

## AP Macroeconomics Practice Exam 1

### Multiple-Choice Questions

Time—1 hour and 10 minutes

60 questions

For the multiple-choice questions that follow, select the best answer and fill in the appropriate letter on the answer sheet.

1. Which of the following statements are true of production possibility frontiers and trade between nations?
  - I. Nations specialize and trade based on comparative advantage in production.
  - II. Free trade allows each nation to consume beyond the production possibility frontier.
  - III. The flow of goods and services is based on the principle of absolute advantage.
  - IV. Nations can consume at points beyond the production possibility frontier by protecting domestic industries from free trade.
  - (A) I and II only
  - (B) II and III only
  - (C) III and IV only
  - (D) I, II, and III only
  - (E) I, II, III, and IV
  
2. A nation is producing at a point inside of its production possibility frontier. Which of the following is a possible explanation for this outcome?
  - (A) This nation has experienced a permanent decrease in its production capacity.
  - (B) This nation has experienced slower than usual technological progress.
  - (C) This nation has avoided free trade between other nations.
  - (D) This nation is experiencing an economic recession.
  - (E) This nation's economy is centrally planned.
  
3. How would fiscal and monetary policymakers combine spending, tax, and monetary policy to fight a recessionary gap, while avoiding large budget deficits?
 

	SPENDING POLICY	TAX POLICY	MONETARY POLICY
(A)	Higher spending	Lower taxes	Sell Treasury securities
(B)	Lower spending	Higher taxes	Buy Treasury securities
(C)	Lower spending	Lower taxes	Increasing the reserve ratio
(D)	Higher spending	Higher taxes	Lowering the discount rate
(E)	Higher spending	Higher taxes	Sell Treasury securities
  
4. Corn is exchanged in a competitive market. Which of the following definitely increases the equilibrium price of corn?
  - (A) Both supply and demand shift rightward.
  - (B) Both supply and demand shift leftward.
  - (C) Supply shifts to the right; demand shifts to the left.
  - (D) Supply shifts to the left; demand shifts to the right.
  - (E) The government imposes an effective price ceiling in the corn market.
  
5. An increase in the Consumer Price Index is commonly referred to as
  - (A) economic growth.
  - (B) inflation.
  - (C) unemployment.
  - (D) discouraged workers.
  - (E) deflation.

6. Which of the following is characteristic of a centrally planned economic system?
- (A) Resources are allocated based on relative prices.
  - (B) The circular flow of goods and services minimizes the role of the federal government.
  - (C) Private ownership of resources is fundamental to economic growth.
  - (D) Government planners decide how best to produce goods and services.
  - (E) Efficiency is superior to the market economic system.
7. The government has just lowered personal income taxes. Which of the following best describes the effects that this policy has on the economy?
- (A) Higher disposable income, higher consumption, higher real GDP, lower unemployment.
  - (B) Higher disposable income, lower consumption, higher real GDP, lower unemployment.
  - (C) Lower disposable income, higher consumption, higher real GDP, lower unemployment.
  - (D) Lower disposable income, lower consumption, lower real GDP, higher unemployment.
  - (E) Higher disposable income, higher consumption, higher real GDP, higher unemployment.
8. Which of the following are harmed by unexpectedly high rates of inflation?
- I. Borrowers repaying a long-term loan at a fixed interest rate.
  - II. Savers who have put their money in long-term assets that pay a fixed interest rate.
  - III. Workers who have negotiated cost-of-living raises into their contracts.
  - IV. Persons living on fixed incomes.
- (A) I and III only
  - (B) II and III only
  - (C) II and IV only
  - (D) I, II, and IV only
  - (E) II, III, and IV only
9. Which of the following statements are true?
- I. The velocity of money is equal to real GDP divided by the money supply.
  - II. Dollars earned today have more purchasing power than dollars earned a year from today.
  - III. The supply of loanable funds consists of investors.
- (A) I only
  - (B) II only
  - (C) III only
  - (D) I and II only
  - (E) I, II, and III
10. If your nominal income rises 4 percent and your real income falls 1 percent, by how much did the price level change?
- (A) 5 percent decrease
  - (B)  $\frac{1}{4}$  percent increase
  - (C) 3 percent increase
  - (D) 3 percent decrease
  - (E) 5 percent increase
11. Which of the following best measures changes in the price level of national product?
- (A) The consumer price index.
  - (B) The real interest rate.
  - (C) The unemployment rate.
  - (D) The producer price index.
  - (E) The GDP deflator.
12. Which of the following lessens the impact of expansionary fiscal policy?
- (A) An increase in the marginal propensity to consume.
  - (B) Lower interest rates that cause a decrease in net exports.
  - (C) Higher interest rates that cause an increase in net exports.
  - (D) Higher interest rates that decrease private investment.
  - (E) Falling price levels.

13. Suppose that the unemployment rate falls from 6 percent to 5 percent and the inflation rate falls from 3 percent to 2 percent. Which of the following best explains these trends?
- (A) An increase in aggregate demand.  
 (B) A decrease in both aggregate demand and aggregate supply.  
 (C) An increase in both aggregate demand and aggregate supply.  
 (D) An increase in aggregate supply.  
 (E) An increase in aggregate demand and a decrease in aggregate supply.
14. Which of the following scenarios best describes the concepts of scarcity and opportunity cost?
- (A) As a birthday present, your cousin sends you a \$20 bill.  
 (B) Your state government, in order to increase support for higher education, must increase the sales tax to keep the budget balanced.  
 (C) Your state government, in order to increase support for higher education, must cut spending for environmental protection to keep the budget balanced.  
 (D) The local fire department conducts a raffle to raise funds for new equipment.  
 (E) Smoke from a forest fire impairs air quality in a small mountain town.
15. Some economists believe that when aggregate demand declines, prices are inflexible or “sticky” in the downward direction. This implies that the aggregate supply curve is
- (A) upward sloping at full employment.  
 (B) horizontal below full employment.  
 (C) vertical at full employment.  
 (D) vertical below full employment.  
 (E) vertical above full employment.
16. Which of the following policies best describes supply-side fiscal policy?
- (A) An increase in the money supply.  
 (B) Increased government spending.  
 (C) Lower taxes on research and development of new technology.  
 (D) Lower taxes on household income.  
 (E) More extensive government social welfare programs.
17. A likely cause of falling Treasury bond prices might be
- (A) expansionary monetary policy.  
 (B) contractionary monetary policy.  
 (C) a depreciating dollar.  
 (D) fiscal policy designed to reduce the budget deficit.  
 (E) a decrease in the money demand.
18. The economy is currently operating at full employment. Assuming flexible wages and prices, how would a decline in aggregate demand affect GDP and the price level in the short run, and GDP and the price level in the long run?

	SHORT-RUN GDP	SHORT-RUN PRICE LEVEL	LONG-RUN GDP	LONG-RUN PRICE LEVEL
(A)	Falls	Falls	No change	Falls
(B)	Falls	Falls	Falls	Falls
(C)	No change	Falls	No change	No change
(D)	Falls	Falls	No change	No change
(E)	Falls	Falls	Falls	Falls

19. In the long run, aggregate supply is
- (A) upward sloping at full employment.  
 (B) horizontal below full employment.  
 (C) vertical at full employment.  
 (D) vertical below full employment.  
 (E) vertical above full employment.
20. What does the presence of discouraged workers do to the measurement of the unemployment rate?
- (A) Discouraged workers are counted as “out of the labor force,” thus understating the unemployment rate, making the economy look stronger than it is.  
 (B) Discouraged workers are counted as “out of the labor force,” thus overstating the unemployment rate, making the economy look weaker than it is.  
 (C) Discouraged workers are not surveyed so there is no impact on the unemployment rate.  
 (D) Discouraged workers are counted as “unemployed,” thus understating the unemployment rate, making the economy look stronger than it is.  
 (E) Discouraged workers are counted as “unemployed,” thus overstating the unemployment rate, making the economy look weaker than it is.

21. Which of the following is true of the complete circular flow model of an open economy?
- All goods and services flow through the government in exchange for resource payments.
  - There is no role for the foreign sector.
  - Households supply resources to producers in exchange for goods and services.
  - Producers provide goods and services to households in exchange for the costs of production.
  - The government collects taxes from firms and households in exchange for goods and services.
22. Which of the following most likely increases aggregate demand in the United States.?
- An American entrepreneur founds and locates a software company in London.
  - The U.S. military relocates a military base from San Diego to Seattle.
  - The Chinese government makes it increasingly difficult for American firms to export goods to China.
  - A Mexican entrepreneur founds and locates a software company in St. Louis.
  - The Canadian government cancels an order for airliners from a firm located in Seattle.
23. When both aggregate supply and aggregate demand increase, which of the following can be said for certain?
- The price level rises, but real GDP falls.
  - Both the price level and real GDP rise.
  - The price level rises, but the change in real GDP is uncertain.
  - The price level falls, but real GDP rise.
  - Real GDP rises, but the change in the price level is uncertain.
24. When nominal GDP is rising, we would expect money demand to
- increase as consumers demand more money as a financial asset, increasing the interest rate.
  - increase as consumers demand more money for transactions, increasing the interest rate.
  - decrease as the purchasing power of the dollar is falling, decreasing the interest rate.
  - decrease as consumers demand more money for transactions, increasing the interest rate.
  - increase as consumers demand more money as a financial asset, decreasing the interest rate.
25. Which of the following tends to increase the spending multiplier?
- An increase in the marginal propensity to consume.
  - A decreased velocity of money.
  - An increase in the marginal propensity to save.
  - An increase in the real interest rate.
  - An increase in the price level.
26. Households demand more money as an asset when
- nominal GDP falls.
  - the nominal interest rate falls.
  - bond prices fall.
  - the supply of money falls.
  - nominal GDP increases.
27. Which of the following represents a combination of contractionary fiscal and expansionary monetary policy?
- | FISCAL POLICY                 | MONETARY POLICY              |
|-------------------------------|------------------------------|
| (A) Higher taxes              | Selling Treasury securities  |
| (B) Lower taxes               | Buying Treasury securities   |
| (C) Lower government spending | Increasing the reserve ratio |
| (D) Lower government spending | Increasing the discount rate |
| (E) Higher taxes securities   | Buying Treasury securities   |
28. Higher levels of consumer wealth and optimism would likely have which of the following changes in the market for loanable funds?
- | MARKET FOR LOANABLE FUNDS | INTEREST RATE |
|---------------------------|---------------|
| (A) Increase in supply    | Rising        |
| (B) Increase in demand    | Rising        |
| (C) Decrease in demand    | Falling       |
| (D) Decrease in supply    | Falling       |
| (E) Decrease in supply    | Rising        |

29. Investment demand most likely increases when
- (A) real GDP increases.
  - (B) the cost of acquiring and maintaining capital equipment rises.
  - (C) investor optimism improves.
  - (D) the real rate of interest rises.
  - (E) taxes on business investment rise.
30. At the peak of a typical business cycle, which of the following is likely the greatest threat to the macroeconomy?
- (A) Unemployment
  - (B) Bankruptcy
  - (C) Declining labor productivity
  - (D) Falling real household income
  - (E) Inflation
31. Suppose that households increase the demand for U.S. Treasury bonds as financial assets. Which of the following accurately describes changes in the money market, the interest rate, and the value of the dollar in foreign currency markets?

	MONEY MARKET	INTEREST RATE	DOLLAR
(A)	Increased supply	Rising	Appreciates
(B)	Increased demand	Rising	Appreciates
(C)	Decreased demand	Falling	Appreciates
(D)	Decreased supply	Falling	Depreciates
(E)	Decreased demand	Falling	Depreciates

32. If households are more optimistic about the future, how would the consumption function be affected?
- (A) The marginal propensity to consume would increase, increasing the slope of the consumption function.
  - (B) The entire consumption function would shift downward.
  - (C) The entire consumption function would shift upward.
  - (D) The marginal propensity to consume would decrease, increasing the slope of the consumption function.
  - (E) The marginal propensity to consume would increase, decreasing the slope of the consumption function.

33. U.S. real GDP most likely falls when
- (A) tariffs and quotas are removed.
  - (B) investment in human capital is high.
  - (C) the money supply is increased.
  - (D) there is a trade surplus in goods and services.
  - (E) the value of the dollar, relative to foreign currencies, is high.
34. If current real GDP is \$5000, and full employment real GDP is at \$4000, which of the following combinations of policies might have brought the economy to this point?
- (A) A decrease in taxes and a lower discount rate.
  - (B) An increase in government spending and an increase in taxes.
  - (C) A decrease in taxes and selling bonds in an open market operation.
  - (D) An increase in government spending and an increase in the discount rate.
  - (E) A decrease in taxes and a decrease in government spending.
35. If a nation is operating at full employment, and the central bank engages in contractionary monetary policy, the nation can expect the interest rate, the purchases of new homes, and the unemployment rate to change in which of the following ways?

	INTEREST RATES	NEW HOMES	UNEMPLOYMENT RATE
(A)	Decrease	Increase	Increase
(B)	Decrease	Decrease	Decrease
(C)	Increase	Decrease	Decrease
(D)	Increase	Decrease	Increase
(E)	Increase	Increase	Increase



36. Expansionary monetary policy is designed to
- (A) lower the interest rate, increase private investment, increase aggregate demand, and increase domestic output.
  - (B) lower the interest rate, increase private investment, increase aggregate demand, and increase the unemployment rate.
  - (C) increase the interest rate, increase private investment, increase aggregate demand, and increase domestic output.
  - (D) increase the interest rate, decrease private investment, increase aggregate demand, and increase domestic output.
  - (E) increase the interest rate, decrease private investment, decrease aggregate demand, and decrease the price level.
37. If the economy is experiencing an inflationary gap, which of the following is most likely to worsen the problem?
- (A) An increase in government spending matched by an equal increase in taxes.
  - (B) An increase in government spending with no change in taxes.
  - (C) A decrease in government spending and a matching increase in taxes.
  - (D) A decrease in taxes with no change in government spending.
  - (E) A decrease in government spending matched by an equal decrease in taxes.
38. Which of the following is a component of the *M1* measure of money supply?
- (A) Savings deposits
  - (B) Gold bullion
  - (C) Cash and coins
  - (D) 30-year Treasury certificates
  - (E) 18-month certificates of deposits
39. Assuming that households save a proportion of disposable income, which of the following relationships between multipliers is correct?
- (A) Tax multiplier > Spending multiplier > Balanced budget multiplier.
  - (B) Spending multiplier = Tax multiplier > Balanced budget multiplier.
  - (C) Spending multiplier > Tax multiplier = Balanced budget multiplier.
  - (D) Spending multiplier > Tax multiplier > Balanced budget multiplier.
  - (E) Tax multiplier > Spending multiplier = Balanced budget multiplier.
40. The fractional reserve banking system's ability to create money is lessened if
- (A) households that borrow redeposit the entire loan amounts back into the banks.
  - (B) banks hold excess reserves.
  - (C) banks loan all excess reserves to borrowing customers.
  - (D) households increase checking deposits in banks.
  - (E) the Federal Reserve lowers the reserve ratio.
41. All else equal, when the United States exports more goods and services,
- (A) the value of the dollar falls as the supply of dollars increases.
  - (B) the value of the dollar rises as demand for dollars increases.
  - (C) the value of the dollar falls as demand for dollars decreases.
  - (D) the value of the dollar rises as the supply of dollars increases.
  - (E) the value of the dollar falls as demand for dollars increases.
42. If the reserve ratio is 10 percent and a new customer deposits \$500, what is the maximum amount of money created?
- (A) \$500
  - (B) \$4500
  - (C) \$5000
  - (D) \$50
  - (E) \$5500

43. Suppose today's headline is that private investment has decreased as a result of an action by the Federal Reserve. Which of the following choices is the most likely cause?
- (A) Selling Treasury securities to commercial banks.
  - (B) Lowering of the discount rate.
  - (C) Decreasing the reserve ratio.
  - (D) Elimination of a corporate tax credit on investment.
  - (E) A stronger stock market has increased investor optimism.
44. If \$1000 is deposited into a checking account and excess reserves increase by \$700, the reserve ratio must be:
- (A) 70%
  - (B) 30%
  - (C) 40%
  - (D) 90%
  - (E) 75%
45. Suppose a nation is experiencing an annual budget surplus and uses some of this surplus to pay down part of the national debt. One potential side effect of this policy would be
- (A) increase interest rates and throw the economy into a recession.
  - (B) increase interest rates and depreciate the nation's currency.
  - (C) decrease interest rates and risk an inflationary period.
  - (D) decrease interest rates and throw the economy into a recession.
  - (E) decrease interest rates and appreciate the nation's currency.
46. Which of the following best describes a key difference between the short-run and long-run aggregate supply curve?
- (A) Short-run aggregate supply is upward sloping as nominal wages quickly respond to price level changes.
  - (B) Long-run aggregate supply is upward sloping as nominal wages quickly respond to price level changes.
  - (C) Short-run aggregate supply is vertical as nominal wages quickly respond to price level changes.
  - (D) Short-run aggregate supply is upward sloping as nominal wages do not quickly respond to price level changes.
  - (E) Long-run aggregate supply is vertical as nominal wages do not quickly respond to price level changes.
47. The "crowding out" effect refers to which of the following?
- (A) Lower interest rates that result from borrowing to conduct expansionary monetary policy.
  - (B) Higher interest rates that result from borrowing to conduct contractionary fiscal policy.
  - (C) Higher interest rates that result from borrowing to conduct expansionary fiscal policy.
  - (D) Higher interest rates due to borrowing to conduct contractionary monetary policy.
  - (E) Lower interest rates due to borrowing to conduct expansionary fiscal policy.
48. Which of the following is a predictable consequence of import quotas?
- (A) Increased competition and lower consumer prices.
  - (B) Increased government tax revenue from imported goods.
  - (C) Rising net exports and a rightward shift in aggregate supply.
  - (D) An improved allocation of resources away from inefficient producers and lower consumer prices.
  - (E) Higher consumer prices and a misallocation of resources away from efficient producers.

49. If the Federal Reserve was concerned about the “crowding out” effect, they could engage in
- (A) expansionary monetary policy by lowering the discount rate.
  - (B) expansionary monetary policy by selling Treasury securities.
  - (C) contractionary monetary policy by raising the discount rate.
  - (D) contractionary monetary policy by lowering the discount rate.
  - (E) expansionary monetary policy by raising the reserve ratio.
50. Which of the following would likely contribute to faster rates of economic growth?
- (A) A more restrictive immigration policy.
  - (B) Negative net investment.
  - (C) Higher taxes on households and firms.
  - (D) Higher government funding of research on clean energy supplies.
  - (E) Protective trade policies.
51. A nation that must consistently borrow to cover annual budget deficits risks
- (A) a depreciation of the nation’s currency as foreigners increase investment in the nation.
  - (B) a decline in net exports as the nation’s goods become more expensive to foreign consumers.
  - (C) lower interest rates that discourage foreign investment in the nation.
  - (D) an appreciation of the nation’s currency as foreigners decrease investment in the nation.
  - (E) lower interest rates that reduce private investment in productive capital.
52. Economic growth is best described as
- (A) an increase in the production possibility frontier and an increase in the natural rate of unemployment.
  - (B) an increase in the production possibility frontier and a leftward shift in long-run aggregate supply.
  - (C) a decrease in the production possibility frontier and a rightward shift in long-run aggregate supply.
  - (D) a decrease in the production possibility frontier and a leftward shift in long-run aggregate supply.
  - (E) an increase in the production possibility frontier and a rightward shift in long-run aggregate supply.
53. Which of the following is true of automatic fiscal policy stabilizers?
- (A) For a given level of government spending, they produce a deficit during a recession and a surplus during an expansion.
  - (B) They serve to prolong recessionary and inflationary periods.
  - (C) The regressive tax system is a fundamental component of automatic stabilizers.
  - (D) For a given level of government spending, they produce a surplus during a recession and a surplus during an expansion.
  - (E) They lengthen the business cycle.
54. Which of the following is an example of expansionary monetary policy for the Federal Reserve?
- (A) Increasing the discount rate.
  - (B) Increasing the reserve ratio.
  - (C) Buying Treasury securities from commercial banks.
  - (D) Lowering income taxes.
  - (E) Removal of import quotas.
55. Labor productivity and economic growth increase if
- (A) a nation subsidizes education for all citizens.
  - (B) a nation imposes tariffs and quotas on imported goods.
  - (C) a nation removes penalties for firms that pollute natural resources.
  - (D) a nation ignores societal barriers like discrimination.
  - (E) a nation taxes income from interest on saving.
56. The short-run Phillips curve depicts the \_\_\_\_ relationship between \_\_\_\_ and \_\_\_\_.
- (A) positive, price level, interest rate
  - (B) negative, interest rate, private investment
  - (C) negative, the inflation rate, the unemployment rate
  - (D) positive, price level, real GDP
  - (E) negative, interest rate, money demand
57. A negative, or contractionary, supply shock will
- (A) shift the Phillips curve to the left.
  - (B) shift the investment demand curve to the right.
  - (C) shift the money demand curve to the right.
  - (D) shift the money supply curve to the left.
  - (E) shift the Phillips curve to the right.



58. When a nation is operating at the natural rate of employment,
- (A) there is no cyclical unemployment.
  - (B) the inflation rate is zero.
  - (C) there is no structural unemployment.
  - (D) the nation is experiencing a recession.
  - (E) the unemployment rate is zero.
59. Which of the following likely results in a permanent increase in a nation's productive capacity?
- (A) A decline in the birth rate.
  - (B) Declining adult literacy rates.
  - (C) Widespread relocation of manufacturing firms to low-wage nations.
  - (D) National program of child immunization.
  - (E) A global increase in the price of crude oil.
60. Lower interest rates in the United States cause the value of the dollar and exports to change in which of the following ways?

	VALUE OF THE DOLLAR	U.S. EXPORTS
(A)	Increasing	Increasing
(B)	Increasing	Decreasing
(C)	Decreasing	Increasing
(D)	Decreasing	Unchanged
(E)	Increasing	Increasing