Chapter 20

Put into practice questions

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Which of the following would increase aggregate demand? Explain your answers.

- An increase in investment. Increases aggregate demand
- A decrease in government spending. Decreases aggregate demand
- A decrease in spending on exports. Decreases aggregate demand
- A fall in import spending. Increases aggregate demand
- An increase in taxation rates. Decreases aggregate demand
- A fall in the amount saved out of each extra pound. Increases aggregate demand

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What factors would shift the aggregate supply curve inwards so that less is supplied at each and every price?

An increase in wages, in rent, an increase in other costs or a fall in productivity.

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An increase in which of the following is the most likely cause of this movement from A to B:

- Consumer confidence YES
- The age at which students can leave school NO
- The rate of interest NO
- The price level NO
- The training of the workforce NO

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The change in equilibrium in the economy is most likely to have been caused by:

- A major fall in the exchange rate NO
- A reduction in the national minimum wage NO
- Increase in welfare payments NO
- An increase in income tax NO
- Increase in training YES

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- Increase in welfare payments
- An increase in income tax
- Increase in training

End of chapter put into practice questions

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Explain why aggregate supply might be price inelastic.

Shortage of resources.

Explain why aggregate supply might be price elastic.

Excess capacity

Show the effect of a decrease in aggregate demand on the equilibrium price level in the economy and the quantity; assume that aggregate supply is relatively price inelastic.

Aggregate demand moves inwards. The equilibrium price and output will fall.
If aggregate supply is relatively price inelastic the effect will be greater on output than price.

Show the effect of an increase in aggregate supply on the equilibrium price and quantity. Assume that aggregate demand is relatively price inelastic.

An increase in aggregate supply will lead to an outward shift in supply. This will reduce the equilibrium price and increase equilibrium quantity. If aggregate demand is relatively price inelastic the effect will be more on price than quantity.

Explain the difference between demand-side policies and supply-side policies using diagrams.

Demand side policies shift aggregate demand. Supply side policies shift aggregate supply.

6. Imagine the components of aggregate demand are:

Consumption £500 billion
Investment £100 billion
Government spending £200 billion
Import spending £150 billion

Total aggregate demand £900 billion
What is the value of export spending? Explain your answer.

AD = C+I+G +X-M
900= 500+100+200 + X – 150
X= £50 billion

All things being equal, which could have caused the price level to have fallen from P1 to P2 in Figure 20.16?

a. A fall in interest rates Demand would increase
b. A fall in exports Yes Demand falls
c. A fall in production costs Supply increases
d. A fall in taxation rates. Demand would increase