

Chapter 7 - Classical and Keynesian Macro Analyses

_____ 1. The classical model assumes

- a. prices and wages are constant.
- b. pure competition.
- c. people suffer from money illusion.
- d. altruism is the main motivating force.

_____ 2. In the classical model, saving

- a. is an injection into the income stream.
- b. and investment are determined by national disposable income.
- c. causes unemployment.
- d. is a leakage from the circular flow.

_____ 3. In the classical model, when households save,

- a. that money becomes a part of the supply of saving curve.
- b. business investment offsets such saving.
- c. full employment will still prevail.
- d. All of the above

T F 4. In the classical model a decrease in consumption will be offset by an increase in Investment spending so that RGDP will not change.

5. Saving represents a(n) _____ curve. Investment represents a(n) _____ curve. In the classical model, desired household saving and desired business investment are equated by the _____ rate. If Consumption falls then Savings _____, The supply of credit _____ which causes the interest rate to _____, which causes Investment to _____ until $Y =$ _____. In addition future GDP will be _____.

6. In the classical model, the LRAS curve is (**horizontal, vertical**). Therefore, changes in the AD curve lead to changes in _____ but since wages change _____ it does not lead to changes in _____.

7. If much unused capacity and massive unemployment exist, the economy will be operating in the _____ range of the SRAS curve. In this range, prices and wage rates are (**fixed, flexible**). Hence, increases in aggregate demand will lead to increases in _____ but no changes in the _____. In that range, real GDP is said to be _____ determined.

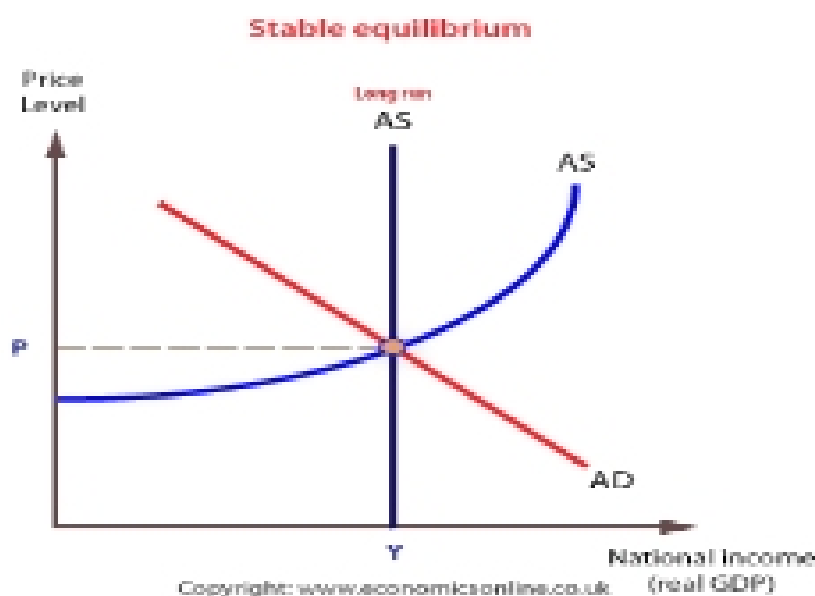
8. For the most part, The short-run aggregate supply curve is _____ sloped. This is because changes in production costs _____ changes in the price level, profitability _____ and producers will have an incentive to produce (**more, less**) as the price level rises.

9. At very high price levels, the SRAS curve becomes very (**flat, steep**) because it becomes (**more difficult, easier**) to get more labor at relatively fixed wage rates.

10. If wage rates fall, the short-run AS curve will shift to the _____ while LRAS is _____. If technological improvements occur and if the prices of raw materials fall permanently, the long-run AS curve and SRAS will shift to the _____.

11. Assuming the economy is operating at equilibrium, predict what happens to the equilibrium price level and equilibrium real GDP as a result of :

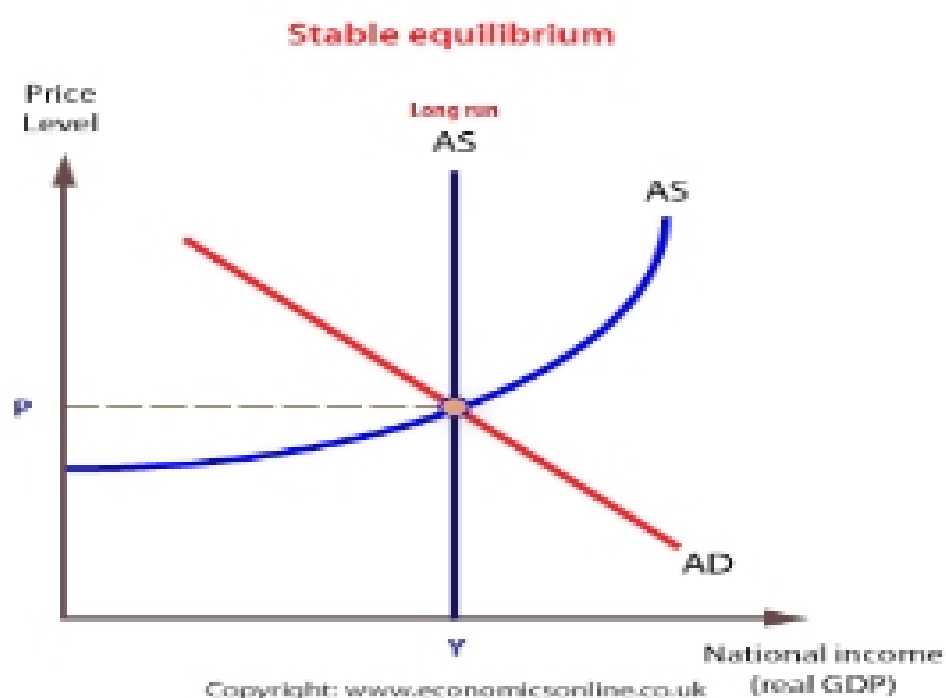
- a. an increase in the labor participation rates;



SR RGDP _____ PL _____ Unemployment _____ point _____

LR RGDP _____ PL _____, Unemployment _____ point _____

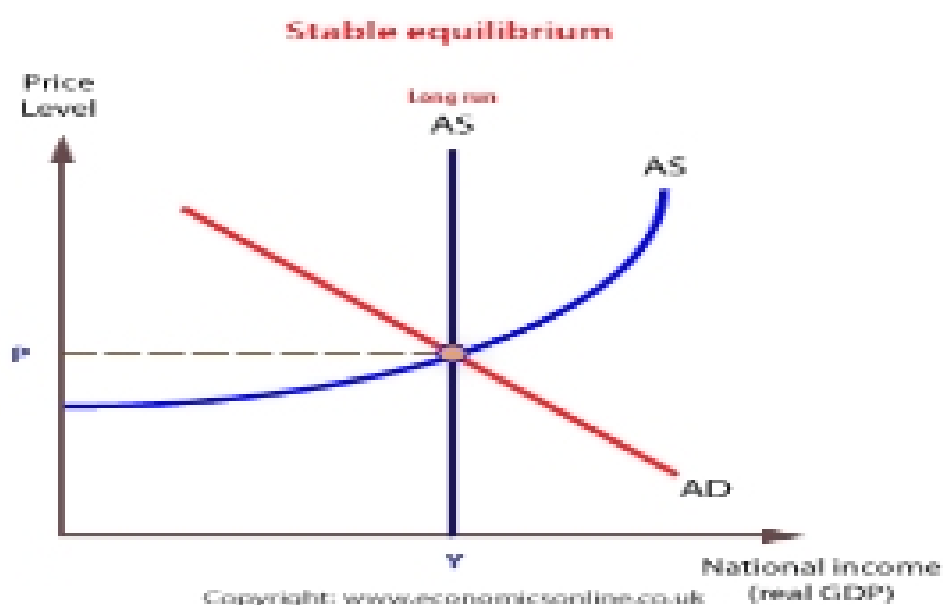
- b. a temporary rise in raw material prices;



SR RGDP _____ PL _____ Unemployment _____ point _____ This is called _____

LR RGDP _____ PL _____ Unemployment _____ point _____

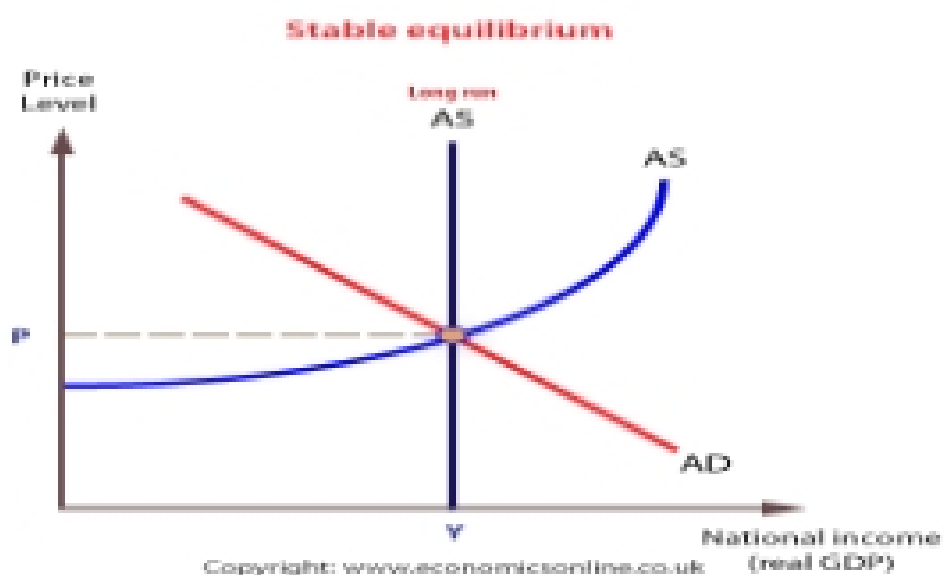
c. a decrease in government spending;



SR RGDP GDP ____ PL ____ Unemployment ____ point ____

LR RGDP ____ PL ____ Unemployment ____ point ____

d. a rise in Consumption spending due to stock market boom.



SR RGDP GDP ____ PL ____ Unemployment ____ point ____

LR RGDP ____ PL ____ Unemployment ____ point ____

14. T F A demand shock that shifts the AD curve rightward will probably cause real GDP to rise and the price level to fall in the short run.

13. T F If a nation's exchange rate weakens, its SRAS curve will shift leftward, its AD curve will shift rightward, and its price level will rise.