ECON 2630 – Practice Problems 7

1. The multiplier effect
   a. tells us nothing about how increases in investment spending affect GDP
   b. tells us that a change in investment spending changes equilibrium GDP by more than the change in investment
   c. works only for increases in investment
   d. is relevant only in situations where the marginal propensity to consume cannot be determined

2. Which of the following would shift the aggregate expenditure line upward?
   a. an increase in labor supply
   b. a decrease in labor demand
   c. a decrease in government spending
   d. a decrease in net exports
   e. an increase in autonomous consumption spending

3. If the MPC is 0.8 and disposable income shrinks by $100 million. Consumption would
   a. rise by $8 million
   b. rise by $80 million
   c. fall by $80 million
   d. fall by $8 million

4. If the marginal propensity to consume is 0.75 and net exports decrease by $200 billion, by how much will equilibrium output decrease?
   a. $0
   b. $150 billion
   c. $200 billion
   d. $266.7 billion
   e. $800 billion

5. If investment spending decreased by $1,000 billion and as a result the equilibrium GDP decreased by 2,500 billion, what will be the value of MPC?
   a. 0.5
   b. 0.6
   c. 0.75
   d. 0.8

6. Why is the effect of saving controversial to economists?
    a. Increased saving always has an unambiguously positive effect on the economy.
    b. Increased saving always has an unambiguously negative effect on the economy.
    c. Increased saving may hurt the economy in the short run but help it in the long run.
    d. Decreased saving my hurt the economy in the short run but help it in the long run.

7. What must the change in taxes have been if GDP increased by $300 billion and the marginal propensity to consume is 0.8?
    a. Taxes must have increased by $60 billion.
    b. Taxes must have been decreased by $60 billion.
    c. Taxes must have been decreased by $75 billion.
    d. Taxes must have been increased by $75 billion.

8. Automatic stabilizers reduce fluctuations in GDP by
    a. eliminating spending shocks
    b. increasing the amount of spending each year
    c. reducing the additional spending that occurs in each round of the multiplier
    d. increasing saving
    e. reducing the need for government involvement in the economy

9. Which of the following is *not* an automatic stabilizer?
    a. forward-looking behavior
    b. interest rates
    c. imports
    d. transfer payments
    e. consumption spending

10. The reason the short-run macro model suggests that the economy can operate either above or below its potential while in the long-run classical model the economy operates automatically at full employment is that
    a. the short-run macro model is flawed and inaccurate
    b. the classical model is flawed and inaccurate
    c. the two models measure completely different aspects of the economy
    d. in the short run, spending affects output, but not in the long run
    e. in the short run the role of government in helping the economy return to equilibrium is not considered