

Week #10 Worksheet Solutions – Loanable F. M. ~ Classical vs. Keynesian

1. If aggregate demand and supply are both increasing,
 - a. real GDP will not change.
 - b. the price level may not change.**
 - c. real GDP will definitely be decreasing.
 - d. the price level will definitely be decreasing.
 - e. the price level will definitely be increasing.

2. An increase in aggregate quantity demanded could be caused by
 - a. a decrease in liquid assets held by households (caused, for example, by a boom in stock market prices).
 - b. an increase in oil prices.
 - c. a decrease in personal income.
 - d. consumer expectations of lower prices in the future.
 - e. a decline in the price level.**

3. An economic contraction can be caused by an increase in
 - a. household wealth.
 - b. investment demand.
 - c. real interest rates.**
 - d. government purchases.

4. Consumers decide to increase their level of saving to repay a larger portion of household debt. What happens?
 - a. Aggregate supply decreases, causing equilibrium GDP to decline.
 - b. Aggregate demand increases, causing the recessionary GDP gap to diminish.
 - c. Aggregate demand shifts to the right, causing a higher equilibrium real GDP.
 - d. Aggregate demand declines, resulting in lower levels of real output and employment.**
 - e. Aggregate supply and aggregate demand both decrease, causing equilibrium GDP to decline.

5. If aggregate supply decreases while aggregate demand simultaneously increases,
 - a. the price level will decline, but we cannot predict what will happen to equilibrium real GDP.
 - b. equilibrium real GDP will increase, but we cannot predict what will happen to the price level.
 - c. the price level will rise.**
 - d. equilibrium real GDP will decline and the price level will remain unchanged.
 - e. the price level and equilibrium real GDP will both remain unchanged.

6. A rise in input prices will cause
 - a. an outward shift in aggregate supply.
 - b. a downward movement along the aggregate supply curve.
 - c. an inward shift in aggregate supply.**
 - d. an upward movement along the aggregate supply curve.
 - e. None of the above

7. An increase in productivity will most likely
- cause an increase in aggregate demand and aggregate supply.
 - cause an increase in aggregate demand.
 - have no effect on aggregate supply or aggregate demand.
 - cause an increase in aggregate supply.
 - None of the above.
8. Starting initially at potential real GDP, an increase in aggregate demand shifts the aggregate demand curve _____, causing real GDP to _____ and the price level to _____.
- outward, rise, fall
 - inward, fall, fall
 - inward, fall, rise
 - outward, fall, fall
 - outward, rise, rise
9. If the stock market crashes, reducing real wealth, at the same time that energy prices are falling, what will likely happen to real GDP and the price level?
- The price level falls, but the change in real GDP is indeterminate.
 - Real GDP and the price level fall.
 - Real GDP rises, but the price level falls.
 - Real GDP falls, but the change in the price level is indeterminate.
10. The classicists argued that an increase in aggregate demand would _____ in the short run, but in the long run real GDP would _____.
- decrease aggregate supply, rise
 - increase real GDP, return to its potential level
 - increase real GDP, rise further causing inflation
 - decrease real GDP, increase
11. John Maynard Keynes argued that
- downward nominal-wage rigidity prevented the classical self-correction mechanism from working to eliminate recessionary GDP gaps.
 - the automatic forces of the market would restore the economy to full employment very quickly.
 - the classical macroeconomic argument that government spending should be used in recessions wouldn't eliminate a recessionary GDP gap.
 - fluctuations in aggregate demand were the primary cause of recessions.
 - Both (a) and (d).
12. If an economy is currently operating at its potential level of real GDP, an increase in aggregate demand will
- increase the price level and produce an inflationary gap.
 - cause stagflation.
 - produce long-run economic growth.
 - decrease the price level and produce a recessionary gap.
13. Which of the following shift the long-run aggregate supply curve rightward?
- Improvements in technology
 - Improvements in the efficiency with which resources are used
 - Increases in the quantity of resources available to a nation
 - Increases in the productivity of productive resources
 - All of the above.