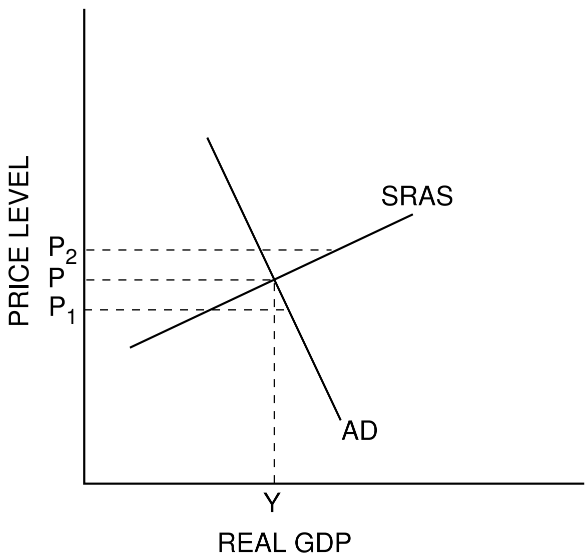
Short-Run Equilibrium Price Level and Output

Part A
Equilibrium

Figure 25.1
Equilibrium Price and Output Levels



1. What are the equilibrium price level and output? _________________

2. What would eventually happen to the price level and output if the initial price level were P_2 rather than P? Why would this happen?

3. What would eventually happen to the price level and output if the initial price level were P_1 rather than P? Why would this happen?

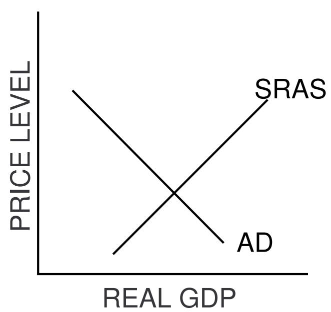
Activity written by John Morton, National Council on Economic Education, New York, N.Y., and James Stanley, Choate Rosemary Hall, Wallingford, Conn.

Part B
Changes in the Equilibrium Price Level and Output

For each situation described below, illustrate the change on the AD and AS graph and describe the effect on the equilibrium price level and real GDP by circling the correct symbol: ↑ for increase, ↓ for decrease, or — for unchanged.

4. Congress passes a tax cut for the middle class, and the president signs it.

Middle Class Tax Cut

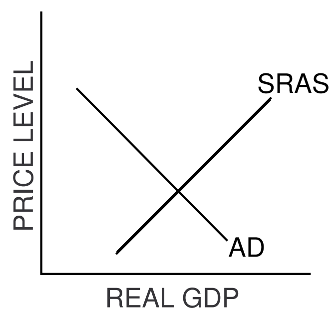


Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

5. During a recession, the government increases spending on schools, highways and other public works.

Increased Government Spending

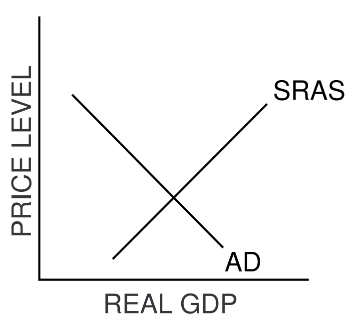


Price level: ↑ ↓ —

Real GDP: ↑ ↓ —

6. New oil discoveries cause large decreases in energy prices.

New Oil Discoveries

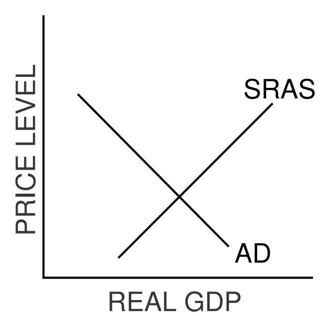


Price level ↑ ↓ —

Real GDP ↑ ↓ —

7. Illustrate the effects of an increase in aggregate demand.

Effects of an Increase in AD

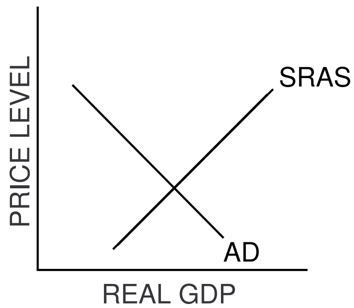


Price level ↑ ↓ —

Real GDP ↑ ↓ —

8. Illustrate the effects of increases in production costs.

Effects of Increases in Production Costs

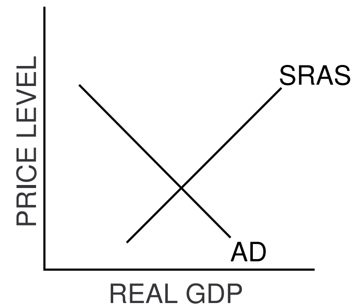


Price level ↑ ↓ —

Real GDP ↑ ↓ —

9. New technology and better education increase productivity.

Effects of New Technology and Better Education

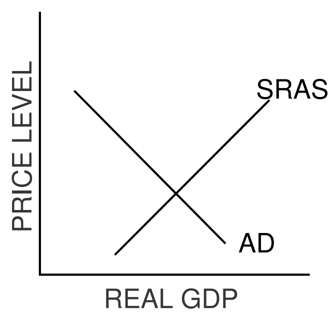


Price level ↑ ↓ —

Real GDP ↑ ↓ —

10. A new president makes consumers and businesses more confident about the future economy. **Note:** Show the change in AD only.

Increased Confidence for Future Economy

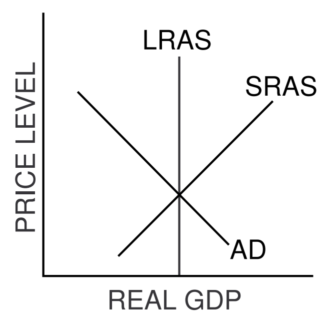


Price level ↑ ↓ —

Real GDP ↑ ↓ —

11. With the unemployment rate at five percent, the federal government reduces personal taxes and increases spending. **Note:** Show the change in AD only.

Reduced Taxes and Increased Government Spending



Price level ↑ ↓ —

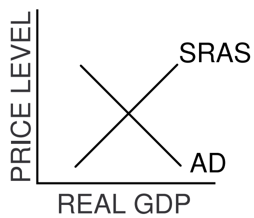
Real GDP ↑ ↓ —

Part C

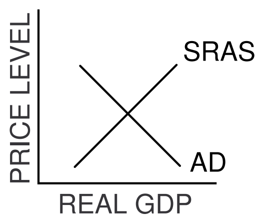
Summarizing Aggregate Demand and Aggregate Supply Shifts

For each of the events below, make additions to the graph to illustrate the change. Then indicate the response in terms of shifts in or movements along the aggregate demand or aggregate supply curve and the short-run effect on real GDP and the price level. Indicate *shifts* in the curve by S and movements *along* the curve by A. Indicate the changes in price level, unemployment and real GDP with an up arrow for an increase and a down arrow for a decrease.

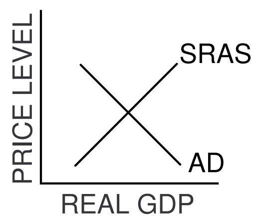
1. Increase in labor productivity due to technological change



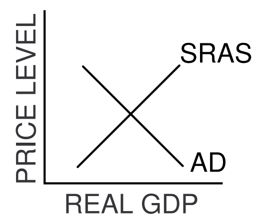
2. Increase in the price of inputs used by many firms



3. Boom in investment assuming some unemployed resources are available



4. A major reduction in investment spending



	1	2	3	4
AD Curve	_____	_____	_____	_____
AS Curve	_____	_____	_____	_____
Real GDP	_____	_____	_____	_____
Price Level	_____	_____	_____	_____
Unemployment	_____	_____	_____	_____