University of Central Florida (UCF) ECO3203 Intermediate Macroeconomics Practice Exam 1 (Sample)

Study Guide

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<u>Questions</u>

1. How does long-run aggregate supply (LRAS) differ from the SRAS?
   A. LRAS is upward sloping; SRAS is vertical
   B. LRAS is vertical; SRAS is upward sloping
   C. LRAS reflects short-term changes; SRAS is constant
   D. LRAS represents total savings; SRAS represents total production

2. Which of the following is NOT a factor influencing aggregate demand?
   A. Investment spending
   B. Government spending
   C. Changes in labor productivity
   D. Net exports

3. In a large open economy, if an import quota is adopted, then:
   A. Net exports remain unchanged, as imports and exports decrease by equal amounts, while the real exchange rate rises.
   B. Net exports remain unchanged, as imports and exports decrease by equal amounts, while the real exchange rate falls.
   C. Net exports rise and the real exchange rate rises.
   D. Net exports rise and the real exchange rate falls.

4. What signifies a robust economy during a year, according to indicators such as unemployment rates?
   A. High levels of unemployment
   B. Stable or falling unemployment rates
   C. Escalating inflation rates
   D. Declining GDP growth

5. To increase the money supply, the Federal Reserve:
   A. buys government bonds.
   B. sells government bonds.
   C. buys corporate stocks.
   D. sells corporate stocks.

6. How can taxes affect aggregate supply?

A. Higher taxes can encourage business production

B. Taxes do not influence production costs

C. Lower taxes can reduce incentives for investment

D. Higher taxes can reduce incentives for businesses to invest

7. What does observing the market for haircuts tell us about price adjustments?

A. Prices are fixed and do not change.

B. Prices remain static in economic downturns.

C. Prices slowly approach the market-clearing equilibrium.

D. Prices can change wildly without notice.

8. What does an increase in taxes usually lead to?

A. Higher consumer spending

B. Decreased money supply

C. Lower government revenues

D. Decrease in aggregate demand

9. What is demand-pull inflation?

A. Inflation resulting from rising production costs

B. Inflation that occurs due to excess demand over supply

C. Inflation that is influenced by government monetary policy

D. Inflation caused by decreased consumer confidence

10. What does Quantitative Easing aim to achieve?

A. Reduce government spending

B. Stimulate the economy by increasing the money supply

C. Control inflation by tightening the money supply

D. Eliminate unemployment

Answers

1. B
2. C
3. A
4. B
5. A
6. D
7. C
8. D
9. B
10. B

Explanations

1. How does long-run aggregate supply (LRAS) differ from the SRAS?

A. LRAS is upward sloping; SRAS is vertical

B. LRAS is vertical; SRAS is upward sloping

C. LRAS reflects short-term changes; SRAS is constant

D. LRAS represents total savings; SRAS represents total production

Long-run aggregate supply (LRAS) is vertical because it represents the economy's potential output when all resources are fully utilized, which is not influenced by the price level. In the long run, the economy operates at full employment, meaning that the amount of goods and services produced is determined by factors such as technology, resources, and labor force rather than by the price level. On the other hand, short-run aggregate supply (SRAS) is upward sloping. This reflects how in the short run, the output can increase with higher prices due to factors such as fixed wages and contracts, which may not allow for immediate adjustments. As prices rise, firms are incentivized to increase production since they can cover their variable costs more easily, leading to an increase in output. Understanding this distinction is critical for analyzing how economies adjust to shocks and changes in policy in both the short and long terms. The vertical nature of LRAS signifies that, in the long run, the economy's capacity is determined by real factors and is not affected by inflationary pressures, highlighting the importance of viewing economic performance beyond short-term fluctuations.

2. Which of the following is NOT a factor influencing aggregate demand?

A. Investment spending

B. Government spending

C. Changes in labor productivity

D. Net exports

In macroeconomics, aggregate demand refers to the total demand for goods and services in an economy at a given overall price level and in a given time period. Factors that influence aggregate demand include consumption, investment spending, government spending, and net exports. Investment spending by businesses affects aggregate demand directly as it reflects the spending on capital goods that contribute to future production. Government spending also plays a significant role in influencing aggregate demand since it includes expenditure on public services, infrastructure, and other government projects that directly stimulate economic activity. Net exports, which represent the difference between a country's exports and imports, also influence aggregate demand since a surplus in net exports contributes positively while a deficit detracts from it. In contrast, changes in labor productivity do not directly influence aggregate demand. While increased labor productivity can lead to higher output and, over time, may influence potential GDP and economic growth, it primarily affects the supply side of the economy. Labor productivity improvements mean that the economy can produce more goods with the same amount of labor, but it doesn't inherently change the aggregate demand within a specific timeframe. Therefore, it is categorized differently from the direct components that constitute aggregate demand, making it the correct answer to the question.

3. In a large open economy, if an import quota is adopted, then:

A. Net exports remain unchanged, as imports and exports decrease by equal amounts, while the real exchange rate rises.

B. Net exports remain unchanged, as imports and exports decrease by equal amounts, while the real exchange rate falls.

C. Net exports rise and the real exchange rate rises.

D. Net exports rise and the real exchange rate falls.

When an import quota is imposed in a large open economy, it restricts the quantity of goods that can be imported. In this scenario, the quota limits imports directly. As a result, the supply of imports decreases while the demand for domestic goods may remain the same, which can lead to a rise in the price of domestically produced goods, ultimately affecting exports as well. Under the circumstances of the quota, it's important to note that with imports restricted, the balance of trade might not necessarily shift drastically in the short term. Since the quota limits imports, domestic consumption may not fall by the same amount, and if exports decrease simultaneously or no change occurs, net exports can remain unchanged. However, since the quota creates less competition for domestic products, the price of these products tends to increase, which could lead to a rise in the real exchange rate. Thus, the assertion that net exports remain unchanged while the real exchange rate rises is accurate. This illustrates how quotas can quiet a significant shift in net exports, stabilizing it under certain conditions, while still affecting the prices and values in the economy.

4. What signifies a robust economy during a year, according to indicators such as unemployment rates?

A. High levels of unemployment

B. Stable or falling unemployment rates

C. Escalating inflation rates

D. Declining GDP growth

A robust economy is typically indicated by stable or falling unemployment rates. When unemployment is low or decreasing, it suggests that more individuals are able to find work, leading to higher disposable income, increased consumer spending, and overall economic growth. A declining unemployment rate is often associated with businesses thriving, driving higher production and potentially increasing wages as companies compete for workers. In contrast, high levels of unemployment would signify economic distress, as a larger portion of the population would be without jobs, reducing overall economic activity. Escalating inflation rates can point to an overheated economy but may not reflect a healthy growth dynamic. Lastly, declining GDP growth usually indicates a weakening economy, not a robust one. Therefore, the presence of stable or falling unemployment is a key indicator of economic strength.

5. To increase the money supply, the Federal Reserve:

A. buys government bonds.

B. sells government bonds.

C. buys corporate stocks.

D. sells corporate stocks.

The Federal Reserve increases the money supply primarily through open market operations, which involve buying and selling government bonds. When the Federal Reserve buys government bonds, it pays for these bonds with money that it creates. This action adds to the reserves of the banking system, effectively increasing the amount of money banks have available to lend. As banks have more funds available, they can offer more loans, which stimulates economic activity by increasing overall spending in the economy. In contrast, selling government bonds would decrease the money supply because when the Federal Reserve sells bonds, it takes money out of the banking system, reducing the amount available for lending. Buying or selling corporate stocks is not a tool used by the Federal Reserve to manage the money supply; its focus is specifically on government securities. Thus, the correct answer reflects the mechanism by which the Federal Reserve can effectively increase the liquidity in the financial system.

6. How can taxes affect aggregate supply?

A. Higher taxes can encourage business production

B. Taxes do not influence production costs

C. Lower taxes can reduce incentives for investment

D. Higher taxes can reduce incentives for businesses to invest

The reasoning behind this choice being correct lies in the relationship between taxes and business behavior regarding investment. Higher taxes on profits, income, or capital gains reduce the net return that businesses receive from their investments. When businesses face increased tax burdens, they may perceive investing in new projects, expanding operations, or hiring additional employees as less appealing. This reduction in investment can lead to a decrease in productive capacity over time, ultimately impacting the aggregate supply in the economy. When businesses have lower after-tax profits, their ability and willingness to produce goods and services may be hampered, leading to a slowdown in economic growth. This dynamic illustrates how higher taxes can create disincentives for businesses to engage in activities that contribute positively to the economy's supply side. In contrast, choices that suggest either lower taxes reduce investment incentives or that taxes do not affect production costs overlook the fundamental economic premise that taxes play a critical role in determining the net profitability of investments and, by extension, the overall supply of goods and services in the economy.

7. What does observing the market for haircuts tell us about price adjustments?

A. Prices are fixed and do not change.

B. Prices remain static in economic downturns.

C. Prices slowly approach the market-clearing equilibrium.

D. Prices can change wildly without notice.

Observing the market for haircuts provides insight into how prices respond to changes in supply and demand, illustrating the concept of market-clearing equilibrium. When demand for haircuts increases, either due to more people wanting haircuts or a rise in consumer income, prices can gradually adjust upwards as service providers respond to this newfound demand. Conversely, if the demand decreases, prices will also adjust downward. This tendency of prices to slowly approach an equilibrium level allows for an efficient allocation of resources, as service quantity aligns with customer demand over time. In the context of this scenario, the gradual adjustment of prices encapsulates how markets function; adjustments do not happen instantly but rather over a period, influenced by factors such as competition, consumer preferences, and changes in the economy. This continuous adjustment process emphasizes the dynamic nature of markets and the importance of price mechanisms in achieving equilibrium. While other options discuss price stability or volatility, they do not accurately reflect the typical behavior observed in markets like haircuts, which tend to experience gradual rather than abrupt changes in pricing. This behavior aligns with the understanding that markets often seek to balance supply and demand through incremental price adjustments.

8. What does an increase in taxes usually lead to?

A. Higher consumer spending

B. Decreased money supply

C. Lower government revenues

D. Decrease in aggregate demand

An increase in taxes typically leads to a decrease in aggregate demand. This is because higher taxes reduce the disposable income of consumers, which in turn leads to lower consumer spending. When consumers have less money to spend, their demand for goods and services decreases. Since aggregate demand is the total demand for goods and services in the economy at a given overall price level and in a given time period, a reduction in consumer spending directly pulls down aggregate demand. In addition, businesses may also be affected by increased taxes, as they face higher costs which can limit their investment and hiring capabilities, further contributing to a decline in overall economic activity. This chain reaction underscores the interconnectedness of consumer behavior and overall economic demand, making the impact of increased taxes clear.

9. What is demand-pull inflation?

A. Inflation resulting from rising production costs

B. Inflation that occurs due to excess demand over supply

C. Inflation that is influenced by government monetary policy

D. Inflation caused by decreased consumer confidence

Demand-pull inflation occurs when the overall demand for goods and services in an economy exceeds the available supply. This imbalance leads to upward pressure on prices. When consumers, businesses, and the government collectively demand more than what the economy can produce, producers respond by increasing their prices, which leads to inflation. This scenario is often illustrated in a booming economy where levels of output are high, but the demand still outstrips supply, prompting an increase in prices. The essence of demand-pull inflation is the relationship between demand and supply. When demand climbs significantly—due to factors like increased consumer spending, government expenditure, or investment—the pressure to meet that demand pushes prices higher. This aspect highlights the role of aggregate demand in the inflationary process, as opposed to other forms of inflation, such as cost-push inflation, which stems from the costs of production rising.

10. What does Quantitative Easing aim to achieve?

A. Reduce government spending

B. Stimulate the economy by increasing the money supply

C. Control inflation by tightening the money supply

D. Eliminate unemployment

Quantitative Easing (QE) is a monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective, typically in situations of very low interest rates. The primary goal of QE is to increase the money supply in the economy, which is achieved by the central bank purchasing financial assets, such as government bonds, from commercial banks and other financial institutions. By doing so, QE lowers interest rates and makes borrowing cheaper, thereby encouraging spending and investment. This increase in the money supply can lead to higher consumption and investment, which, in turn, stimulates economic activity and helps to support job creation. Furthermore, a growing economy can help in stabilizing or increasing inflation rates, particularly when inflation is below the target level set by the central bank. The correct answer highlights that the primary objective of Quantitative Easing is to stimulate the economy through an increase in the money supply, positioning it effectively as a countermeasure against economic downturns or periods of stagnation.