

Practice Study Questions Chapter 12

Course: Macroeconomics: A Contemporary Introduction, 7e (McEachern)

Instructor: Jonathan Fink

Instructions:

1. Fiscal policy is concerned with
 - a. government spending and taxation only
 - b. government spending and money only
 - c. money and taxation only
 - d. government spending, taxation, and money
 - e. money only

2. Fiscal policy focuses on manipulating
 - a. aggregate demand to smooth out business fluctuations
 - b. aggregate supply to smooth out business fluctuations
 - c. both aggregate supply and aggregate demand to smooth out business fluctuations
 - d. aggregate demand to stimulate the economy and aggregate supply to contract it
 - e. short-run aggregate supply to stimulate the economy and aggregate demand to contract it

3. A \$100 billion increase in government purchases will have the same effect on real GDP as a \$100 billion decrease in taxes.
 - a. True
 - b. False

4. "Net taxes" equals "taxes minus transfer payments."
 - a. True
 - b. False

5. If government expenditures or taxes are assumed to be autonomous, they
 - a. do not depend upon on the level of GDP
 - b. may be changed only through direct action by Congress
 - c. change only when the price level changes
 - d. change only upon executive order by the president of the United States
 - e. are autonomous at low levels of GDP but not at higher levels of GDP

Practice Study Questions Chapter 12

6. Assume that initially G is \$100 and equilibrium real GDP demanded is \$1,000. If the multiplier is 4 and G increases to \$200, real GDP demanded will increase
- a. by \$100
 - b. by \$2,000
 - c. by \$1,000
 - d. to \$1,400
 - e. to \$2,000
-
7. If the government increases its purchases by \$100 and the multiplier is 4, then equilibrium real GDP demanded
- a. increases by \$25
 - b. decreases by \$25
 - c. increases by \$100
 - d. increases by \$400
 - e. decreases by \$400
-
8. A \$100 increase in government purchases will have exactly the same effect on equilibrium real GDP as a \$125 decrease in autonomous net taxes when the MPC equals 0.8.
- a. True
 - b. False
-
9. A \$100 increase in government purchases will have exactly the same effect on equilibrium real GDP as a \$125 decrease in autonomous net taxes regardless of the value of the MPC.
- a. True
 - b. False
-
10. An increase in the MPC will increase the simple tax multiplier but have no effect on the simple spending multiplier.
- a. True
 - b. False
-
11. The simple tax multiplier is
- a. $1/\text{MPC}$
 - b. 1
 - c. $1/(1 - \text{MPC})$
 - d. $\text{MPC}/(1 - \text{MPC})$
 - e. $-\text{MPC}/(1 - \text{MPC})$
-

Practice Study Questions Chapter 12

12. Suppose both autonomous taxes and transfer payments increase by \$50 billion. If the $MPC = 0.75$, by how much does equilibrium real GDP demanded change?
- a. \$0
 - b. \$50 billion
 - c. -\$50 billion
 - d. \$200 billion
 - e. -\$200 billion
-

13. If autonomous net taxes decline by \$40 billion and the $MPC = 0.75$, then equilibrium real GDP demanded
- a. declines by \$120 billion
 - b. increases by \$120 billion
 - c. declines by \$160 billion
 - d. increases by \$160 billion
 - e. increases by \$40 billion
-

14. If the $MPC = 0.8$, then the simple tax multiplier equals
- a. 0.8
 - b. 4
 - c. 5
 - d. -4
 - e. -5
-

15. Assume autonomous net taxes rise by \$400; the marginal propensity to consume = $3/4$. Net exports, planned investment, taxes, and government purchases are autonomous and remain fixed. As a result, consumption will *initially*
- a. fall by \$400
 - b. rise by \$400
 - c. fall by \$300
 - d. rise by \$300
 - e. remain unchanged
-

16. A contractionary gap exists when aggregate demand is insufficient to sustain real output at the economy's potential output level.
- a. True
 - b. False
-

Practice Study Questions Chapter 12

17. When net taxes increase and government purchases decrease,
- the price level will rise
 - the money supply must rise
 - the aggregate demand curve shifts leftward
 - output and employment both rise
 - the aggregate supply curve shifts leftward
-
18. Reducing net taxes and reducing government purchases are both effective ways of eliminating an expansionary gap.
- True
 - False
-
19. If fiscal policy is used to close an expansionary gap, the
- SRAS curve shifts leftward and the price level falls
 - SRAS curve shifts rightward and the price level increases
 - SRAS curve shifts rightward and the price level falls
 - AD curve shifts leftward and the price level decreases
 - AD curve shifts rightward and the price level decreases
-
20. Suppose that instead of using discretionary fiscal policy to close an expansionary gap, policy makers left the economy alone. What would probably happen?
- depression would result
 - the economy would be stuck in an expansionary gap
 - the aggregate demand curve would shift, eliminating the problem
 - the gap would close after a spurt of inflation
 - the short-run aggregate supply curve would shift to the right
-
21. The classical economists believed that the economy automatically move toward equilibrium at full employment.
- True
 - False
-
22. Which of the following best describes the concept of *laissez-faire*?
- Government should not intervene in the economy.
 - Government should actively intervene in the economy whenever it judges the action to be beneficial.
 - Government should intervene in the economy only to promote short-term economic stability.
 - Government should intervene in the economy only to maximize long-term growth rates.
 - Government should intervene in the economy only when the economy is not at full employment or there is substantial inflation.
-

Practice Study Questions Chapter 12

23. The opposite of a *laissez-faire* economic policy is
- active government intervention
 - a reliance on prices to adjust to changing market conditions
 - classical economics
 - neoclassical economics
 - quantity supplied creates its own quantity demanded
-
24. Keynes thought that one macroeconomic problem is that the economy
- can tend toward an equilibrium level of output that is below the potential level
 - tends toward a potential level of output that is below the equilibrium level
 - makes the potential and equilibrium levels of output equal
 - can be pushed below the equilibrium level of output by fiscal policy
 - can be pushed below the potential level of output by fiscal policy
-
25. According to Keynes,
- fiscal policy should not be used to influence the economy
 - the economy eventually tends toward the potential output
 - to get the economy to potential output, the SRAS curve must shift to the right
 - the economy could be stuck at equilibrium below the potential output for a prolonged period
 - deviations from potential output are short-lived
-
26. Military spending is a good example of an automatic stabilizer.
- True
 - False
-
27. Because of automatic stabilizers, disposable income varies proportionately less than real GDP during periods of economic fluctuations.
- True
 - False
-
28. Which of the following is true of automatic stabilizers?
- They require ongoing decisions about government purchases and taxation to promote full employment and price stability.
 - They include the unemployment compensation program.
 - They tend to stimulate aggregate demand when the economy is experiencing an expansionary gap.
 - They include tax cuts passed by Congress to ease a current recession in an economy that has a proportional income tax.
 - They include government purchases of goods and services requiring Congressional approval.
-

Practice Study Questions Chapter 12

29. A progressive income tax ensures that during expansionary periods,
- consumption will increase by more than the increase in disposable income
 - consumption will increase by more than the decrease in disposable income
 - disposable income will increase by more than the increase in GDP
 - disposable income will increase by less than the increase in GDP
 - disposable income will increase by more than the decrease in GDP
-
30. During the 1970s, demand-management policy
- continued to be highly successful in curing the economy's economic problems
 - was found to be highly unsuitable in periods of stagflation such as the decade of the 1970s
 - was so unsuccessful that economists advised a return to the pre-World War II philosophy of fiscal policy
 - was unsuccessful because the automatic stabilizers no longer influenced the economy
 - was unsuitable because it affected aggregate supply more than aggregate demand
-
31. Economists and policy makers questioned the effectiveness of discretionary fiscal policy during the 1970s for all the following reasons *except*
- the difficulty of estimating the natural rate of unemployment
 - the time lags involved in implementing fiscal policy
 - the existence of possible feedback effects of fiscal policy on aggregate supply
 - the distinction between current and permanent income
 - the problems of inflation and unemployment were basically solved
-
32. Which of the following best describes stagflation?
- rising unemployment together with economic growth
 - deflation coupled with a decline of the money supply
 - deficits coupled with rising unemployment
 - rising unemployment and inflation rates
 - inflation coupled with balance of trade deficits
-
33. The "Golden Age" of fiscal policy--the decade in which it was most in political favor and in which it seemed to work best--was
- the 1930s
 - the 1940s
 - the 1950s
 - the 1960s
 - the 1970s
-

Practice Study Questions Chapter 12

34. Which of the following is *not* a weakness of fiscal policy as a tool of economic stabilization?
- a. It is ineffective in dealing with stagflation.
 - b. Its correct implementation depends on an accurate estimate of potential output.
 - c. It is subject to lags.
 - d. Households may not respond to changes they perceive as temporary.
 - e. Households may not respond to changes they perceive as permanent.
-

35. Although discretionary fiscal policy worked fairly well in the U.S. in the 1960s, it worked even better during the stagflation years of the 1970s.
- a. True
 - b. False
-

36. By the middle of the 1980s the U.S. federal budget deficit
- a. grew to about 1 percent of GDP
 - b. grew to about 5 percent of GDP
 - c. fell to about 5 percent of GDP
 - d. grew to about 25 percent of GDP
 - e. grew to about 40 percent of GDP
-

37. The federal income tax cut of 1981
- a. triggered a recession
 - b. caused the unemployment rate to climb to 10 percent in 1982
 - c. helped sustain a continued expansion during the 1980s
 - d. seemed to have no effect on the economy
 - e. triggered rapid inflation
-

38. The federal income tax cut of 1981
- a. caused the unemployment rate to climb to 10 percent in 1982
 - b. contributed to the growth of the national debt during the 1980s
 - c. was an example of a contractionary fiscal policy
 - d. was an example of a contractionary monetary policy
 - e. seemed to have no effect on the economy
-

39. During the years 1981-1988,
- a. U.S. government tax revenue increased faster than government spending
 - b. U.S. government tax revenue fell faster than government spending fell
 - c. U.S. government spending increased faster than tax revenue increased
 - d. U.S. employment fell and so did the government budget deficit
 - e. U.S. employment fell while the federal budget deficit increased
-

Practice Study Questions Chapter 12

40. Political business cycles are so called because
- a. Congress recognizes them officially through legislative action every four years
 - b. they historically recur every ten years
 - c. they are the result of partisan in-fighting in Congress
 - d. they prevent an incumbent political party from gaining re-election
 - e. they result when politicians use discretionary fiscal policy to increase output and employment in order to gain re-election
-

Practice Study Questions Chapter 12

ANSWER KEY

Question # Answer

1	a
2	a
3	b
4	a
5	a
6	d
7	d
8	a
9	b
10	b
11	e
12	a
13	b
14	d
15	c
16	a
17	c
18	b
19	d
20	d
21	a
22	a
23	a
24	a
25	d
26	b
27	a
28	b
29	d
30	b
31	e
32	d
33	d
34	e
35	b

Practice Study Questions Chapter 12

ANSWER KEY

<u>Question #</u>	<u>Answer</u>
<u>36</u>	<u>b</u>
<u>37</u>	<u>c</u>
<u>38</u>	<u>b</u>
<u>39</u>	<u>c</u>
<u>40</u>	<u>e</u>