production function approach to analyzing economic growth, total factor productivity accounts for:

- ✗ **A) capital deepening and any increase in the amount of capital available.**
- ✗ **B)** technological advances and growth of the labor force.
- ✓ **C)** output growth not attributable to growth in labor and capital.

Explanation

The production function as defined as Y = A × *f*(L, K) where Y is the aggregate output; L = quantity of labor; K = amount of capital available; and A = total factor productivity. Total factor productivity represents output growth not directly attributable to changes in the quantities of either labor or capital, and is thought to primarily reflect technological advances.

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Question ID: 413755

The IS curve illustrates the:

- ✗ **A) inverse relationship between income and the price level.**
- ✓ **B)** inverse relationship between real interest rates and income.
- ✗ **C)** direct relationship between investment and savings.

Explanation

The IS curve slopes downward and shows an inverse relationship between real interest rates and income equilibria.

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Question ID: 413766

Which of the following factors is *most likely* to increase long-run aggregate supply?

- ✗ **A) Wage rates increase.**
- ✗ **B)** Aggregate demand decreases.
- ✓ **C)** The average rate of labor productivity increases.

Explanation

Factors that shift the long-run aggregate supply curve (LAS) to the right include improvements in technology and productivity, increases in the supply of resources, and institutional changes that increase the efficiency of resource use. An increase in the productivity of the average worker is likely to shift the LAS curve to the right. Wage rate changes shift the short-run aggregate supply curve (SAS) but not the LAS curve. A decline in consumer demand would represent a move down the LAS curve but not a shift in LAS.

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Question ID: 454994

From an initial long-run equilibrium, an increase in aggregate demand combined with a decrease in short-run aggregate supply will *most likely* result in:

✗ **A)** **a lower price level.**

✓ **B)** a higher price level.

✗ **C)** higher real GDP.

Explanation

Both an increase in aggregate demand and a decrease in short-run aggregate supply increase the price level. Their combined effect on real GDP depends on the magnitudes of the changes in AD and SRAS.

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Question ID: 413771

Which of the following is *most likely* to cause an increase in aggregate demand?

✗ **A)** **An increase in the general price level.**

✓ **B)** High capacity utilization rates.

✗ **C)** Relative appreciation in the country's currency.

Explanation

As capacity utilization rates increase to high levels (typically 80% to 85%), business investment in plant and equipment increases, shifting the AD curve to the right. A change in the price level represents a movement along the demand curve, not a shift in it. Appreciation of the country's currency increases the cost of exports and reduces the cost of imports, which shifts the aggregate demand curve to the left (net exports decrease).

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Question ID: 413750

If private saving equals private business investment, a trade surplus implies that there is:

✗ **A)** **no fiscal surplus or deficit.**

✗ **B)** a fiscal deficit.

✓ **C)** a fiscal surplus.

Explanation

The fundamental relationship among saving, investment, the fiscal balance, and the trade balance is stated as: (G - T) = (S - I) - (X - M). If S = I, this equation becomes (G - T) = - (X - M), or (T - G) = (X - M). In this case, if the trade balance is in surplus (exports are greater than imports), the fiscal balance must also be in surplus (taxes are greater than government spending).

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Question ID: 413779

Sources of long-run economic growth *most likely* include increases in:

✓ **A)** **labor supply, physical capital, and technology.**

✗ **B)** government spending, labor supply, and physical capital.

✗ **C)** human capital, money supply, and natural resources.

Explanation

Sources of sustainable long-run economic growth (increases in long-run aggregate supply) include increases in the labor force, human capital (the education and skill level of the labor force), the stock of physical capital, the supply of natural resources, and the level of technology. Increases in the money supply or government spending increase aggregate demand but do not increase long-run aggregate supply.

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Question ID: 413753

If the government is running a budget deficit, which of the following relationships are *least likely* to occur in the economy at the same time?

	Exports relative to imports	Savings relative to investment
✗ **A)**	**exports < imports**	**private savings > private investment**
✓ **B)**	exports > imports	private savings < private investment
✗ **C)**	exports < imports	private savings < private investment

Explanation

A government budget deficit, a trade surplus, and an excess of private investment over private savings cannot all occur at the same time. If the government runs a budget deficit, the deficit must be financed by a trade deficit (exports < imports), surplus private savings (private savings > private investment), or both.

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Question ID: 413754

Total investment is one of the components of a country's GDP. Which of the following is *least likely* to be considered a source of funds for investment?

✗ **A) Foreign borrowing.**
✓ **B)** Household expenditures.
✗ **C)** National savings.

Explanation

Total investment is one of the major components of GDP (the others are consumption, government spending, and net exports). Investment is defined as expenditures allocated to fixed assets and inventory. The sources of funds for investment are national savings, foreign borrowing, and government savings.

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Question ID: 413758

Which of the following is *least likely* a reason that the aggregate demand curve slopes downward?

✗ **A) The wealth effect causes consumers to spend less when the price level rises.**
✓ **B)** Because entitlements are adjusted for inflation, a rising price level forces government spending to increase.

✗ **C)** Business investment declines as a rising price level increases interest rates.

Explanation

The aggregate demand curve plots real GDP against the price level. Rising entitlement payments that result from an increasing price level affect nominal GDP, but not real GDP. Both remaining choices describe reasons why the consumption and investment components of real GDP decrease when the price level increases.

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Question ID: 413746

The GDP deflator is the percentage difference between:

- ✗ **A) GDP calculated using the income and expenditure approaches.**
- ✓ **B)** nominal GDP and real GDP.
- ✗ **C)** GDP calculated using the value-of-final-output method and the sum-of-final-output method.

Explanation

The GDP deflator is the percentage difference between nominal GDP and real GDP, reflecting inflation since the base period.

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Question ID: 413776

An increase in aggregate demand can result in output greater than potential GDP in:

- ✓ **A) the short run only.**
- ✗ **B)** the short run and the long run.
- ✗ **C)** neither the short run nor the long run.

Explanation

From long-run equilibrium, an increase in aggregate demand can result in short-run equilibrium output greater than potential GDP. However, this above-full-employment output cannot be sustained in the long run because upward pressure on input costs (e.g., wages) will decrease short-run aggregate supply, decreasing output back to the full-employment level in the long run.

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Question ID: 413751

The relationship between savings (S), investment (I), government spending (G), government tax revenue (T), exports (X), and imports (M) is:

- ✗ **A) (G − T) = (S − I) + (X − M).**
- ✓ **B)** (S − I) = (G − T) + (X − M).
- ✗ **C)** (X − M) = (S − I) + (G − T).

Explanation

The fundamental relationship of saving to investment, the fiscal balance, and the trade balance is S = I + (G − T) + (X − M), or (S − I) = (G − T) + (X − M). This relationship can be solved for the fiscal balance, (G − T) = (S − I) − (X − M), or for the trade balance, (X − M) = (S − I) − (G − T).