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 (Yd) 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:
   a) Reducing investment and increasing government spending.
   b) Turning a portion of consumption into government spending.
   c) Using saving to finance both investment and the deficit.
   d) Reducing government spending and increasing taxation.

9) What is the form of the consumption function when taxes (T) affect disposable income (Yd)?
   a) \( C = a + bYd - T \)
   b) \( C = a + bY + bT \)
   c) \( C = a + b(Yd - T) \)
   d) \( C = a + b(Y - T) \)

10) Consider an economy where \( C = 100 + .8Y, I = 100, G = 100, \) and \( T = 100, \) what is the equilibrium level of output?
    a) 1,500.
    b) 275.
    c) 900.
    d) 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?
    a) Inventories will rise and output will increase.
    b) Inventories will rise and output will decrease.
    c) Inventories will fall and output will decrease.
    d) 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?
    a) \( C + S = I + G. \)
    b) \( Y = a + bT + I + G. \)
    c) \( Y = C + I + G. \)
    d) \( S + T = I + G. \)

13) How much of an increase in government spending would be required to generate a $200 billion increase in the equilibrium level of output?
    a) An amount less than $200 billion in government spending.
    b) An amount greater than $200 billion in government spending.
    c) Exactly $200 billion in government spending.
    d) 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:
    a) An increase in planned investment.
    b) An increase in the marginal propensity to consume.
    c) A decrease in lump sum taxes.
    d) All of the above.
15) The government spending multiplier shows:
   a) How government spending is one of those variables that does not change in response to changes in the economy.
   b) The amount by which government spending changes with changes in the level of output.
   c) The ratio of the change in equilibrium output to an initial change in government spending.
   d) The ratio of the change in government spending to a change in autonomous planned investment.

16) The tax multiplier is:
   a) Not the same as the multiplier for a change in government spending.
   b) A negative multiplier.
   c) The ratio of a change in the equilibrium level of output to a change in taxes.
   d) 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 ___________.
   a) smaller; larger
   b) larger; larger.
   c) larger; smaller
   d) smaller; smaller

18) Which of the following formulas shows the impact of a change in taxes on equilibrium income?
   a) $S + T = I + G$
   b) $(-) \Delta T * b/1 – b$
   c) $Y = 1/(1 – b) * (a – bT + I + G)$
   d) $C + S = I + G$
   e) $Y = a + b(Y – T) + I + G$

19) The value of the balanced-budget multiplier equals:
   a) $(-)MPC/MPS$
   b) $1/MPC + 1/MPS$
   c) $-\Delta T * (MPC/(1 – MPC)}$
   d) One.

20) What happens when there is a simultaneous increase in government spending of $100 and a lump-sum tax of $100?
   a) Equilibrium income would decrease by $200, or double the amount of the increase in T.
   b) Nothing happens. Equilibrium income remains the same because the amount of government spending (G) is compensated by the amount of taxation (T).
   c) Equilibrium income would decrease by $100, or the amount of increase in T.
   d) 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:
   a) \( \Delta T \cdot (\text{MPC}) \)
   b) \( \Delta T \cdot (-\text{MPC/MP}\text{S}) \)
   c) \( \Delta G \)
   d) \( \Delta G \cdot (1 - \text{MPS}) \)

22) The federal budget can be conceived as:
   a) An embodiment of some beliefs about how (if at all) the government should manage the macroeconomy.
   b) A reflection of goals the government wants to achieve.
   c) A political document that dispenses favors to some groups and places burdens on others.
   d) All of the above.

23) The largest receipts for the U.S. federal government come from:
   a) Indirect business taxes; contributions to social insurance
   b) Personal income taxes and contributions for social insurance.
   c) Sales taxes and income taxes
   d) Personal income taxes; indirect business taxes
   e) Personal income taxes and corporate taxes

24) The large federal government deficits of the 1980s were the result of:
   a) Higher interest payments as a percentage of GDP.
   b) A large defense buildup.
   c) Lower personal income tax rates.
   d) All of the above.

25) After a large deficit buildup in the 1980s, the federal government deficit:
   a) Was an even larger deficit, as a percent of GDP, in 2003 than it was in 1983.
   b) Was vastly diminished during the G.W. Bush administration.
   c) Turned into a surplus during the two Clinton administrations.
   d) 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?
   a) To finance the debt, the government issues government securities to the public.
   b) The federal debt is the sum of accumulated budget deficits minus surpluses over time.
   c) Some of the debt issued by the federal government ends up being held by the federal government itself.
   d) All of the above.

27) Which of the following statements is correct about the government’s control over its budget?
   a) The government has complete control over the expenditure side of the budget, but not complete control over the revenue side.
   b) The government does not have complete control of either the revenue side or the expenditure side of the budget.
   c) The size of the government budget, and whether it is in surplus or deficit, is controlled entirely by Congress, not by the economy.
   d) 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:
   a) Inherent stock market mechanisms that automatically cause stock market gains to be cancelled out by losses.
   b) Government revenue and expenditure items that automatically change with changes in economic activity.
   c) Discretionary monetary policy maneuvers that keep inflation automatically under control.
   d) Invisible hand mechanisms that automatically bring the economy out of a recession.

29) The term fiscal drag refers to:
   a) 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.
   b) The drag of budget deficits on the economy.
   c) The impact of taxes on the economy, which may put a drag on an economic expansion.
   d) Increases in government spending that put a drag on planned investment spending.

30) When the economy reaches full employment, the budget deficit is:
   a) Zero.
   b) Equal to the cyclical deficit.
   c) A combination of cyclical and structural deficits.
   d) 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.
   a) True
   b) False

32) The government does not have complete control over tax revenues and certain expenditures.
   a) True
   b) False

33) Disposable income is the income used by households to consume, save, and pay taxes.
   a) True
   b) False

34) When the economy is in equilibrium, saving plus net taxes equal planned investment plus government purchases.
   a) True
   b) False

35) The multiplier effect of an increase in government spending is equivalent to the multiplier effect of a decrease in taxation.
   a) True
   b) False

36) Exports are a leakage and imports an injection into the circular flow.
   a) True
   b) 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.

\[ \begin{array}{c|c|c}
 a & 50 & \\
 b & 0.75 & \\
 I & 100 & \\
 G & 0 & 100 \\
 Atd. & & \\
 mnd. & & \\
 \gamma^* & & \\
 \gamma & C + I & C + I + G \\
 0 & & \\
 200 & & \\
 400 & & \\
 600 & & \\
 800 & & \\
 1000 & & \\
 1200 & & \\
\end{array} \]
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.

<table>
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<tr>
<th></th>
<th>Consumption without tax (C)</th>
<th>C + I + G without Tax</th>
<th>Yd - Y - T</th>
<th>Consumption with tax (C')</th>
<th>C' + I + G with Lump-Sum Tax</th>
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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?