Difficult questions of Chapter 10

15) The slope of the aggregate expenditure curve equals the change in
   A) autonomous expenditure divided by the change in real GDP.
   B) real GDP divided by the change in planned expenditure.
   C) government expenditure divided by the change in real GDP.
   D) planned expenditure divided by the change in real GDP.

   Answer: D

Slope of the AE = change in aggregate planned expenditure/ change in real GDP.

(Note: GDP can be determined in two ways: the total expenditure or total income, here we use the total expenditure, and is the planned expenditure.)

18) A decrease in autonomous consumption will
   A) shift the consumption function upward.
   B) change the slope of the consumption function.
   C) decrease the marginal propensity to save.
   D) shift the aggregate expenditure function downward.
Answer: D

The sum of investment, government purchase, and exports, which does not vary with real GDP, is called autonomous expenditure. i.e. I+G+X, The aggregate expenditure function AE= I+G+X+C-M. So when the autonomous expenditure decreases, it will shift the aggregate expenditure function.

20) In the above figure, at the equilibrium, induced expenditure is
A) $100 billion.
B) $200 billion.
C) some amount not given in the above answers.
D) $300 billion.

Answer: A

AE= I+G+X+C-M, and I+G+X is autonomous expenditure, C-M is induced expenditure. Autonomous expenditure is the level of aggregate planned expenditure if real GDP were zero. At the equilibrium point AE=300, autonomous expenditure =200, so induced expenditure = 300 - 200 = 100.
23) If real GDP is $2 billion and planned aggregate expenditure is $2.25 billion, inventories will
   A) be depleted and output will decrease.  B) be depleted and output will increase.
   C) pile up and output will decrease.      D) pile up and output will increase.

   **Answer: B**

   Actual aggregate expenditure is always equal to real GDP, but aggregate planned
   expenditure is not necessarily equal to actual aggregate expenditure and therefore is not
   necessarily equal to real GDP. If aggregate planned expenditure exceeds real GDP, firms
   sell more than they produce and inventories decrease below the level that firms had
   planned. So the answer is B.

24) If prices are fixed, an increase in aggregate expenditures results in an increase in equilibrium GDP that
   A) is greater than the change in aggregate expenditure.
   B) is less than the change in aggregate expenditure.
   C) has no necessary relationship to the size of the change in aggregate expenditure.
   D) is equal to the change in aggregate expenditure.

   **Answer: A**

   The change in autonomous expenditure leads to an amplified change in equilibrium
   expenditure. This amplified change is the multiplier effect—equilibrium expenditure
   increases by more than the increase in autonomous expenditure, b/c the multiplier is
   greater than 1.

25) Because of the multiplier, a one-time change in expenditure will
   A) expand income by an infinite amount.
   B) generate more additional income than the initial change in expenditure.
   C) decrease saving and investment activity and future income.
   D) have little secondary effect on income.

   **Answer: B**

   Same as 24)
27) In the above figure, autonomous expenditure along $AE_2$ equals
A) $4$ trillion.
B) $2$ trillion.
C) $8$ trillion.
D) an amount not given in the above answers.

Answer: A

Autonomous expenditure is the sum of investment, government purchases and exports, which does not vary with real GDP. So in this problem, the answer should be 4.

28) In the above figure, the multiplier is
A) 3.0.
B) 2.0.
C) 1.5.
D) 2.5.

Answer: B

The multiplier is the amount by which a change in autonomous expenditure is magnified or multiplied to determine the change in equilibrium expenditure and real GDP. Multiplier = change in equilibrium expenditure/ change in autonomous expenditure. In this question, change in equilibrium expenditure = 8-4=4; change in autonomous expenditure = 4-2=2. So, multiplier= 4/2=2.

33) The equations above describe the economy of La La Land. What is the equilibrium level of expenditure?
A) 30
B) 29
C) 60
D) 90

Answer: C

Aggregate expenditure has four components:
Consumption expenditure;
Investment
Government purchases of goods and services;
Net exports(exports - imports).
Equilibrium level of expenditure should be intersecting point between 45 degree line and AE line.
Y = C + I + G + NX
In this question, C = 8 + 0.7Y, I = 5, G = 7, NX = 10 - 0.2Y,
So, Y = 8 + 0.7Y + 5 + 7 + 10 - 0.2Y
Y = 60

34) The equations above describe the economy of La La Land. What is the equilibrium level of consumption expenditure?
   A) 60
   B) 40
   C) 50
   D) None of the above answers are correct.

Answer: C

From above equation, we know that C = 8 + 0.7Y, and from last question, we got Y = 60, so we can easily get C = 50.

Consumption function: C = 600 + 0.8Y
Aggregate expenditure function: AE = 1000 + 0.5Y

35) Based on the two equations above, equilibrium expenditure is
   A) 1,000.
   B) 3,000.
   C) 2,000.
   D) 1,600.

Answer: C

From question 33, we know that equilibrium level of expenditure should be intersecting point between 45 degree line and AE line. So you just need let Y = 1000 + 0.5Y, and solve Y, and Y = 2000.

15 KEY ANSWERS: