ECO 120: Global Macroeconomics **Name (8 points):** ____________________
Instructor: James M. Murray, PhD
Practice Exam 3

Multiple-Choice: 2 points each. Choose the response that best answers each question.

1. Suppose when consumers receive an additional \$225 of income, on average they increase their spending by \$180. What is the marginal propensity to save?

   (a) 0.2

   (b) \$45

   (c) \$180

   (d) 0.8

2. Which of the following leads to a higher expenditure multiplier effect?

   (a) Increase in the marginal propensity to import

   (b) Decrease in the marginal propensity to consumer

   (c) Decrease in the marginal propensity to save

   (d) Increase in aggregate supply

3. When consumers decide to spend more of their additional income on imports, what happens to the expenditure multiplier?

   (a) Multiplier increases

   (b) Multiplier stays the same because additional expenditure stays the same

   (c) Multiplier decreases

   (d) The mutliplier may increase or decrease

4. Suppose consumers expect higher income in the future? What would be the effect of the expectation on aggregate expenditure plans in the present period?

   (a) Increase in aggregate expenditure

   (b) No change in aggregate expenditure until income increases

   (c) Aggregate expenditure may increase or decrease.

   (d) Decrease in aggregate expenditure until income increases

5. Suppose a gloomy economic outlook causes businesses' investment spending to decrease by \$50bn. Which of the following is an accurate description of the expenditure multiplier effect?

    (a) In the long-run, real GDP will decrease by more than \$50bn.

    (b) Real GDP will not change until the long-run

    (c) In the short-run, real GDP will decrease by less than \$50bn

    (d) In the short-run, real GDP will decrease by more than \$50bn

6. Suppose interest rates increase. Which of the following changes in expenditure plans are likely as a result?

    (a) Increase in exports

    (b) Decrease in consumption

    (c) Increase in investment

    (d) Increase in real GDP

7. Which of the following is true regarding investment and interest rates?

    (a) Investment spending depends negatively on interest rates

    (b) Investment spending increases when interest rates increase

    (c) Investment spending is more productive with higher interest rates

    (d) Investment spending depends positively on interest rates

8. Suppose there is an unexpected decrease in business inventories. What will be the impact on inventory investment?

    (a) Inventory investment spending decreases

    (b) Inventory investment spending increases

    (c) Inventory investment may increase or decrease

    (d) Inventory investment will only change when inventories are gone

9. If sales unexpectedly increase, what is the impact on business inventories?

    (a) Inventories may increase or decrease

    (b) Inventories decrease

    (c) Inventories do not change

    (d) Inventories increase

10. Suppose when consumers receive \$300 of additional income, consumption spending increases by \$250 and import spending increases by \$50. What is the expenditure multiplier?

    (a) 0.167

    (b) 3

    (c) 1

    (d) 0.33

11. Suppose when consumers receive \$120 of additional income, consumption spending increases by \$85 and import spending increases by \$15. What is the expenditure multiplier?

    (a) 1.2

    (b) 0.833

    (c) 0.417

    (d) 2.4

12. Suppose a war ends leading to a decrease in expenditures on military equipment and weapons. How does this affect government spending and aggregate demand?

    (a) Government spending decreases and aggregate demand shifts to the left.

    (b) Government spending decreases and aggregate demand shifts to the right.

    (c) Government spending increases and aggregate demand shifts to the left.

    (d) Government spending increases and aggregate demand shifts to the right.

13. Which of the following is upward sloping with respect to the aggregate price level?

    (a) Aggregate demand

    (b) Short-run aggregate supply

    (c) Long-run aggregate supply

    (d) Both short-run and long-run aggregate supply

14. Which of the following leads to a leftward shift in the aggregate supply curve?

    (a) Increase in prices for final goods and services

    (b) Increase in global energy prices

    (c) Decrease in aggregate demand

    (d) Decrease in wages

15. Suppose consumers expect taxes to decrease in the future. Which of the following would happen in the present as a result?
    (a) Aggregate demand shifts to the right.
    (b) Aggregate supply shifts to the right.
    (c) Aggregate demand shifts to the left.
    (d) Nothing

16. Why does the short-run aggregate supply curve shift to the right in the long run, following a decrease in aggregate demand?
    (a) Workers and firms adjust their expectations of wages and prices upward and they push for higher wages and prices.
    (b) Workers and firms adjust their expectations of wages and prices downward and they accept lower wages and prices.
    (c) Workers and firms adjust their expectations of wages and prices downward and they push for higher wages and prices.
    (d) Workers and firms adjust their expectations of wages and prices upward and they accept lower wages and prices.

17. To stimulate the economy in 2020 in response to the COVID-19 health and economic crisis, Congress passed a stimulus package resulting in government spending increases and tax reductions for consumers. Which of the following should be the result?
    (a) Aggregate supply shifts to the right and real GDP decreases.
    (b) Aggregate demand shifts to the right and real GDP increases.
    (c) Aggregate demand shifts to the left and real GDP decreases.
    (d) Aggregate supply shifts to the right and real GDP increases.

18. Which of the following results in a leftward shift in real money demand?
    (a) Improvement in financial technology
    (b) Increase in income
    (c) Decrease in the interest rate
    (d) Increase in the interest rate

19. Which of the following monetary policies lead to an increase in the interest rate?
    (a) Decrease in government expenditures
    (b) Increase in money supply
    (c) Increase in taxes
    (d) Decrease in money supply

20. If the central bank wishes to decrease the price level, which monetary policy should it use?

   (a) Increase money supply

   (b) Decrease taxes

   (c) Decrease money supply

   (d) Increase taxes

21. Suppose the interest rate increases. Which of the following would be the effect on the market for final goods and services?

   (a) Consumption demand and investment demand both decrease, causing the aggregate demand curve to shift to the left.

   (b) Consumption demand and investment demand both decrease, causing both the aggregate demand and aggregate supply curves to shift to the left.

   (c) Consumption demand and investment demand both decrease, causing the aggregate supply curve to shift to the left.

   (d) Consumption demand and investment demand both increase, causing both the aggregate demand and aggregate supply curves to shift to the right.

22. Which of the following variables do not change in response to the interest rate?

   (a) Consumption demand

   (b) Aggregate demand

   (c) Money supply

   (d) Money demand

23. Suppose consumers decide to increase their expenditures on imports. All other things remaining the same, what is the impact on the market for final goods and services?

   (a) Aggregate supply shifts to the right and real GDP increases.

   (b) Aggregate demand shifts to the left and real GDP decreases.

   (c) Aggregate demand shifts to the right and real GDP increases.

   (d) Aggregate supply shifts to the left and real GDP decreases.

24. Suppose incomes decrease abroad leading to a decrease in sales abroad. All other things remaining the same, what is the impact on the market for final goods and services?

   (a) Exports increase, aggregate demand increases, and real GDP increases

   (b) Imports decrease, aggregate demand decreases, and real GDP decreases

   (c) Exports decrease, aggregate supply decreases, and real GDP decreases

   (d) Exports decrease, aggregate demand decreases, and real GDP decreases

25. Suppose the economy is at the long-run equilibrium when a drop in consumer confidence leads to a decrease in consumption demand. What are the short-run and long-run effects on real GDP?

    (a) Real GDP decreases in the short-run and increases back to its previous level in the long-run.

    (b) Real GDP increases in the short-run and increases back to its previous level in the long-run.

    (c) Real GDP decreases in both the short-run and the long-run.

    (d) Real GDP increases in the short-run but decreases in the long-run.

Short-Answer Problem-Solving Questions: 6 points each. Write your answer in the space provided. The instruction to "illustrate" means use a graphical economics model. The instruction to "describe" means to give a short explanation for any changes in the model (i.e. a shifting curve), and describe the final result.

26. Suppose that when there is an increase in income of \$100, consumer spending increases by \$85 and spending on imports, in particular, increases by \$5. Unfortunately, a drop in consumer confidence resulted in a decrease in consumer spending by \$125 billion. Compute the short-run impact on real GDP.

27. Suppose the economy is in recession, where real GDP is currently \$22 trillion and potential GDP is \$24 trillion. The government would like to pass a stimulus package to increase real GDP back to potential GDP. The marginal propensity to consume is 0.90 and the marginal propensity to import is 0.15. How much should the increase in government expenditures be?

28. Suppose the economy is at the long-run equilibrium when a change in exchange rates leads to an increase in imports. Describe and illustrate the ***short-run*** impact on equilibrium real GDP and price level.

29. Suppose the economy is at the long-run equilibrium when there is an increase in global energy prices. Describe and illustrate the ***short-run*** impact on equilibrium real GDP and price level.

30. Suppose the economy is initially at the long-run equilibrium when there is a decrease in government expenditures. Describe and illustrate ***both*** the ***short-run and long-run*** effects on equilibrium real GDP and price level.

31. Suppose the economy is initially at the long-run equilibrium when the Fed decides to print less money. Describe and illustrate the ***short-run*** effects on the equilibrium interest rate, real GDP, and price level.

32. Suppose the economy is in recession (real GDP is below potential GDP). Suggest a monetary policy to bring the economy out of recession. Describe and illustrate the impact on the equilibrium quantity of money, interest rate, real GDP, and price level.