

# Chapter 9 The Government and Fiscal Policy

## 9.1 Government in the Economy

1) Fiscal policy refers to

- A) the techniques used by a business firm to reduce its tax liability.
- B) the behavior of the nation's central bank, the Federal Reserve, regarding the nation's money supply.
- C) the spending and taxing policies used by the government to influence the economy.
- D) the government's ability to regulate a firm's behavior in the financial markets.

Answer: C

2) Which of the following is NOT a category of fiscal policy?

- A) government policies regarding the purchase of goods and services
- B) government policies regarding taxation
- C) government policies regarding money supply in the economy
- D) government policies regarding transfer payments and welfare benefits

Answer: C

3) What determines tax revenues?

- A) the income tax rate B) the rate of interest
- C) the money supply in the economy D) the rate of inflation

Answer: A

4) Which of the following is INCORRECT regarding tax revenues?

- A) they increase during recessions
- B) they change with changes in the tax rate
- C) they are a revenue source in the government's budget
- D) they increase the rate of interest

Answer: A

239

5) During recessions, government spending usually

- A) decreases because unemployment payments decrease.
- B) increases because unemployment payments increase.
- C) decrease because unemployment payments increase.
- D) increases because unemployment payments decrease.

Answer: B

6) Disposable income

- A) increases when net taxes increase. B) increases when income increases.
- C) decreases when saving increases. D) increases when saving decreases.

Answer: B

7) Bill's income is \$1,000 and his net taxes are \$350. His disposable income is

- A) \$1,350. B) \$650. C) -\$350. D) \$750.

Answer: B

8) When the government sector is included in the income-expenditure model, the equation for aggregate income is

- A)  $Y = C + S - T$ . B)  $Y = C + I$ . C)  $Y = C + I + G$ . D)  $Y = C + S + I$ .

Answer: C

9) The difference between what a government spends and what it collects in taxes in a year is

- A) net revenue.
- B) net taxes.
- C) the government budget deficit or surplus.
- D) the government debt.

Answer: C

240

10) In 2007, the city of Canfield collected \$500,000 in taxes and spent \$450,000. In 2007, the city of Canfield had a

- A) budget surplus of \$450,000. B) budget surplus of \$50,000.
- C) budget deficit of \$50,000. D) budget surplus of \$5,000.

Answer: B

11) In 2007, the city of Miketown collected \$250,000 in taxes and spent \$350,000. In 2007, the city of Miketown had a

- A) budget surplus of \$100,000. B) budget surplus of 57%.
- C) budget deficit of \$100,000. D) budget deficit of \$200,000.

Answer: C

12) After government is added to the income-expenditure model, the formula for the aggregate consumption function is

- A)  $C = a - b(Y - T)$ . B)  $C = a - b(T - Y)$ .
- C)  $C = a + b(Y + T)$ . D)  $C = a + b(Y - T)$ .

Answer: D

13) The aggregate consumption function is  $C = 100 + .6Yd$ . If income is \$1,000 and net taxes are \$300, consumption equals

- A) 800. B) 520. C) 580. D) 700.

Answer: B

14) The aggregate consumption function is  $C = 800 + .8Yd$ . If income is \$2,000 and net taxes are \$500, consumption equals

- A) 2,000. B) 1,500. C) 2,150. D) 2,050.

Answer: A

241

15) The aggregate consumption function is  $C = 100 + .8Yd$ . If income is \$600 and net taxes are zero, consumption equals

- A) zero. B) 460. C) 580. D) 360.

Answer: C

16) The aggregate consumption function is  $C = 1,000 + .9Yd$ . If income is \$3,600 and net taxes are \$600, consumption equals

- A) 3,400. B) 3,700. C) 2,400. D) 4,000.

Answer: B

- 17) If output is less than planned aggregate expenditure, there will be  
 A) an unplanned increase in inventories. B) an unplanned decrease in inventories.  
 C) no change in inventories. D) a planned increase in inventories.  
 Answer: B

Refer to the information provided in Table 9.1 below to answer the questions that follow.

Table 9.1

**Table 9.1**

All Numbers are in \$ Billion

Output (Income)	Consumption Spending	Net Taxes	Investment Spending	Government Spending
400	400	100	200	100
800	700	100	200	100
1,200	1,000	100	200	100
1,600	1,300	100	200	100
2,000	1,600	100	200	100

- 18) Refer to Table 9.1. At an output level of \$1,200 billion, the level of aggregate expenditure is  
 A) \$1,000 billion. B) \$1,200 billion. C) \$1,300 billion. D) \$1,400 billion.  
 Answer: C

242

- 19) Refer to Table 9.1. At an output level of \$1,200 billion, there is an unplanned inventory change of  
 A) positive \$10 billion. B) zero.  
 C) negative \$100 billion. D) positive \$100 billion.  
 Answer: C

- 20) Refer to Table 9.1. At an output level of \$2,000 billion, the level of aggregate expenditure is  
 A) \$1,500 billion. B) \$1,800 billion. C) \$1,900 billion. D) \$2,000 billion.  
 Answer: C

- 21) Refer to Table 9.1. At an output level of \$2,000 billion, there is an unplanned inventory change of  
 A) positive \$100 billion. B) positive \$10 billion.  
 C) negative \$100 billion. D) zero.  
 Answer: A

- 22) Refer to Table 9.1. The equilibrium level of output is \_\_\_\_\_ billion.  
 A) \$800 B) \$1,200 C) \$1,600 D) \$2,000  
 Answer: C

23) Refer to Table 9.1. At an output level of \$800 billion, disposable income equals \_\_\_\_\_ billion.

- A) \$800 B) \$700 C) \$600 D) \$500

Answer: B

243

24) Refer to Table 9.1. At an output level of \$2,000 billion, the value of saving

- A) cannot be determined from the given information.  
B) is \$300 billion.  
C) is \$200 billion.  
D) is \$100 billion.

Answer: B

25) Refer to Table 9.1. At the equilibrium level of income, leakages equal \_\_\_\_\_ billion.

- A) \$0 B) \$100 C) \$200 D) \$300

Answer: D

26) Refer to Table 9.1 At an output level of \$1,200 billion, there is a tendency for output

- A) to fall. B) to increase.  
C) to remain constant. D) to either increase or decrease.

Answer: B

*Refer to the information provided in Table 9.2 below to answer the questions that follow.*

**Table 9.2**

<b>Output (Income)</b>	<b>Net Taxes</b>	<b>Consumption Spending</b>	<b>Planned Investment Spending</b>	<b>Government Purchases</b>
<i>Y</i>	<i>T</i>	<i>C</i>	<i>I</i>	<i>G</i>
500	100	400	150	50
1,000	100	800	150	50
1,500	100	1,200	150	50
2,000	100	1,600	150	50
2,500	100	2,000	150	50

27) Refer to Table 9.2. At an output level of \$1,500 billion, the level of aggregate expenditure is \_\_\_\_\_ billion.

- A) \$1,300 B) \$1,400 C) \$1,500 D) \$1,600

Answer: B

244

28) Refer to Table 9.2. At an output level of \$1,500 billion, there is an unplanned inventory

- A) decrease of \$200 billion. B) change of \$0.
- C) increase of \$100 billion. D) increase of \$150 billion.

Answer: C

29) Refer to Table 9.2. At an output level of \$2,500, the level of aggregate expenditure is \_\_\_\_\_ billion.

- A) \$1,500 B) \$2,000 C) \$2,300 D) \$2,200

Answer: D

30) Refer to Table 9.2. At an output level of \$2,500, there is an unplanned inventory

- A) increase of \$300 billion. B) decrease of \$200 billion.
- C) change of \$0. D) increase of \$200 billion.

Answer: A

31) Refer to Table 9.2. The equilibrium level of output is \_\_\_\_\_ billion.

- A) \$1000 B) \$1,500 C) \$2,000 D) \$2,500

Answer: A

32) Refer to Table 9.2. At an output level of \$1,500, disposable income

- A) is \$1,000.
- B) is \$1,200.
- C) is \$1,400.
- D) cannot be determined from this information.

Answer: C

245

33) Refer to Table 9.2. At an output level of \$2,500, the level for saving

- A) is \$300.
- B) is \$400.
- C) is \$500.
- D) cannot be determined from this information.

Answer: B

34) Refer to Table 9.2 At the equilibrium level of income, leakages equal \_\_\_\_\_ billion.

- A) \$0 B) \$300 C) \$500 D) \$200

Answer: D

35) Refer to Table 9.2. At an output level of \$2,500, there is a tendency for output

- A) to increase. B) to remain constant.
- C) to either increase or decrease. D) to fall.

Answer: D

***The Italian economy can be characterized by Equation 9.1.***

EQUATION 9.1:

$$C = 300 + .8Yd$$

$$G = 400$$

$$T = 200$$

$$I = 200$$

36) Refer to Equation 9.1. The equilibrium level of output for the Italian economy is

A) \$2,850. B) \$3,700. C) \$3,145. D) \$3,800.

Answer: B

37) Refer to Equation 9.1. At the equilibrium level of output in Italy, consumption equals

A) \$3,100. B) \$3,250. C) \$3,400. D) \$3,625.

Answer: A

246

38) Refer to Equation 9.1. At the equilibrium level of output in Italy, saving equals

A) \$450. B) \$400. C) \$550. D) \$500.

Answer: B

39) Refer to Equation 9.1. At the equilibrium level of output in Italy, leakages equal

A) \$650. B) \$600. C) \$750. D) \$700.

Answer: B

***The Canadian economy can be characterized by Equation 9.2.***

EQUATION 9.2:

$$C = 500 + .5Yd$$

$$\text{Taxes} = 600$$

$$\text{Equilibrium Output} = \$4,000$$

40) Refer to Equation 9.2. At equilibrium, the sum of investment and government purchases in Canada is

A) \$1,800.

B) \$1,500.

C) \$1,750.

D) cannot be determined from the given information

Answer: A

41) Refer to Equation 9.2. At equilibrium, government purchases in Canada is

A) \$1,500.

B) \$1,000.

C) \$1,250.

D) cannot be determined from the given information

Answer: D

247

42) Refer to Equation 9.2. At equilibrium, saving in Canada equals

A) \$1,200. B) \$1,600. C) \$1,350. D) \$1,250.

Answer: A

43) Refer to Equation 9.2. At equilibrium leakages in Canada equal

A) \$1,750. B) \$1,800. C) \$2,100. D) \$1,700.

Answer: B

44) Assuming there is no foreign trade in the economy, the economy is in equilibrium when

- A)  $S + T = C + I$ . B)  $I + G = S + T$ . C)  $IT = S + G$ . D)  $G + T = S + I$ .

Answer: B

45) Assuming there is no foreign trade in the economy, equilibrium is achieved when government purchases equal

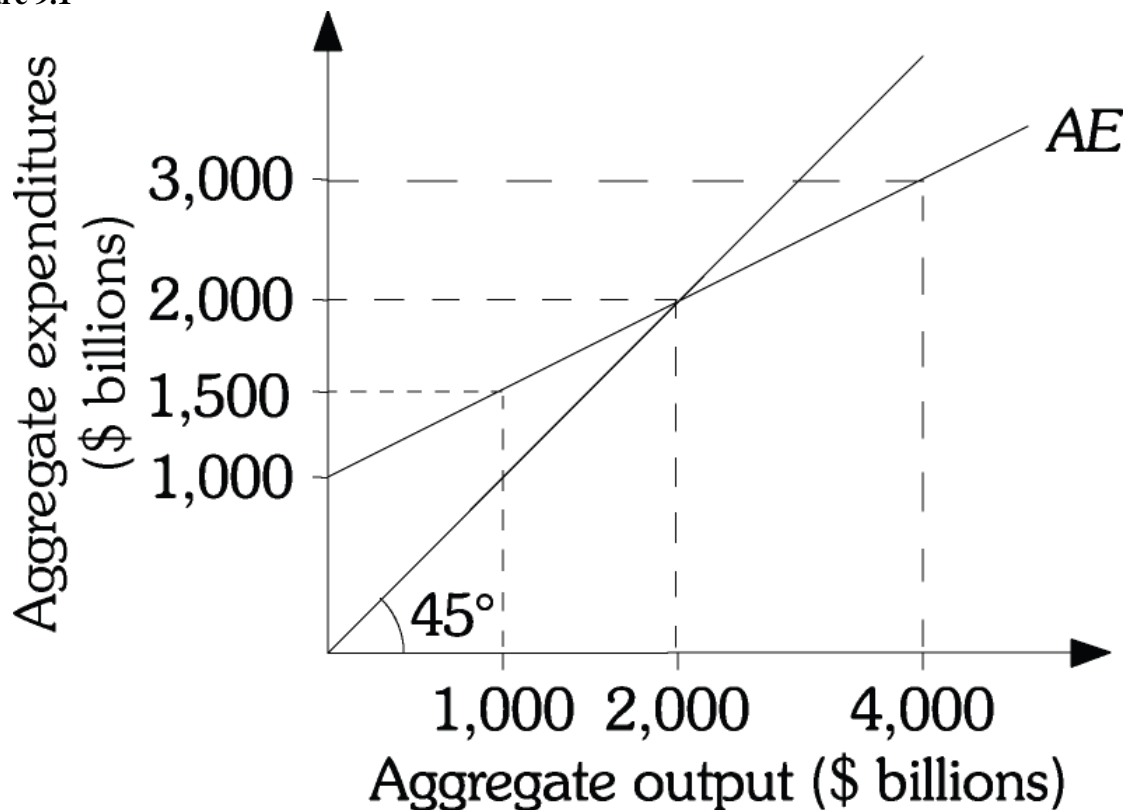
- A) saving minus net taxes minus consumption.  
B) saving plus net taxes minus investment.  
C) net taxes plus investment minus saving.  
D) net taxes minus investment minus saving.

Answer: B

248

Refer to the information provided in Figure 9.1 below to answer the questions that follow.

Figure 9.1



46) Refer to Figure 9.1. The equilibrium level of aggregate expenditure is \$\_\_\_\_\_ billion.

- A) 3,000 B) 2,000 C) 4,000 D) 1,500

Answer: B

47) Refer to Figure 9.1. The *MPC* in this economy is

- A) 0.4.  
B) 0.6.  
C) 0.5.  
D) cannot be determined from the given information

Answer: C

48) Refer to Figure 9.1. At equilibrium, injections  
A) can be greater than \$1,000 billion. B) equal \$1,500 billion.  
C) equal leakages. D) equal \$2,000 billion.  
Answer: C

249

49) Refer to Figure 9.1. At equilibrium, the part of consumption that is dependent on income equals \$\_\_\_\_\_ billion.  
A) \$1,500  
B) \$1,000  
C) \$2,000  
D) cannot be determined from the given information  
Answer: B

50) Refer to Figure 9.1. Suppose that the consumption function is  $C = 400 + 0.5Yd$  and taxes are \$200 billion, at equilibrium the value of injections are  
A) \$700 billion. B) \$500 billion. C) \$650 billion. D) \$350 billion.  
Answer: A

51) Refer to Figure 9.1. Suppose that the consumption function is  $C = 400 + 0.5Yd$  and taxes are \$200 billion, at equilibrium the value of autonomous consumption is  
A) \$400 billion. B) \$300 billion. C) \$100 billion. D) \$200 billion.  
Answer: A

52) Refer to Figure 9.1. Suppose that the consumption function is  $C = 400 + 0.5Yd$  and taxes are \$200 billion, at equilibrium, what is the value of consumption?  
A) \$1,350 B) \$2,000 C) \$1,300 D) \$1,150  
Answer: C

53) If planned injections exceed leakages, output will  
A) decrease. B) increase.  
C) remain constant. D) either increase or decrease.  
Answer: B

250

54) For the economy to be in equilibrium,  
A) government purchases must equal tax revenue and saving must equal investment.  
B) government purchases must equal the sum of tax revenue, saving and investment.  
C) government purchases plus investment must equal saving plus tax revenue.  
D) investment plus tax revenue must equal government purchases plus saving.  
Answer: C

## 2 True/False

1) The economy is in equilibrium when aggregate output equals consumption spending.  
Answer: FALSE

2) For the economy to be in equilibrium, the following condition must be satisfied:  $G + I = S + T$ .  
Answer: TRUE

3) When investment is greater than planned investment, output grows.  
Answer: FALSE



4) Disposable income is income less net taxes.

Answer: TRUE

## 9.2 Fiscal Policy at Work: Multiplier Effects

### 1 Multiple Choice

1) If the government wants to reduce unemployment, government purchases should be \_\_\_\_\_ and/or taxes should be \_\_\_\_\_.

A) increased; increased B) decreased; decreased

C) decreased; increased D) increased; decreased

Answer: D

251

2) The President of Vulcan hires you as an economic consultant. He is concerned that the output level in Vulcan is too high and that this will cause prices to rise. He feels that it is necessary to reduce output by \$10 billion. He tells you that the *MPC* in Vulcan is 0.6. Which of the following would be the best advice to give to the Vulcan president?

A) reduce government purchases by \$4 billion

B) increase taxes by \$10 billion

C) reduce government purchases by \$10 billion

D) increase taxes by \$2.5 billion

Answer: A

3) The leader of Atlantis hires you as an economic consultant. He is concerned that the output level in Atlantis is too low and that this will cause prices to fall. He feels that it is necessary to increase output by \$200 billion. He tells you that the *MPC* in Atlantis is 0.8. Which of the following would be the best advice to give to the Atlantis president?

A) reduce government spending by \$100 billion

B) decrease taxes by \$50 billion

C) increase government spending by \$200 billion

D) increase government spending by \$100 billion

Answer: B

Refer to the information provided in Table 9.3 below to answer the questions that follow.  
**Table 9.3**

**Table 9.3**  
**All Numbers are in \$ Million**

Output (Income)	Net Taxes	Consumption	Savings	Planned Investment	Planned Government Spending
1,000	200	—	120	200	200
1,100	200	760	140	200	200
1,200	200	840	—	200	200
1,300	200	—	180	200	200
1,400	200	1,000	200	200	200
1,500	200	1,080	220	200	200
1,600	200	1,160	—	200	200

4) Refer to Table 9.3. Assuming constant *MPC*, at income of \$1,000 million, consumption is \$\_\_\_\_\_ million, and at income of \$1,300 million, consumption is \$\_\_\_\_\_ million.

A) 600; 860 B) 640; 900 C) 680; 920 D) 720; 960

Answer: C

252

5) Refer to Table 9.3. Assuming constant *MPC*, at income of \$1,200 million, saving is \$\_\_\_\_\_ million, at income of \$1,600 million, saving is \$\_\_\_\_\_ million.

A) 150; 230 B) 160; 240 C) 170; 250 D) 180; 260

Answer: B

6) Refer to Table 9.3. The *MPC* in this economy is \_\_\_\_\_ and the *MPS* is \_\_\_\_\_.

A) 0.5; 0.5 B) 0.7; 0.5 C) 0.9; 0.1 D) 0.8; 0.2

Answer: D

7) Refer to Table 9.3. The equilibrium level of aggregate output is \$\_\_\_\_\_ million.

A) 1,200 B) 1,300 C) 1,400 D) 1,500

Answer: C

8) Refer to Table 9.3. Which of the following variables is NOT considered autonomous?

A) Saving B) Planned investment

C) Planned government spending D) none of the above

Answer: A

9) Refer to Table 9.3. Suppose the economy is in equilibrium and the government increases spending by \$50 million, the new equilibrium output is \$\_\_\_\_\_ million

A) 1,650 B) 1,450 C) 1,750 D) 1,350

Answer: A

10) Refer to Table 9.3. Suppose the economy is in equilibrium and the government raises taxes from \$200 million to \$220 million, equilibrium output will \_\_\_\_\_ by \$\_\_\_\_\_ million.

A) decrease; 20 B) increase; 20 C) decrease; 80 D) increase; 80

Answer: C

Refer to the information provided in Table 9.4 below to answer the questions that follow.

Table 9.4

**Table 9.4**  
**All Figures in Billions of Dollars**

Output (Income)	Consumption		Planned		
	Net Taxes	Spending ( $C = 100 + .9Y_d$ )	Savings	Investment Purchases	Government Spending
2,400	100	2,170	150	130	200
2,800	100	2,530	170	130	200
3,000	100	2,710	190	130	200
3,200	100	2,890	210	130	200
3,400	100	3,070	230	130	200
3,600	100	3,250	250	130	200
3,800	100	3,300	270	130	200

11) Refer to Table 9.4. The equilibrium level of income is  
A) \$3,400 billion. B) \$3,800 billion. C) \$2,000 billion. D) \$3,600 billion.

Answer: A

12) Refer to Table 9.4. The *MPS*

A) is .8.

B) is .1.

C) is .2

D) cannot be determined from the available information.

Answer: B

13) Refer to Table 9.4. The value of the government spending multiplier

A) is 10.

B) is .9.

C) is 5.

D) cannot be determined from the available information.

Answer: A

254

14) Refer to Table 9.4. The economy is at the equilibrium level of output. If government spending increases to a level of \$400 billion, the new equilibrium level of output is

A) \$5,400 billion. B) \$2,100 billion. C) \$6,040 billion. D) \$6,600 billion.

Answer: A

15) Refer to Table 9.4. The economy is at the equilibrium level of output. If government spending decreases by \$100 billion, the new equilibrium level of output is

A) \$3,100 billion. B) \$2,400 billion. C) \$1,450 billion. D) \$1,550 billion.

Answer: B

16) Refer to Table 9.4. If taxes are reduced from \$100 billion to \$50 billion, the new equilibrium level of output is

A) \$4,050 billion. B) \$1,600 billion. C) \$3,850 billion. D) \$2,100 billion.

Answer: C

17) Refer to Table 9.4. If taxes are reduced from \$100 billion to \$50 billion and government spending is reduced from \$200 billion to \$150 billion, the new equilibrium level of income

A) is \$3,350 billion.

B) is \$3,550 billion.

C) is \$1,600 billion.

D) cannot be determined from this information.

Answer: A

18) The government purchases multiplier is

A) the difference between the old equilibrium level of output and the new equilibrium level of output.

B) the ratio of the change in government purchases to the change in the equilibrium level of output.

C) the ratio of the change in the equilibrium level of output to a change in government purchases.

D) the difference between the new and old levels of government purchases.

Answer: C

255

19) If the *MPC* is .75, the government spending multiplier is

A) 2.5. B) 4. C) 3. D) 1.75.

Answer: B

20) If the *MPC* is .5, the tax multiplier is

A) -2.5. B) -2. C) -1. D) -1.666.

Answer: C

21) If the government spending multiplier is 2 and government purchases increase by \$200 billion, output will increase by

A) \$100 billion. B) \$400 billion. C) \$1,600 billion. D) \$500 billion.

Answer: B

22) If the government spending multiplier is 5 and government spending decreases by \$200 billion, output will \_\_\_\_\_ by \$\_\_\_\_\_ billion.

A) increase; 200 B) decrease; 1,000

C) decrease; 40 D) decrease; 200

Answer: B

*The economy of Bananaland can be characterized by Equation 9.3.*

EQUATION 9.3:

$$C = 2,000 + .75Yd$$

$$T = 200$$

$$G = 400$$

$$I = 500$$

23) Refer to Equation 9.3. The equilibrium level of income in Bananaland is

A) 4,800. B) 11,000. C) 10,000. D) 5,600.

Answer: B

256

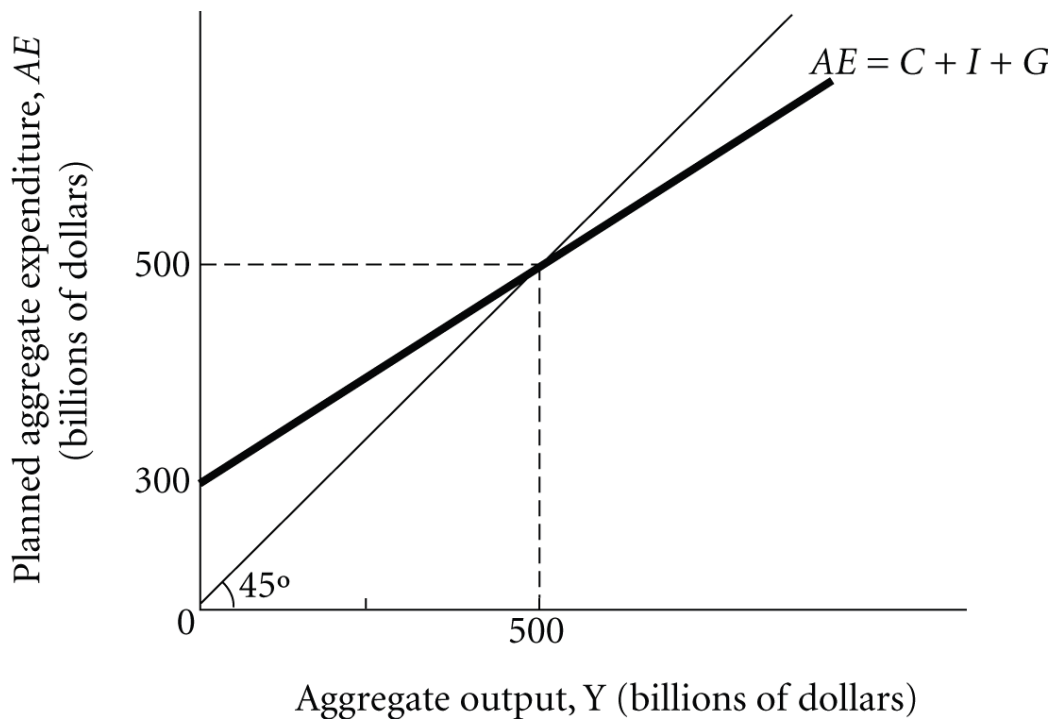
24) Refer to Equation 9.3. If government spending in Bananaland increases by \$50, equilibrium output increases by

A) \$100. B) \$200. C) \$400. D) \$800.

Answer: B

*Refer to the information provided in Figure 9.3 below to answer the questions that follow.*

**Figure 9.3**



25) Refer to Figure 9.3. At equilibrium, autonomous planned expenditures equal \$\_\_\_\_\_ billion.

A) 200 B) 100 C) 500 D) 300

Answer: D

26) Refer to Figure 9.3. The expenditure multiplier is

- A) 4. B) 5. C) 2.5. D) 2.

Answer: C

27) Refer to Figure 9.3. If autonomous planned expenditure increases by \$20 billion, equilibrium aggregate output \_\_\_\_\_ to \$\_\_\_\_\_ billion.

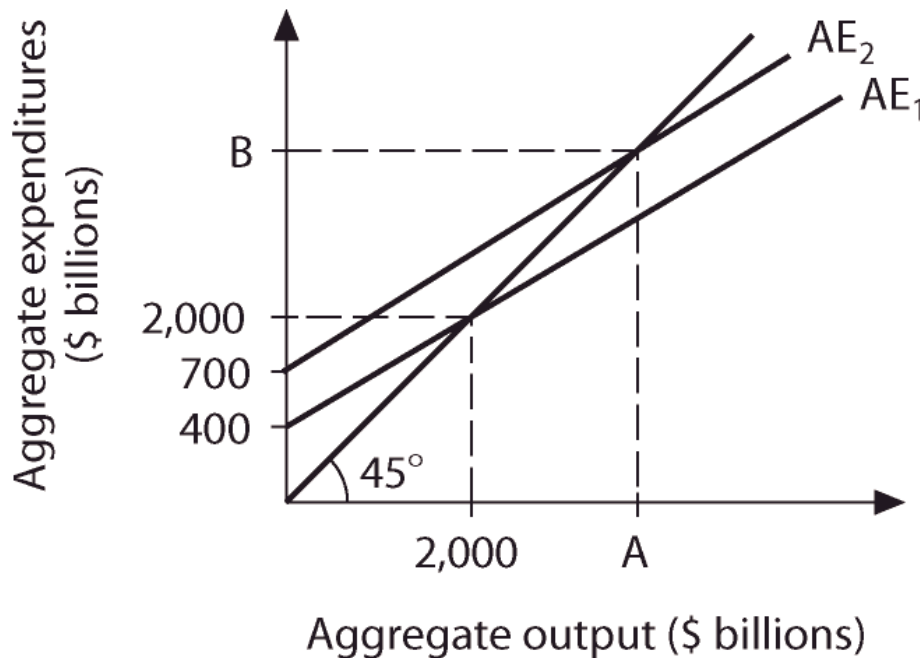
- A) decreases; 360 B) increases; 550 C) increases; 600 D) increases; 640

Answer: B

257

Refer to the information provided in Figure 9.4 below to answer the questions that follow.

Figure 9.4



28) Refer to Figure 9.4. Along aggregate expenditure AE<sub>1</sub>, the MPC is

- A) .6. B) .7. C) .8. D) .9.

Answer: C

29) Refer to Figure 9.4. What is the value of Point A?

- A) \$3,500 billion.  
B) \$6,000 billion.  
C) \$7,000 billion.  
D) cannot be determined from the given information

Answer: A

30) Refer to Figure 9.4. What is the value of Point B?

- A) \$7,000 billion  
B) \$3,500 billion  
C) \$6,000 billion  
D) cannot be determined from the given information

Answer: B

258

31) Refer to Figure 9.4. What is the value of the expenditure multiplier?

A) 8 B) 10 C) 5 D) 20

Answer: C

32) Refer to Figure 9.4. Along  $AE_1$ , injections equal leakages when aggregate output equals \$\_\_\_\_\_ billion.

A) 1,500 B) 3,000 C) 2,500 D) 2,000

Answer: D

33) Refer to Figure 9.4. If aggregate expenditures are represented by  $AE_2$  and government spending increases by \$20 billion, equilibrium aggregate output increases by \$\_\_\_\_\_ billion.

A) 100 B) 200 C) 400 D) 800

Answer: A

34) Government spending increases by \$40 billion and the equilibrium level of output increases by \$200 billion. The government spending multiplier

A) is 5.

B) is 4.

C) is 6.

D) cannot be determined from this information, because the  $MPC$  is not given.

Answer: A

35) Assume an economy is in equilibrium at an output level of \$1,500 billion. If government spending increases by \$200 billion, then at the output level of \$1,500 billion, there is

A) an unplanned rise in inventories.

B) an unplanned fall in inventories.

C) an unplanned inventory change of zero.

D) either an unplanned increase or decrease in inventories depending on the value of the  $MPC$ .

Answer: B

259

36) Assume an economy is in equilibrium at an output level of \$600 billion. If government purchases decrease by \$75 billion, then at the output level of \$600 billion, there is

A) an unplanned increase in inventories.

B) an unplanned inventory change of zero.

C) either an unplanned increase or decrease in inventories depending on the value of the  $MPC$ .

D) an unplanned decrease in inventories.

Answer: A

37) A decrease in lump-sum taxes will

A) make the consumption function flatter.

B) make the consumption function steeper.

C) shift the consumption function downward.

D) shift the consumption function upward.

Answer: D

38) The tax multiplier is

- A) the ratio of the change in taxes to the change in the equilibrium level of output.
- B) the *MPC* multiplied by the *MPS*.
- C) the difference in taxes multiplied by the change in the equilibrium level of output.
- D) the ratio of the change in the equilibrium level of output to the change in taxes.

Answer: D

39) If the *MPC* is 0.7, the tax multiplier is

- A) -2.22. B) -1.22. C) -2.33. D) -3.33.

Answer: C

40) If the *MPS* is 0.4, the tax multiplier is

- A) -2.5. B) -1.67. C) -1.5. D) -2.33.

Answer: C

260

41) If the *MPS* is 0.5, the tax multiplier is

- A) -5. B) -2. C) -1. D) -0.5.

Answer: C

42) Taxes are reduced by \$70 billion and income increases by \$280 billion. The value of the tax multiplier is

- A) -4. B) -20. C) -10. D) -5.

Answer: A

43) Taxes are reduced by \$15 billion and income increases by \$75 billion. The value of the tax multiplier is

- A) -4. B) 9. C) -10. D) -5.

Answer: D

44) If the tax multiplier is -9 and taxes are reduced by \$100 billion, output

- A) falls by \$100 billion. B) falls by \$900 billion.
- C) increases by \$900 billion. D) increases by \$100 billion.

Answer: C

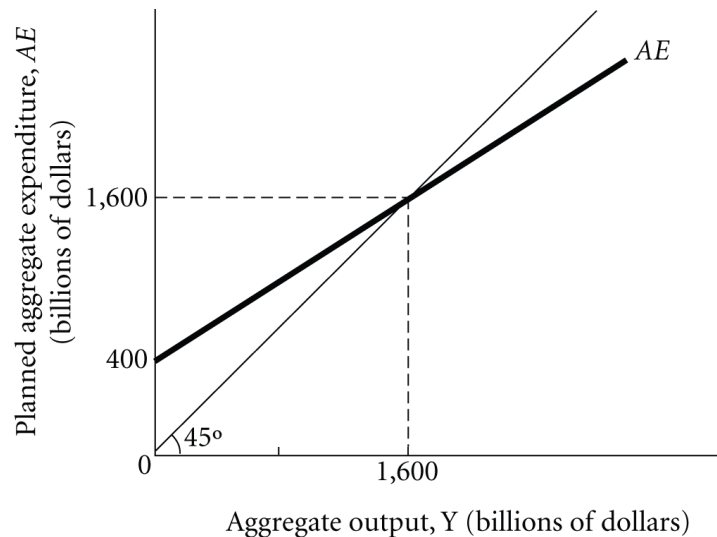
45) If the tax multiplier is -12 and taxes are increased by \$6 billion, output

- A) falls by \$2 billion. B) falls by \$72 billion.
- C) increases by \$2 billion. D) increases by \$72 billion.

Answer: B



Refer to the information provided in Figure 9.5 below to answer the questions that follow.  
**Figure 9.5**



46) Refer to Figure 9.5. Which of the following equations best represents the aggregate expenditure function?

- A)  $AE = 1,600 + .4Y$ . B)  $AE = 400 + .75Y$ .  
 C)  $AE = 1,200 + .8Y$ . D)  $AE = 1,000 + .5Y$ .

Answer: B

47) Refer to Figure 9.5. At aggregate output of \$2,400 billion, unplanned inventories equal \$\_\_\_\_\_ billion.

- A) 200 B) 800 C) -800 D) -400

Answer: A

48) Refer to Figure 9.5. The government spending multiplier equals \_\_\_\_\_ and the tax multiplier equals \_\_\_\_\_.

- A) 2.5; -1.5 B) 4; -3 C) 5; -4 D) 9; -8

Answer: B

49) Refer to Figure 9.5. If the economy is in equilibrium and the government increases spending by \$100 billion, equilibrium aggregate expenditures increase to \$\_\_\_\_\_ billion.

- A) 1,700 B) 1,800 C) 2,000 D) 2,400

Answer: C

50) Refer to Figure 9.5. If the economy is in equilibrium and the government decreases spending by \$200 billion, equilibrium aggregate output decreases to \$\_\_\_\_\_ billion.

- A) 1,400 B) 1,200 C) 1,000 D) 800

Answer: D

51) Refer to Figure 9.5. If the economy is in equilibrium and the government increases taxes by \$50 billion, equilibrium aggregate output \_\_\_\_\_ to \$\_\_\_\_\_ billion.

- A) increases; 2,000 B) decreases; 1,550  
 C) decreases; 1,450 D) decreases; 1,400

Answer: C

52) Refer to Figure 9.5. If the economy is in equilibrium and the government increases spending by \$100 billion and increases taxes by \$100 billion, equilibrium aggregate output

- A) does not change.
- B) increases by \$100 billion.
- C) increases by less than \$100 billion.
- D) increases by more than \$100 billion.

Answer: B

53) If the government spending multiplier is 10, then the tax multiplier

- A) is -5.
- B) is -4.
- C) is -9.
- D) cannot be determined because the *MPS* is not given.

Answer: C

54) If the tax multiplier is -8.42, then the government purchases multiplier

- A) is 8.42.
- B) is 9.42.
- C) is 1.58.
- D) cannot be determined because the *MPS* is not given.

Answer: B

263

55) If government spending is increased by \$300, taxes are reduced by \$300, and the *MPS* is .5, equilibrium output will change by

- A) \$300.
- B) \$0.
- C) \$900.
- D) an amount that cannot be determined from this information.

Answer: C

Mohammed taha  
[www.yufoe.weebly.com](http://www.yufoe.weebly.com)

56) If government purchases are increased by \$100, taxes are reduced by \$100, and the *MPC* is .8, equilibrium output will change by

- A) -\$400.
- B) \$1,800.
- C) \$900.
- D) an amount that cannot be determined from this information.

Answer: C

57) If government spending is increased by \$550 and taxes are increased by \$550, the equilibrium level of income will

- A) decrease by \$550.
- B) not change.
- C) increase by \$550.
- D) increase by \$1,100.

Answer: C

58) If government purchases are decreased by \$800 and taxes are decreased by \$800, the equilibrium level of income will

- A) decrease by \$800.
- B) increase by \$800.
- C) not change.
- D) decrease by \$1600.

Answer: A

264

59) Assume that the  $MPC$  is  $.75$ . If government spending increases by \$400, equilibrium output \_\_\_\_\_; and if taxes increase by \$400, equilibrium output \_\_\_\_\_.

- A) increases by \$1,600; decreases by \$1,600
- B) increases by \$1,600; decreases by \$1,200
- C) increases by \$1,200; decreases by \$1,600
- D) increases by \$400; decreases by \$400

Answer: B

60) Assume that the  $MPC$  is  $.9$ . If government purchases increase by \$100, equilibrium output \_\_\_\_\_; and if taxes increase by \$100, equilibrium output \_\_\_\_\_.

- A) increases by \$1,000; decreases by \$1,000
- B) increases by \$900; decreases by \$1,000
- C) increases by \$1,000; decreases by \$900
- D) increases by \$400; decreases by \$400

Answer: C

61) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The Chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the  $MPC$  is  $.8$ . Which of the following policies should you recommend?

- A) Increase government purchases by \$60 billion.
- B) Increase government purchases by \$150 billion.
- C) Cut taxes by \$60 billion.
- D) Cut taxes by \$60 billion and to increase government purchases by \$60 billion.

Answer: A

62) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The Chairperson of the BEA tells you that he believes the current unemployment rate is too low. The unemployment rate can be increased if aggregate output decreases. He wants to know what policy to pursue to decrease aggregate output by \$100 billion. The best estimate he has for the  $MPC$  is  $.9$ . Which of the following policies should you recommend?

- A) Decrease government spending by \$10 billion.
- B) Decrease government spending by \$100 billion.
- C) Increase taxes by \$100 billion.
- D) Cut taxes by \$60 billion and to increase government spending by \$60 billion.

Answer: A

265

63) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the  $MPC$  is  $.8$ . Which of the following policies should you recommend?

- A) Increase government purchases by \$75 billion.
- B) Reduce taxes by \$75 billion.
- C) Reduce taxes by \$75 billion and to increase government purchases by \$75 billion.
- D) Reduce the budget deficit by \$300 billion.

Answer: B

64) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The chairperson of the BEA tells you that he believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. He wants to know what policy to pursue to increase aggregate output by \$500 billion. The best estimate he has for the  $MPC$  is .7. Which of the following policies should you recommend?

- A) Decrease government spending by \$75 billion.
- B) Reduce taxes by \$214.3 billion.
- C) Reduce taxes by \$314.3 billion and to decrease government spending by \$500 billion.
- D) Reduce the budget deficit by \$300 billion.

Answer: B

65) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the  $MPC$  is .8. Which of the following policies should you recommend?

- A) Increase government spending by \$300 billion and reduce taxes by \$300 billion.
- B) Reduce government spending by \$300 billion and increase taxes by \$300 billion.
- C) Increase both government spending and taxes by \$300 billion.
- D) Decrease both government spending and taxes by \$300 billion.

Answer: C

266

66) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The chairperson of the BEA tells you that he believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. He wants to know what policy to pursue to increase aggregate output by \$500 billion. The best estimate he has for the  $MPC$  is .75. Which of the following policies should you recommend?

- A) Reduce government spending by \$500 billion and reduce taxes by \$500 billion.
- B) Increase both government spending and taxes by \$500 billion.
- C) Increase government spending by \$500 billion and reduce taxes by \$500 billion.
- D) none of the above

Answer: B

67) As the size of the  $MPC$  increases, the value of the balanced-budget multiplier

- A) increases. B) decreases.
- C) remains constant. D) could either increase or decrease.

Answer: C

68) Suppose that in the beginning of 2007 the federal debt was \$9 trillion. During 2007, the government balanced its budget. At the end of 2007, the federal debt

- A) increased. B) stayed the same.
- C) decreased. D) was eliminated.

Answer: B

## 2 True/False

1) If autonomous spending increases, the aggregate expenditure function becomes steeper.

Answer: FALSE

2) If the government increases taxes by \$4 billion and increases spending by \$4 billion, equilibrium output increases by \$4 billion.

Answer: TRUE

267

3) A tax cut of \$12 billion will have less effect on the economy than an increase in government purchases of \$12 billion.

Answer: TRUE

## 9.3 The Federal Budget

1) The total amount owed by the federal government to the public is the

A) federal budget deficit. B) federal debt.

C) net tax revenue. D) fiscal drag.

Answer: B

2) What is the largest expenditure source in the government's budget?

A) consumption B) transfer payments

C) net interest payments D) net subsidies

Answer: B

3) What is the largest source of revenue in the government's budget?

A) social insurance B) indirect business taxes

C) corporate taxes D) personal taxes

Answer: D

4) A government's debt is reduced when it

A) balances its budget. B) sells more bonds.

C) runs a deficit. D) runs a surplus.

Answer: D

268

5) When a government runs a deficit

A) its debt increases. B) it must raise taxes

C) its debt decreases. D) it must cut spending.

Answer: A

## 2 True/False

1) The amount the government owes to the public is the deficit.

Answer: FALSE

2) If tax receipts are less than government expenditures the government is running a deficit.

Answer: TRUE

3) If the government runs a deficit, then the government debt increases.

Answer: TRUE

4) Defense spending is the largest part of the U.S. government spending.

Answer: FALSE

5) The government budget is balanced when tax receipts equal government spending.

Answer: TRUE

269

#### 9.4 The Economy's Influence on the Government Budget

1) Which of the following is a CORRECT sequence of events during a recession?

A) unemployment falls, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises

B) unemployment rises, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises

C) unemployment rises, income falls, tax revenue rises, unemployment benefits fall, and the budget deficit falls

D) unemployment rises, income rises, tax revenue rises, unemployment benefits rise, and the budget deficit rises

Answer: B

2) Which of the following is a CORRECT sequence of events during an expansion?

A) unemployment falls, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit falls

B) unemployment rises, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises

C) unemployment rises, income falls, tax revenue rises, unemployment benefits fall, and the budget deficit falls

D) unemployment falls, income rises, tax revenue rises, unemployment benefits fall, and the budget deficit falls

Answer: D

3) The presence of automatic stabilizers means that the federal deficit is \_\_\_\_\_ than it otherwise would be in a recession and \_\_\_\_\_ than it otherwise would be in an expansion.

A) larger; smaller B) smaller; larger

C) smaller; smaller D) larger; larger

Answer: A

4) During a recession, automatic stabilizers cause the federal deficit to

A) decrease. B) either increase or decrease.

C) remain unchanged. D) increase.

Answer: D

270

5) An example of an automatic stabilizer is

A) the food stamp program.

B) changing the tax laws to increase the marginal tax rates.

C) the indexation of social security benefits to the consumer price index.

D) the interest the government pays on loans.

Answer: A

6) If the economy is in a recession, the full-employment deficit is \_\_\_\_\_ the actual deficit.

- A) larger than
- B) equal to
- C) smaller than
- D) equal to or larger than

Answer: C

7) If the economy's full-employment output is \$6 trillion, actual output is \$3.5 trillion, and the budget deficit is \$20 billion, the deficit in this case is known as a

- A) natural employment deficit.
- B) cyclical deficit.
- C) structural deficit.
- D) debt deficit.

Answer: B

8) If the economy's full-employment output is \$9 trillion, actual output is \$9 trillion, and the budget deficit is \$20 billion, the deficit in this case is known as a

- A) natural employment deficit.
- B) cyclical deficit.
- C) structural deficit.
- D) fiscal deficit.

Answer: C

9) Assume that in the United States the actual deficit is \$300 billion. If the United States were at full employment, the deficit would be \$100 billion. The structural deficit in the United States is

- A) \$100 billion.
- B) \$200 billion.
- C) \$300 billion.
- D) \$400 billion.

Answer: A

271

10) Assume that in the Atlantis the actual deficit is \$200 billion. If the Atlantis were at full employment, the deficit would be \$50 billion. The structural deficit in the Atlantis is

- A) \$100 billion.
- B) \$200 billion.
- C) \$50 billion.
- D) \$150 billion.

Answer: C

11) In which case will the government collect more tax revenue?

- A) 40% tax rate and \$40,000 average income
- B) 90% tax rate and \$10,000 average income
- C) 20% tax rate and \$90,000 average income
- D) 4% tax rate and \$80,000 average income

Answer: C

12) If taxes are a function of income, then the *AE* function is

- A) flatter than if taxes are a lump-sum amount.
- B) steeper than if taxes are a lump-sum amount.
- C) vertical.
- D) downward sloping.

Answer: A

13) Related to the *Economics in Practice* on p. 174 [486]: The value of the rebate checks issued by the government in 2008 will impact the economy and be affected by the

- A) government spending multiplier.
- B) tax multiplier.
- C) money multiplier.
- D) balanced-budget multiplier.

Answer: B

14) Related to the *Economics in Practice* on p. 174 [486]: As a direct stimulus for the economy, tax rebates will generally have \_\_\_\_\_ increasing government spending.

- A) a greater impact than
- B) a smaller impact than
- C) an equal impact to
- D) no impact, as opposed to

Answer: B

272

**2 True/False**

1) During recessions, automatic stabilizers work to reduce government expenditures and increase government revenues.

Answer: FALSE

2) The structural deficit is the deficit at full employment.

Answer: TRUE

3) In an expansion the U.S. federal government deficit automatically grows.

Answer: FALSE

4) Automatic stabilizers include those elements of government spending that automatically grow during a recession.

Answer: TRUE

9.5 Appendix A: Deriving the Fiscal Policy Multipliers

1) The formula for the government spending multiplier is

A)  $1/(1 + MPC)$ . B)  $1/MPS$ . C)  $1/MPC$ . D)  $1/(1 + MPS)$ .

Answer: B

2) If the  $MPS$  is 0.2, the tax multiplier is

A) -4. B) -1.11. C) -9. D) -5.

Answer: A

273

3) If the  $MPS$  is 0.1, the government spending multiplier is

A) 10. B) 1.11. C) 5. D) 2.

Answer: A

4) The formula for the tax multiplier is

A)  $-(MPS/MPC)$ . B)  $MPS/MPC$ . C)  $-(MPC/MPS)$ . D)  $-1/MPS$ .

Answer: C

5) If the  $MPC$  is 0.9, the tax multiplier is

A) -9. B) -10. C) -1.10. D) 10.

Answer: A

6) The balanced-budget multiplier

A) equals 0. B) is greater than 0 but less than 1.

C) is greater than 1. D) equals 1.

Answer: D

**2 True/False**

1) As the  $MPC$  decreases, the government spending multiplier increases.

Answer: FALSE

2) The balanced-budget multiplier works whenever the government increases spending and increases taxes by the same amount.

Answer: TRUE



274

9.6 Appendix B: The Case in Which Tax Revenues Depend on Income

1) Assume that taxes depend on income. The  $MPC$  is 0.8 and  $t$  is 0.25. The government spending multiplier is

A) 1.67. B) 2.5. C) 5. D) 10.

Answer: B

2) Assume that taxes depend on income. The  $MPC$  is 0.9 and  $t$  is 0.3. The government spending multiplier is

A) 10. B) 2.7. C) 1.17. D) 1.42.

Answer: B

3) Assume that taxes depend on income. The  $MPC$  is 0.5 and  $t$  is 0.2. If government spending increases by \$10 billion, the equilibrium level of output will increase by

A) \$16.7 billion. B) \$25 billion. C) \$50 billion. D) \$100 billion.

Answer: A

4) Assume that taxes depend on income. The  $MPC$  is 0.8 and  $t$  is 0.4. If government purchases increase by \$100 billion, the equilibrium level of output will increase by

A) \$16.7 billion. B) \$215.9 billion.

C) \$57.5 billion. D) \$192.31 billion.

Answer: D

5) If taxes depend on income and the  $MPC$  is 0.6 and  $t$  is 0.3, the tax multiplier is

A) -1.72. B) -1.03. C) -2.0. D) -2.24.

Answer: B

[www.yufoe.weebly.com](http://www.yufoe.weebly.com)

275

6) Assume that taxes depend on income and the  $MPC$  is 0.6 and  $t$  is 0.3. An increase in taxes of \$10 billion will decrease equilibrium income by

A) \$17.2 billion. B) \$10.3 billion. C) \$20.0 billion. D) \$22.4 billion.

Answer: B

7) If taxes depend on income, then the magnitude of the government spending multiplier \_\_\_\_\_ it would be if taxes were a lump-sum amount.

A) could be either larger than or smaller than

B) is larger than

C) is equal to what

D) is smaller than

Answer: D

8) If taxes depend on income, then the absolute value of the tax multiplier \_\_\_\_\_ it would be if taxes were a lump-sum amount.

A) could be either larger than or smaller than

B) is larger than

C) is equal to what

D) is smaller than

Answer: D

- 9) As the tax rate increases, the government spending multiplier
- A) increases.
  - B) decreases.
  - C) does not change.
  - D) could either increase or decrease depending on the value of the *MPC*.

Answer: B

276

- 10) As the tax rate increases, the absolute value of the tax multiplier
- A) increases.
  - B) decreases.
  - C) does not change.
  - D) could either increase or decrease depending on the value of the *MPC*.

Answer: B

## 2 True/False

- 1) When taxes depend on income, a higher tax rate implies a higher government spending multiplier.

Answer: FALSE

- 2) When the *MPC* is 0.8 and *t* is 0.4, then the government spending multiplier is about -1.54.

Answer: FALSE

- 3) If the *MPS* is 0.25 and *t* is 0.4, then the tax multiplier is about -2.96.

Answer: FALSE

- 4) If the *MPS* is 0.4 and *t* is 0.3, then the tax multiplier is about -1.03.

Answer: TRUE

- 5) When the tax rate increases, the absolute value of the tax multiplier falls.

Answer: TRUE

Mohammed taha

[www.yufoe.weebly.com](http://www.yufoe.weebly.com)