AD/AS Model Practice Problems

1. The basic aggregate demand and aggregate supply curve model helps explain
A) fluctuations in real GDP and the price level.
B) long-term growth.
C) price fluctuations in an individual market.
D) output fluctuations in an individual market.

2. The ________ shows the relationship between the price level and quantity of real GDP demanded.
A) consumer price index
B) aggregate expenditure line
C) 45-degree line
D) aggregate demand curve

3. Because of the slope of the aggregate demand curve, we can say that
A) a decrease in the price level leads to a lower level of real GDP demanded.
B) an increase in the price level leads to no change in the level of real GDP demanded.
C) a decrease in the price level leads to a higher level of real GDP demanded.
D) an increase in the price level leads to a higher level of real GDP demanded.

4. Which of the following best describes the "wealth effect"?
A) When the price level falls, the real value of household wealth falls.
B) When the price level falls, the nominal value of household wealth falls.
C) When the price level falls, the nominal value of household wealth rises.
D) When the price level falls, the real value of household wealth rises.

5. The "interest rate effect" can be described as an increase in the price level that raises the interest rate and chokes off
A) government spending.
B) government spending and unplanned investment.
C) investment and consumption spending.
D) net exports.

6. The international trade effect states that
A) an increase in the price level will raise net exports.
B) an increase in the price level will lower net exports.
C) an increase in the price level will raise exports.
D) an increase in the price level will lower imports.
7. An increase in the price level results in a(n) ________ in the quantity of real GDP demanded because ________.
A) decrease; a higher price level reduces consumption, investment, and net exports.
B) increase; a higher price level reduces consumption, investment, and net exports.
C) decrease; a higher price level increases consumption, investment, and net exports.
D) increase; a higher price level increases consumption, investment, and net exports.

8. The recession of 2007-2009 made many consumers pessimistic about their future incomes. How does this increased pessimism affect the aggregate demand curve?
A) This will move the economy up along a stationary aggregate demand curve.
B) This will move the economy down along a stationary aggregate demand curve.
C) This will shift the aggregate demand curve to the left.
D) This will shift the aggregate demand curve to the right.

9. Which of the following will shift the aggregate demand curve to the right, ceteris paribus?
A) an increase in interest rates
B) a decrease in disposable income
C) a decrease in expected profits for firms
D) an increase in net exports

10. If the U.S. dollar decreases in value relative to other currencies, how does this affect the aggregate demand curve?
A) This will move the economy up along a stationary aggregate demand curve.
B) This will move the economy down along a stationary aggregate demand curve.
C) This will shift the aggregate demand curve to the left.
D) This will shift the aggregate demand curve to the right

11. How do lower taxes affect aggregate demand?
A) They increase disposable income, consumption, and aggregate demand.
B) They reduce disposable income, consumption, and aggregate demand.
C) They decrease corporate investment and aggregate demand.
D) They increase aggregate supply and thus increase aggregate demand as well
12. **Refer to the above figure.** *Ceteris paribus,* an increase in the price level would be represented by a movement from
A) $AD_1$ to $AD_2$.
B) $AD_2$ to $AD_1$.
C) point $A$ to point $B$.
D) point $B$ to point $A$.

13. **Refer to the above figure.** *Ceteris paribus,* an increase in interest rates, unrelated to a change in the price level, would be represented by a movement from
A) $AD_1$ to $AD_2$.
B) $AD_2$ to $AD_1$.
C) point $A$ to point $B$.
D) point $B$ to point $A$.

14. **Refer to the above figure.** *Ceteris paribus,* an increase in personal income taxes would be represented by a movement from
A) $AD_1$ to $AD_2$.
B) $AD_2$ to $AD_1$.
C) point $A$ to point $B$.
D) point $B$ to point $A$.

15. **Refer to the above figure.** *Ceteris paribus,* a decrease in government spending would be represented by a movement from
A) $AD_1$ to $AD_2$.
B) $AD_2$ to $AD_1$.
C) point $A$ to point $B$.
D) point $B$ to point $A$. 
16. Full-employment GDP is also known as
A) realized GDP.
B) potential GDP.
C) politico-economic GDP.
D) balanced-budget GDP.

17. The level of aggregate supply in the long run is *not* affected by
A) changes in technology.
B) changes in the capital stock.
C) changes in the price level.
D) changes in the number of workers.

18. The long-run aggregate supply curve will shift to the right if
A) the economy experiences technological change.
B) there is a decrease in population.
C) the economy experiences high levels of inflation.
D) net exports decrease.

19. Suppose a developing country receives more machinery and capital equipment as foreign entrepreneurs increase the amount of investment in the economy. As a result,
A) the long-run aggregate supply curve will shift to the right.
B) the long-run aggregate supply curve will shift to the left.
C) the economy will move up along the long-run aggregate supply curve.
D) the economy will move down along the long-run aggregate supply curve.

20. Which aggregate supply curve has a positive slope?
A) long run only
B) short run only
C) both long run and short run
D) neither long run nor short run

21. The short-run aggregate supply curve has a(n) ________ slope because as prices of ________ rise, prices of ________ rise more slowly.
A) positive; final goods and services; inputs
B) infinite; final goods and services; inputs
C) positive; inputs; final goods and services
D) infinite; inputs; final goods and services
22. The invention of the cotton gin ushered in the Industrial Revolution and began a long period of technological innovation. What did this technological change do to the short-run supply curve?
A) It shifted the short-run aggregate supply curve to the left.
B) It shifted the short-run aggregate supply curve to the right.
C) It moved the economy up along a stationary short-run aggregate supply curve.
D) It moved the economy down along a stationary short-run aggregate supply curve.

23. Hurricane Katrina destroyed oil and natural gas refining capacity in the Gulf of Mexico which subsequently drove up natural gas, gasoline, and heating oil prices. Three years later, once the refining capacity was restored, these prices came back down. The restoration of refining capacity should
A) shift the short-run aggregate supply curve to the left.
B) shift the short-run aggregate supply curve to the right.
C) move the economy up along a stationary short-run aggregate supply curve.
D) move the economy down along a stationary short-run aggregate supply curve.

24. Refer to the above figure. Ceteris paribus, an increase in the labor force would be represented by a movement from
A) SRAS1 to SRAS2.
B) SRAS2 to SRAS1.
C) point A to point B.
D) point B to point A.

25. Refer to the above figure. Ceteris paribus, a decrease in the capital stock would be represented by a movement from
A) SRAS1 to SRAS2.
B) SRAS2 to SRAS1.
C) point A to point B.
D) point B to point A.
26. **Refer to the above figure.** *Ceteris paribus,* an increase in the price level would be represented by a movement from
A) $SRAS_1$ to $SRAS_2$.
B) $SRAS_2$ to $SRAS_1$.
C) point $A$ to point $B$.
D) point $B$ to point $A$.

27. Long-run macroeconomic equilibrium occurs when
A) aggregate demand equals short-run aggregate supply.
B) aggregate demand equals short-run aggregate supply and they intersect at a point on the long-run supply curve.
C) structural and frictional unemployment equals zero.
D) output is above potential GDP.

28. When the aggregate demand curve and the short-run aggregate supply curve intersect,
A) the long-run aggregate supply curve must also intersect at the same point.
B) inflation must be increasing.
C) structural and frictional unemployment equal zero.
D) the economy is in short-run macroeconomic equilibrium.

29. Interest rates in the economy have fallen. How will this affect aggregate demand and equilibrium in the short run?
A) Aggregate demand will rise, the equilibrium price level will rise, and the equilibrium level of GDP will rise.
B) Aggregate demand will rise, the equilibrium price level will fall, and the equilibrium level of GDP will rise.
C) Aggregate demand will fall, the equilibrium price level will fall, and the equilibrium level of GDP will fall.
D) Aggregate demand will fall, the equilibrium price level will rise, and the equilibrium level of GDP will fall.

30. If the short-run aggregate supply increases by less than the long-run aggregate supply, then, at the short-run equilibrium,
A) GDP will be below potential GDP.
B) aggregate demand will increase.
C) GDP will be above potential GDP.
D) GDP will be equal to potential GDP.
31. A negative supply shock in the short run causes
A) the aggregate supply curve to shift to the left.
B) the price level to fall.
C) unemployment to fall.
D) equilibrium real GDP to rise.

32. Which of the following is considered a negative supply shock?
A) increasing immigration in the economy causes the labor supply to rise
B) an improvement in technology
C) an increase in unemployment
D) an unexpected decrease in the refining capacity for oil

33. A decrease in aggregate demand results in a(n) ________ in the ________.
A) recession; long run
B) expansion; long run
C) expansion; short run
D) recession; short run

34. In the dynamic aggregated demand and aggregate supply model, if AD shifts faster than AS,
A) inflation occurs.
B) deflation occurs.
C) stagflation occurs.
D) disinflation occurs.

Key

7. A  19. A  31. A
8. C  20. B  32. D
10. D  22. B  34. A
11. A  23. B
12. D  24. A