

CHAPTER 9

- 1) Which of the following is a concern of fiscal policy?
 - a) Policies concerning government purchases of goods and services.
 - b) Policies concerning taxes.
 - c) Policies concerning transfer payments, such as unemployment compensation, Social Security benefits, welfare payments, and veterans' benefits to households.
 - d) All of the above.

- 2) The behavior of the Federal Reserve concerning the nation's money supply is called:
 - a) Budgetary policy.
 - b) Automatic fiscal policy.
 - c) Discretionary fiscal policy.
 - d) Monetary policy.

- 3) Over which of the following categories does the government have more control?
 - a) The size of corporate profits.
 - b) Tax revenue.
 - c) Tax rates.
 - d) Government expenditures.

- 4) The collection of taxes and the payment of transfer payments are two government activities that best fit one of the categories below. Which one?
 - a) Monetary policy.
 - b) Net taxes.
 - c) Discretionary fiscal policy.
 - d) The variable G .

- 5) Select the best answer. Households use their disposable income (Y_d) to do the following:
 - a) Consume and save.
 - b) Consume, save, pay taxes, and buy imports.
 - c) Consume, save, and pay taxes.
 - d) Consume.

- 6) When government enters the circular flow of income, which of the following is an expression for planned aggregate expenditure?
 - a) $G - T$
 - b) $Y - T$
 - c) $C + I + G$
 - d) $C + S + T$

- 7) Which of the following is an expression for the budget deficit?
 - a) $C + S + T$
 - b) $G - T$
 - c) $Y - T$
 - d) $C + I + G$

- 8) In the circular flow of income, a government budget deficit is financed by:
- Reducing investment and increasing government spending.
 - Turning a portion of consumption into government spending.
 - Using saving to finance both investment and the deficit.
 - Reducing government spending and increasing taxation.
- 9) What is the form of the consumption function when taxes (T) affect disposable income (Y_d)?
- $C = a + bY_d - T$
 - $C = a + bY + bT$
 - $C = a + b(Y_d - T)$
 - $C = a + b(Y - T)$
- 10) Consider an economy where $C = 100 + .8Y$, $I = 100$, $G = 100$, and $T = 100$, what is the equilibrium level of output?
- 1,500.
 - 275.
 - 900.
 - 1,100.
- 11) Consider an economy where $C = 100 + .8Y$, $I = 100$, $G = 100$, and $T = 100$. When the level of output is 1,000, what will happen to inventories?
- Inventories will rise and output will increase.
 - Inventories will rise and output will decrease.
 - Inventories will fall and output will decrease.
 - Inventories will fall and output will increase.
- 12) In the circular flow that includes households, firms, and government, which of the following expressions is the leakages/injections approach to equilibrium?
- $C + S = I + G$.
 - $Y = a + bT + I + G$.
 - $Y = C + I + G$.
 - $S + T = I + G$.
- 13) How much of an increase in government spending would be required to generate a \$200 billion increase in the equilibrium level of output?
- An amount less than \$200 billion in government spending.
 - An amount greater than \$200 billion in government spending.
 - Exactly \$200 billion in government spending.
 - None of the above. Equilibrium output does not change with changes in government spending.
- 14) The effect of an increase in government spending is most similar to the effect of:
- An increase in planned investment.
 - An increase in the marginal propensity to consume.
 - A decrease in lump sum taxes.
 - All of the above.

- 15) The government spending multiplier shows:
- How government spending is one of those variables that does not change in response to changes in the economy.
 - The amount by which government spending changes with changes in the level of output.
 - The ratio of the change in equilibrium output to an initial change in government spending.
 - The ratio of the change in government spending to a change in autonomous planned investment.
- 16) The tax multiplier is:
- Not the same as the multiplier for a change in government spending.
 - A negative multiplier.
 - The ratio of a change in the equilibrium level of output to a change in taxes.
 - All of the above.
- 17) Fill in the blanks. Because the initial increase in planned aggregate expenditure is _____ for a tax cut than for a government spending increase, the final effect on the equilibrium level of income will be _____.
- smaller; larger
 - larger; larger.
 - larger; smaller
 - smaller; smaller
- 18) Which of the following formulas shows the impact of a change in taxes on equilibrium income?
- $S + T = I + G$
 - $(-) \Delta T * b/1 - b$
 - $Y = 1/(1 - b) * (a - bT + I + G)$
 - $C + S = I + G$
 - $Y = a + b(Y - T) + I + G$
- 19) The value of the balanced-budget multiplier equals:
- $(-)MPC/MPS$
 - $1/MPC + 1/MPS$
 - $-\Delta T * (MPC/(1 - MPC))$
 - One.
- 20) What happens when there is a simultaneous increase in government spending of \$100 and a lump-sum tax of \$100?
- Equilibrium income would decrease by \$200, or double the amount of the increase in T.
 - Nothing happens. Equilibrium income remains the same because the amount of government spending (G) is compensated by the amount of taxation (T).
 - Equilibrium income would decrease by \$100, or the amount of increase in T.
 - Equilibrium income would increase by \$100, or the amount of increase in G.

- 21) The balanced-budget multiplier has a final impact on equilibrium income equal to:
- $\Delta T \cdot (MPC)$
 - $\Delta T \cdot (-MPC/MPS)$
 - ΔG
 - $\Delta G \cdot 1 - MPS$
- 22) The federal budget can be conceived as:
- An embodiment of some beliefs about how (if at all) the government should manage the macroeconomy.
 - A reflection of goals the government wants to achieve.
 - A political document that dispenses favors to some groups and places burdens on others.
 - All of the above.
- 23) The largest receipts for the U.S. federal government come from:
- Indirect business taxes; contributions to social insurance
 - Personal income taxes and contributions for social insurance.
 - Sales taxes and income taxes
 - Personal income taxes; indirect business taxes
 - Personal income taxes and corporate taxes
- 24) The large federal government deficits of the 1980s were the result of:
- Higher interest payments as a percentage of GDP.
 - A large defense buildup.
 - Lower personal income tax rates.
 - All of the above.
- 25) After a large deficit buildup in the in the 1980s, the federal government deficit:
- Was an even larger deficit, as a percent of GDP, in 2003 than it was in 1983.
 - Was vastly diminished during the G.W. Bush administration.
 - Turned into a surplus during the two Clinton administrations.
 - Continued to worsen steadily throughout the 1990s and into the 2000s.
- 26) Which of the following statements is/are correct about the U.S. federal debt?
- To finance the debt, the government issues government securities to the public.
 - The federal debt is the sum of accumulated budget deficits minus surpluses over time.
 - Some of the debt issued by the federal government ends up being held by the federal government itself.
 - All of the above.
- 27) Which of the following statements is correct about the government's control over its budget?
- The government has complete control over the expenditure side of the budget, but not complete control over the revenue side.
 - The government does not have complete control of either the revenue side or the expenditure side of the budget.
 - The size of the government budget, and whether it is in surplus or deficit, is controlled entirely by Congress, not by the economy.
 - The government has complete control over the revenue side of the budget, but not complete control over the expenditure side.

- 28) Automatic stabilizers refer to:
- Inherent stock market mechanisms that automatically cause stock market gains to be cancelled out by losses.
 - Government revenue and expenditure items that automatically change with changes in economic activity.
 - Discretionary monetary policy maneuvers that keep inflation automatically under control.
 - Invisible hand mechanisms that automatically bring the economy out of a recession.
- 29) The term fiscal drag refers to:
- The time it takes for the government to discover a problem in the economy, determine the correct action, and implement policies to deal with it.
 - The drag of budget deficits on the economy.
 - The impact of taxes on the economy, which may put a drag on an economic expansion.
 - Increases in government spending that put a drag on planned investment spending.
- 30) When the economy reaches full employment, the budget deficit is:
- Zero.
 - Equal to the cyclical deficit.
 - A combination of cyclical and structural deficits.
 - Equal to the structural deficit.
- 31) Discretionary fiscal policy refers to changes in taxes or spending that are the result of deliberate changes in government policy.
- True
 - False
- 32) The government does not have complete control over tax revenues and certain expenditures.
- True
 - False
- 33) Disposable income is the income used by households to consume, save, and pay taxes.
- True
 - False
- 34) When the economy is in equilibrium, saving plus net taxes equal planned investment plus government purchases.
- True
 - False
- 35) The multiplier effect of an increase in government spending is equivalent to the multiplier effect of a decrease in taxation.
- True
 - False
- 36) Exports are a leakage and imports an injection into the circular flow.
- True
 - False

37) The federal deficit was the lowest during the Reagan era, but grew substantially during the Clinton era.

- a) True
- b) False

38) Automatic stabilizers are automatic changes in government expenditures and taxation that tend to stabilize GDP throughout the business cycle.

- a) True
- b) False

39) Automatic taxation stabilizers create a so-called fiscal drag during economic expansions.

- a) True
- b) False

40) The full-employment budget may include a structural deficit.

- a) True
- b) False

41) Fill in the blanks in the table below, and graph the impact of the increase in government spending on aggregate expenditure.

$a =$	50		
$b =$	0.75		
$I =$	100		
$\bar{G} =$	0	$\bar{G} =$	100
$Aut. =$		$Aut. =$	
$mult. =$		$mult. =$	
$Y^* =$		$Y^* =$	
Y	$C + I$	$C + I + G$	
0			
200			
400			
600			
800			
1000			
1200			

42) The purpose of this exercise is to demonstrate the impact of spending and taxation under a balanced-budget philosophy. Fill in the blanks in the table below.

$a =$	50				
$b =$	0.75				
$I =$	100				
$G =$	0	$G =$	100		
$T =$	0	$T =$	100		
$Aut. =$		$Aut. =$			
$Y^* =$		$Y^* =$			
	<i>Consumption without tax (C)</i>	<i>C + I + G without Tax</i>	<i>Yd = Y - T</i>	<i>Consumption with tax (C')</i>	<i>C' + I + G with Lump-Sum Tax</i>
Y					
0					
200					
400					
600					
700					
800					
1000					
1200					

43) Derive a formula for the equilibrium level of income in the following economy:

$$C = a + bY$$

$$I = I$$

$$G = G$$

44) Derive a formula for the equilibrium level of income in the following economy:

a) $C = a + b(Y - T)$

$$T = T_0 - tY$$

$$I = I$$

$$G = G$$

b) What is the impact of imposing this form of tax on the value of the multiplier and on the value of autonomous expenditures?