

Chapter 13

Fiscal Policy

13.1 Discretionary Fiscal Policy

- 1) When the government deliberately alters its level of spending and/or taxes in order to achieve specific national economic goals, it is exercising
- A) monetary policy.
 - B) discretionary fiscal policy.
 - C) a Ricardian policy.
 - D) a laissez-faire policy.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 2) Which of the following is an example of fiscal policy?
- A) a reduction in the federal funds rate.
 - B) a reduction in the money supply.
 - C) a reduction in lump-sum taxes.
 - D) an increase in the physical stock of capital.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Which of the following would shift the aggregate demand curve to the right?
- A) An increase in government spending
 - B) An increase in taxes
 - C) An increase in interest rates
 - D) An increase in input prices

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Which of the following fiscal policy actions would be appropriate if the economy is experiencing an inflationary gap?
- A) An increase in government spending
 - B) An increase in taxes
 - C) A decrease in interest rates
 - D) An increase in the money supply

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 5) An increase in government spending would cause which of the following to happen?
- A) The aggregate demand curve would shift to the right.
 - B) The aggregate demand curve would shift to the left.
 - C) The aggregate supply curve would shift to the right.
 - D) The aggregate supply curve would shift to the left.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 6) Suppose the economy is experiencing a recessionary gap at the current level of GDP. Which of the following fiscal policy actions would be most appropriate given this recessionary gap?
- A) decreasing interest rates
 - B) increasing the money supply
 - C) decreasing taxes
 - D) a simultaneous and equal reduction in taxes and reduction in government spending

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Fiscal policy refers to the
- A) manipulation of the money supply in order to increase the amount of paper currency in circulation.
 - B) adjustment of government spending and taxes in order to achieve certain national economic goals.
 - C) adjustment of national income data to account for price level changes.
 - D) changing the way unemployment data is calculated so as to make it appear that unemployment is lower than it actually is.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Fiscal policy involves which of the following?
- A) Tax policy
 - B) Interest rates
 - C) Buying and selling government-agency bonds
 - D) None of the above

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 9) When television commentators refer to "tax and spend" policy, they are referring to
- A) fiscal policy.
 - B) monetary policy.
 - C) the Federal Reserve policy.
 - D) automatic stabilizers.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Which of the following is NOT a fiscal policy action?
- A) increasing government expenditures on military hardware
 - B) decreasing government spending on the arts
 - C) raising the quantity of money in circulation
 - D) lowering income tax rates

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 11) Fiscal policy is defined as
- A) the design of a tax system to transfer income from the rich to the poor.
 - B) the use of Congressional power to pursue social and political goals.
 - C) the discretionary changing of government expenditures and/or taxes to achieve national economic goals.
 - D) the use of the taxing power of the government to redistribute wealth in a socially acceptable manner.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 12) Which of the following is an example of a discretionary fiscal policy action?
- A) increasing government spending to deal with a recession
 - B) a decrease in tax revenues as taxpayers' incomes decrease
 - C) increasing the minimum wage rate
 - D) raising regulations in the health care industry

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: New

- 13) Which of the following is a discretionary fiscal policy action?
- A) an increase in the amount of unemployment compensation because more people become unemployed
 - B) a progressive tax system that leads to an increase in income tax revenues during an economic boom
 - C) a deliberate tax cut when the economy experiences high unemployment
 - D) an increase in Supplemental Security Income payments when more people become eligible for the benefits

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: New

- 14) Typical goals for fiscal policy are
- A) high employment and price stability.
 - B) high prices for consumers and low prices for businesses.
 - C) running high deficits and raising consumer prices.
 - D) increasing the money supply so the government can spend more.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 15) Fiscal policy to solve short-run economic problems supports the Keynesian notion of
- A) there being no government role in the economy.
 - B) an active government role in the economy.
 - C) the need for autocratic rule.
 - D) the long-run nature of the economy.

Answer: B

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 16) According to traditional Keynesian economics, expansionary fiscal policy initiated by the federal government
- A) is never appropriate.
 - B) is an appropriate way to prevent recessions and depressions.
 - C) is an appropriate way to slow down an over-heated economy.
 - D) will always fail due to crowding out effects.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

17) Discretionary fiscal policy is

- A) automatic changes in government expenditures and interest rates that achieve certain national economic goals.
- B) deliberate changes in government expenditures or taxes in order to achieve certain national economic goals.
- C) used to achieve full employment by changing monetary growth targets.
- D) changes in support for research and education in order to achieve certain national economic goals.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

18) All the following actions represent fiscal policy EXCEPT

- A) a reduction in the money supply by the Federal Reserve.
- B) an increase in government spending.
- C) a reduction in individual income tax rates.
- D) an increase in corporate income tax rates.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

19) Fiscal policy is implemented by

- A) the central bank.
- B) private businesses.
- C) the Internal Revenue Service.
- D) the federal government.

Answer: D

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: New

20) Which of the following represent expansionary fiscal policy?

- A) a reduction in government spending
- B) an increase in average individual income tax rates
- C) a cut in corporate income tax rates
- D) an increase in marginal individual income tax rates

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

21) The discretionary change of government expenditures or taxes to achieve national economic goals is

- A) a recessionary gap.
- B) Ricardian–equivalence theorem.
- C) supply–side economics.
- D) fiscal policy.

Answer: D

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

22) Discretionary fiscal policy is best described as

- A) a deliberate attempt to cause the economy to move to full employment and price stability more quickly than it might otherwise.
- B) a deliberate attempt to improve the functioning of free markets.
- C) an automatic change in income transfer payments to keep the economy at full employment.
- D) the design of a tax system that automatically stabilizes economic activity over time.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

23) Keynes believed that the way to prevent recessions and depressions was to

- A) reduce spending when there is a recessionary gap.
- B) only change tax rates as a means of regulating the economy.
- C) maximize the crowding out effect.
- D) increase aggregate demand through expansionary fiscal policy.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

24) Fiscal policy involves discretionary changes in

- A) interest rates.
- B) exchange rates.
- C) income tax rates.
- D) the rate of growth of the quantity of money in circulation.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 25) According to traditional Keynesian analysis, fiscal policy operates by
- A) informing consumers and business people about its plans for the economy so they will know how to adjust their behavior.
 - B) indirectly affecting aggregate demand through its effect on interest rates.
 - C) directly affecting aggregate demand.
 - D) directly affecting aggregate supply.

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 26) To close a recessionary gap through fiscal policy, the government should
- A) decrease government spending in order to increase aggregate supply.
 - B) increase government spending in order to increase aggregate demand.
 - C) reduce taxes in order to stimulate investment, and thus increase aggregate supply.
 - D) increase government spending and taxes in order to both increase aggregate demand and aggregate supply.

Answer: B

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 27) An example of fiscal policy is
- A) a reduction in government spending.
 - B) a reduction in investment spending by the private sector.
 - C) an increase in autonomous spending by consumers.
 - D) an increase in Social Security spending by the elderly.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 28) Fiscal policy includes all of the following EXCEPT
- A) changing taxes.
 - B) changing government spending.
 - C) policies that influence aggregate demand.
 - D) policies that influence the rate of growth of the quantity of money in circulation.

Answer: D

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 29) If the economy is operating on the long-run aggregate supply curve, then expansionary fiscal policy will
- A) generate higher prices in the short run, but will induce aggregate supply to increase in the long run.
 - B) generate an increase in real GDP and higher prices in both the short run and the long run.
 - C) generate an increase in real GDP without higher prices in the short run, but then real GDP will return to its long-run level, and the price level will increase.
 - D) generate an increase in real GDP and higher prices in the short run, but then real GDP will decrease to its long-run level, and the price level will increase some more.

Answer: D

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 30) If the economy is experiencing an inflationary gap and the government wants to accelerate the adjustment to the long-run equilibrium, it should
- A) reduce aggregate demand by cutting government spending or raising taxes.
 - B) reduce aggregate demand by increasing government spending or cutting taxes.
 - C) increase aggregate supply by cutting government spending or raising taxes.
 - D) increase aggregate supply by increasing government spending or lowering taxes.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 31) Suppose the government increases lump-sum taxes. This causes
- A) disposable income to decrease, which causes consumption spending to decrease and aggregate demand to decrease.
 - B) government spending to decrease, which causes aggregate demand to decrease.
 - C) consumption spending to decrease and spending on imports to increase. The effect on aggregate demand depends on whether domestic spending or spending on imports decreased the most.
 - D) disposable income to decrease, which causes aggregate supply to decrease.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 32) Other things being equal, a reduction in taxes will
- A) lead to a reduction in the long run aggregate supply curve as businesses enjoy greater profits.
 - B) influence the short run aggregate supply curve but not the aggregate demand curve.
 - C) lead to a corresponding reduction in interest rates increasing the crowding out effect.
 - D) cause an increase in aggregate demand due to increases in consumption, investment, or net exports.

Answer: D

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 33) Which of the following actions could be undertaken if the government wants to reduce an inflationary gap?
- A) Increase taxes and reduce government spending.
 - B) Reduce taxes and increase government spending.
 - C) Increase taxes and increase government spending.
 - D) Reduce taxes and reduce government spending.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 34) Which of the following actions could be undertaken if the government wants to close a recessionary gap?
- A) Increase taxes and reduce government spending.
 - B) Reduce taxes and increase government spending.
 - C) Increase taxes and increase government spending.
 - D) Reduce taxes and reduce government spending.

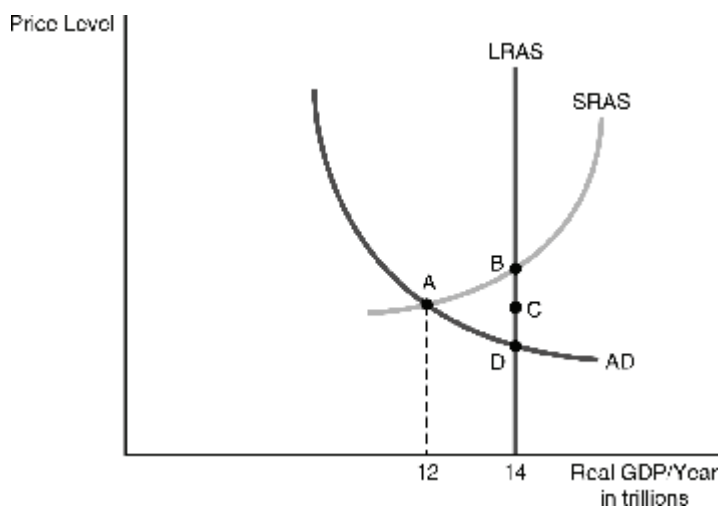
Answer: B

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition



- 35) Refer to the above figure. Suppose the economy is operating at point A. There is a recessionary gap of _____, which can be closed by _____.
- A) \$3 trillion; increasing government spending by \$1 trillion
 - B) \$1 trillion; expansionary fiscal policy that shifts the short-run aggregate supply curve through point C
 - C) \$2 trillion; expansionary fiscal policy that generates another \$2 trillion in total spending
 - D) \$2 trillion; an increase in government spending of \$14 trillion

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 36) Refer to the above figure. Suppose the economy is at point A. By the proper use of fiscal policy, the government can
- A) boost taxes to shift LRAS through point A.
 - B) increase government spending to get the economy to point B.
 - C) raise income tax rates to get the economy to point C.
 - D) reduce government spending to get the economy to point D.

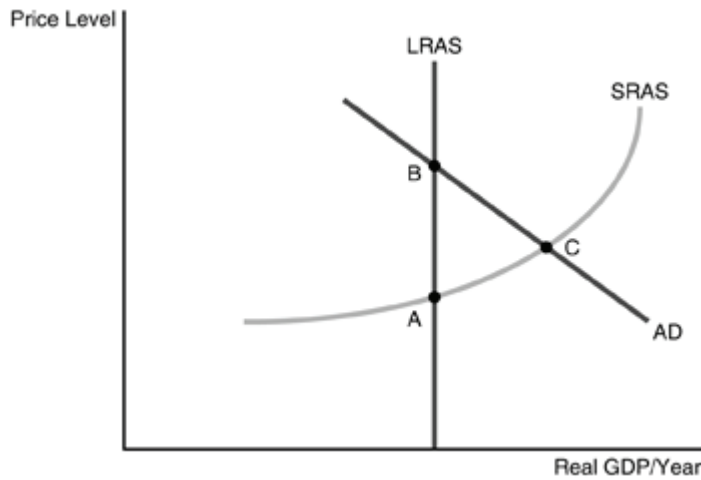
Answer: B

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition



- 37) Refer to the above figure. If the economy is currently operating at point C, then there is
- A) a stable long-run equilibrium situation.
 - B) a recessionary gap.
 - C) an inflationary gap.
 - D) unemployment.

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 38) Refer to the above figure. Suppose the U.S. economy is currently operating at point C. Which of the following actions would you recommend to the president of the United States?
- A) Reduce taxes to stimulate investment, consumption and net exports.
 - B) Increase government spending while holding taxes constant.
 - C) Engage in contractionary fiscal policy by reducing government spending.
 - D) Reduce the interest rate to stimulate investment minimizing the crowding out effect.

Answer: C

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 39) Refer to the above figure. Suppose that the economy was originally at point A, and then it reached point C by means of a fiscal policy action. Which of the following is correct?
- A) Point C is a short-run equilibrium that could have been attained through a tax cut, but in the long run the economy will end up at point B.
 - B) Point C is both a short-run equilibrium and a long-run equilibrium that could have been attained through an increase in government spending.
 - C) Point C is a long-run equilibrium that could have been attained through a tax increase, although reaching this point first required a short-run equilibrium at point B.
 - D) Point C is a short-run equilibrium that could have been attained through a reduction in government spending, but in the long run the economy will end up at point B.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 40) Refer to the above figure. If the economy is currently at point C, then an increase in taxes will lead to
- A) an increase in the price and an increase in real GDP.
 - B) an increase in the price and a decrease in real GDP.
 - C) a decrease in the price and a decrease in real GDP.
 - D) a decrease in the price and an increase in real GDP.

Answer: C

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 41) Suppose there currently is an inflationary gap. What could the government do to bring prices down?
- A) Nothing.
 - B) Reduce government spending.
 - C) Increase government spending.
 - D) Shift the long-run aggregate supply curve.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 42) An example of expansionary fiscal policy could be
- A) to increase taxes.
 - B) to reduce taxes.
 - C) to reduce government spending.
 - D) to reduce interest rates.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 43) In the short run, expansionary fiscal policy usually will
- A) increase the price level and increase real GDP.
 - B) increase the price level and decrease real GDP.
 - C) decrease the price level and increase real GDP.
 - D) decrease the price level and decrease real GDP.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 44) Contractionary fiscal policy will most likely
- A) involve cutting taxes.
 - B) raise real GDP.
 - C) reduce the price level.
 - D) involve increasing government spending.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 45) In the short run, if the government attempts to increase aggregate demand, it should
- A) increase government spending and reduce taxes.
 - B) decrease government spending and increase taxes.
 - C) shift the long-run aggregate supply curve to the right.
 - D) shift the short-run aggregate supply curve to the right.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 46) The government might engage in expansionary fiscal policy if it wanted to
- A) reduce the price level.
 - B) reduce real GDP.
 - C) shift the aggregate demand curve to the left.
 - D) reduce the level of unemployment.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 47) Suppose the economy has a high level of unemployment. This would imply
- A) that the government should engage in expansionary fiscal policy and increase the tax rate.
 - B) that the economy is operating to the left of the LRAS curve and that government spending could be increased to reduce unemployment.
 - C) that fiscal policy has been ineffective and should be abandoned.
 - D) that the economy is operating on the SRAS curve and that government spending could be decreased to reduce unemployment.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 48) Fiscal policy
- A) uses the tools of taxation and spending in an effort to address inflation and unemployment.
 - B) uses the tool of business regulation to increase economic efficiency.
 - C) uses the tool of interest rates to stimulate private savings.
 - D) uses the tool of the exchange rate to discourage imports.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 49) The changing of government expenditures or taxes to achieve national economic goals is
- A) discretionary fiscal policy.
 - B) automatic fiscal policy.
 - C) recessionary fiscal policy.
 - D) inflationary fiscal policy.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 50) Discretionary fiscal policy is so named because it
- A) is undertaken at the order of the nation's central bank.
 - B) occurs automatically as the nation's level of GDP changes.
 - C) involves specific changes in taxes and government spending undertaken by Congress and the president.
 - D) involves secret advice given by the Council of Economic Advisers to the president.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 51) If there is a deliberate change in taxes and spending, it is called
- A) a recessionary gap.
 - B) an inflationary gap.
 - C) discretionary fiscal policy.
 - D) discretionary monetary policy.

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 52) Which of the following fiscal policy actions would definitely cause an *increase* in the size of a recessionary gap?
- A) increases in taxes and cuts in government spending
 - B) cuts in taxes
 - C) increases in taxes and increases in government spending
 - D) cuts in taxes and increases in government spending

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 53) Which of the following fiscal policy actions would definitely cause a *reduction* in the size of an inflationary gap?
- A) cuts in taxes and increases in government spending
 - B) increases in government spending
 - C) increases in taxes
 - D) cuts in taxes

Answer: C

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 54) When the government cuts taxes or increases government spending
- A) the long-run aggregate supply curve shifts to the left.
 - B) the short-run aggregate supply curve shifts to the left.
 - C) the aggregate demand curve shifts to the left.
 - D) the aggregate demand curve shifts to the right.

Answer: D

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

55) Which of the following is NOT related to fiscal policy?

- A) passage of new securities laws
- B) decreasing marginal tax rates
- C) reducing the budget deficit
- D) increasing government expenditures

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

56) Which one of the following is true about the effects of fiscal policy?

- A) A decrease government spending will increase aggregate supply.
- B) A tax change does not have any direct or indirect effects on aggregate demand.
- C) A decrease in government spending will decrease aggregate demand.
- D) An increase in government spending will reduce aggregate demand.

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

57) Which of the following conditions describes a recessionary gap?

- A) The short-run equilibrium level of real GDP is above the long-run level of real GDP.
- B) The short-run equilibrium level of real GDP is below the long-run level of real GDP.
- C) The actual interest rate is above the equilibrium interest rate.
- D) The actual interest rate is below the equilibrium interest rate.

Answer: B

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

58) How might fiscal policy be used to correct an inflationary gap?

- A) The exchange rate would be adjusted to encourage imports.
- B) The exchange rate would be adjusted to discourage imports.
- C) The interest rate would be adjusted to encourage saving.
- D) Taxes would be increased to reduce aggregate demand.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 59) How might fiscal policy be used to correct a recessionary gap?
- A) The exchange rate would be adjusted to encourage imports.
 - B) The exchange rate would be adjusted to discourage imports.
 - C) Government spending would be adjusted to increase aggregate demand.
 - D) Business operations would be regulated by the government to become more efficient.

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 60) Expansionary fiscal policy is used to
- A) combat inflation.
 - B) combat recessions.
 - C) encourage private saving.
 - D) make businesses more efficient.

Answer: B

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 61) In 2009, Congress passed a bill that involved government spending increases and tax cuts with the purpose of stimulating the U.S. economy. This policy is an example of
- A) an automatic stabilizer.
 - B) contractionary fiscal policy.
 - C) expansionary fiscal policy.
 - D) expansionary monetary policy.

Answer: C

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 62) Tax policy conducted for the purpose of achieving full employment, price stability, or economic growth is an example of
- A) monetary policy.
 - B) interest-rate policy.
 - C) exchange-rate policy.
 - D) discretionary fiscal policy.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 63) Government spending conducted for the purpose of achieving full employment, price stability, or economic growth is an example of
- A) monetary policy.
 - B) interest-rate policy.
 - C) exchange-rate policy.
 - D) fiscal policy.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

64) Discretionary Fiscal policy

- A) is the use of government spending and tax policies to influence economic growth and inflation.
- B) is the use of regulation to influence economic growth and inflation.
- C) is the purchase and sale of Treasury securities to influence economic growth and inflation.
- D) is the conversion of nominal data to real data.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

65) The fiscal policy of the United States is

- A) summarized in the budget of the U.S. federal government.
- B) the sum of the budgets of each state and municipality.
- C) published in the Federal Reserve Bank's Annual Report.
- D) announced by the President in his State of the Union message.

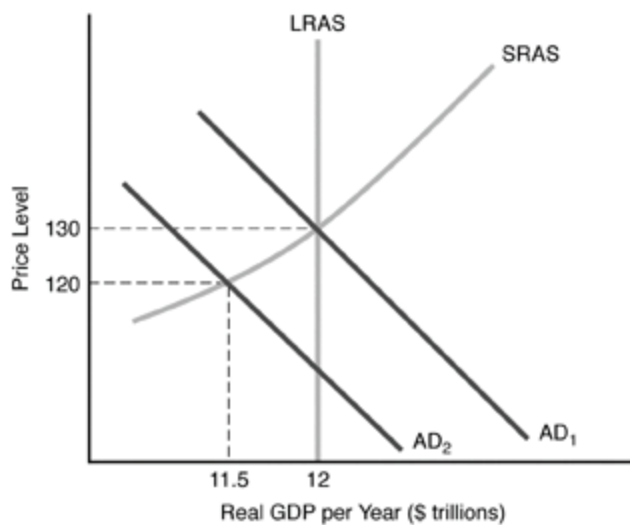
Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

66) Refer to the above figure. If the relevant aggregate demand curve is AD_2 , what is the current economic situation?

- A) inflationary gap
- B) recessionary gap
- C) equilibrium
- D) overemployment

Answer: B

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 67) Refer to the above figure. Suppose the relevant aggregate demand curve is AD_2 . If the government wants to use discretionary fiscal policy to close the existing gap, it should
- A) decrease taxes.
 - B) increase taxes.
 - C) increase the money supply.
 - D) decrease government spending.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 68) Refer to the above figure. If the relevant aggregate demand curve was AD_2 , the government could do all of the following to close the existing gap EXCEPT
- A) increase government spending on roads.
 - B) reduce marginal tax rates.
 - C) reduce corporate taxes.
 - D) reduce defense spending.

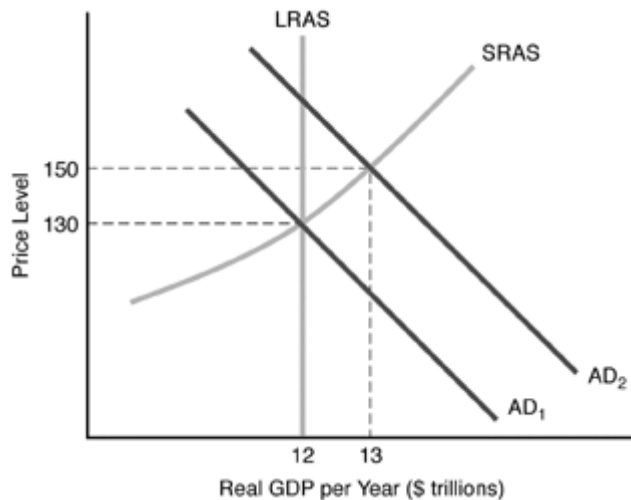
Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised



- 69) Refer to the above figure. If the relevant aggregate demand curve is AD_2 , what is the current economic situation?
- A) inflationary gap
 - B) recessionary gap
 - C) equilibrium
 - D) overemployment

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 70) Refer to the above figure. Suppose the relevant aggregate demand curve is AD_2 . If the government wants to use fiscal policy to close the existing gap, it should
- A) increase taxes.
 - B) decrease taxes.
 - C) increase the money supply.
 - D) increase government spending.

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 71) Refer to the above figure. If the relevant aggregate demand curve is AD_1 , then the economy is experiencing
- A) an inflationary gap.
 - B) a recessionary gap.
 - C) a deflationary gap.
 - D) full employment.

Answer: D

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: New

- 72) Suppose the current level of real GDP is below the full-employment level of real GDP. Which of the following represents a fiscal policy action that could be implemented to reduce the size of this recessionary gap?
- A) Increase government spending.
 - B) Decrease interest rates.
 - C) Increase the money supply.
 - D) all of the above

Answer: A

Diff: 2

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 73) When the current short-run equilibrium is to the right of the long-run aggregate supply, appropriate discretionary fiscal policy used to address this problem would be to
- A) increase taxes.
 - B) decrease taxes.
 - C) increase government spending.
 - D) decrease the discount rate.

Answer: A

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

74) Which of the following statements about fiscal policy is true?

- A) Real Gross Domestic Product (GDP) can be increased above its long-run equilibrium only in the short run.
- B) Real Gross Domestic Product (GDP) can never be increased above its long-run equilibrium, even for a brief period of time.
- C) Government can shift the aggregate demand curve inward by increasing spending.
- D) Government can shift the aggregate demand curve outward by reducing spending.

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

75) Which one of the following is an example of discretionary fiscal policy used to correct a recessionary gap?

- A) a tax decrease passed into law by Congress
- B) an increase in the money supply by the Federal Reserve
- C) a decrease in government expenditures approved by Congress
- D) an agreement among major banks to raise interest rates

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

76) Which one of the following is an example of discretionary fiscal policy used to correct an inflationary gap?

- A) a tax increase passed into law by Congress
- B) decrease in the money supply by the Federal Reserve
- C) an increase in government expenditures approved by Congress
- D) an agreement among major banks to lower interest rates

Answer: A

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

77) What is discretionary fiscal policy and what is its purpose?

Answer: Discretionary fiscal policy is the deliberate changing of government spending and/or taxes. Its purpose is to move the economy toward full employment with price stability more rapidly than it would if left on its own.

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

78) Explain how fiscal policy can correct a contractionary gap.

Answer: A contractionary gap can be closed by an increase in aggregate demand. By increasing government spending or reducing taxes, aggregate demand increases, thereby raising the level of real GDP.

Diff: 1

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

79) Suppose the government believes the economy is operating beyond the full-employment real GDP. What kind of fiscal policy could it pursue?

Answer: The government could initiate contractionary fiscal policy and either reduce government spending or increase taxes. The aggregate demand curve shifts to the left. With an upward sloping short-run aggregate supply curve, real GDP falls and the price level falls.

Diff: 3

Topic: 13.1 Discretionary Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

13.2 Possible Offsets to Fiscal Policy

1) What does research tell us about the impact of Ricardian equivalence effects on the economy?

- A) There is no evidence of any impact of Ricardian equivalence effects.
- B) Ricardian equivalence effects have a huge impact on aggregate demand.
- C) There is a very small impact on both aggregate demand and aggregate supply.
- D) Ricardian equivalence effects may exist, but their magnitudes are unclear.

Answer: D

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

2) The Ricardian equivalence theorem states that

- A) an increase in government spending has no effect on aggregate supply.
- B) increases in government spending have a larger impact on real Gross Domestic Product (GDP) than decreases in taxes.
- C) an increase in the government budget deficit created by a current tax cut has no effect on aggregate demand.
- D) an increase in the government budget deficit has no effect on real Gross Domestic Product (GDP) because it only affects the price index.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB:

Question Status: Previous Edition

- 3) The concept that increased government spending will lead to lower investment and consumer spending is referred to as the
- A) inflationary effect.
 - B) crowding-out effect.
 - C) aggregate demand effect.
 - D) Keynesian effect.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 4) The Laffer curve shows a relationship between
- A) inflation rates and unemployment rates.
 - B) interest rates and investment spending.
 - C) price level and real Gross Domestic Product (GDP).
 - D) tax rates and tax revenues.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 5) By definition, a direct expenditure offset will occur whenever
- A) the government increases spending in an area that competes with the private sector.
 - B) the government increases spending for the military.
 - C) the interest rate rises.
 - D) the interest rate falls.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 6) If the government began providing free textbooks to college students who would otherwise have bought their books from the private sector, the government's action would result in
- A) an increase in real Gross Domestic Product (GDP).
 - B) a direct expenditure offset.
 - C) a Ricardian dilemma.
 - D) a reduction of the government deficit.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 7) If the government increases spending and there is a complete direct expenditure offset, then
- A) aggregate demand and real Gross Domestic Product (GDP) will not change.
 - B) aggregate demand and real Gross Domestic Product (GDP) will increase by the amount of the spending increase.
 - C) the price level will drop.
 - D) the government spending multiplier will be greater than zero.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 8) The government wants to increase its spending by \$1 billion to stimulate the economy and is counting on the government spending multiplier to help. Taking into account direct expenditure offset effects, what is its best spending option?
- A) A new cruise missile for the military
 - B) Expanding the school lunch program
 - C) Constructing more low income housing
 - D) Providing textbooks for college students

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 9) According to supply-side economics, changes in marginal tax rates will have which of the following effects?
- A) change the incentive to work
 - B) change the incentive to save
 - C) change the incentive to invest
 - D) all of the above

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 10) One part of the supply-side argument is that
- A) lower marginal tax rates are required to induce Congress to reduce government spending.
 - B) lower marginal tax rates can increase total tax revenues.
 - C) the marginal tax rate should be set at 50 percent.
 - D) the relevant aggregate supply curve is close to horizontal.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 11) The supporters of a proposal to increase marginal taxes on those earning over \$200,000 a year say this change would generate \$100 billion in new tax revenues. A supply-side economist would argue that the actual revenue raised will be
- A) less than \$100 billion because some people will respond by working less.
 - B) exactly \$100 billion because there are no offsetting factors to a tax increase.
 - C) more than \$100 billion, because lower income people will work harder when they perceive the tax system to be fairer.
 - D) more than \$100 billion because interest rates will also be affected.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Supply-side economists argue that
- A) lower tax rates sometimes lead to increased tax revenues.
 - B) higher tax rates lead to increased productivity.
 - C) lower tax rates lead to a drop in real Gross Domestic Product (GDP).
 - D) lower tax rates always lead to lower tax revenues.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 13) According to supply-side economists, lower marginal tax rates will not necessarily lead to lower tax revenues because
- A) the crowding out effect does not apply to taxes.
 - B) lower tax rates have no effect on the opportunity cost of labor.
 - C) the aggregate supply curve will shift inward to the left if the tax rates are lowered.
 - D) the lower marginal tax rates will be applied to a growing tax base due to economic growth.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 14) Supply-side economics focuses on tax cuts to stimulate
- A) aggregate demand by reducing saving.
 - B) aggregate supply by increasing production.
 - C) government spending.
 - D) military research.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 15) When supply-side policy is successful in pushing up equilibrium real Gross Domestic Product (GDP), the reason is that the policy generates
- A) a decrease in aggregate demand.
 - B) an increase in aggregate supply.
 - C) a decrease in employment.
 - D) a decrease in saving.

Answer: B

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 16) If the government increases spending but does not raise taxes,
- A) aggregate demand will increase without any effect on the price level.
 - B) borrowing by the government will take place.
 - C) the government will have to sell some assets, such as oil and national parks.
 - D) the government will have to either lower expenditures or raise taxes the next year.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 17) The crowding-out effect is
- A) the tendency of contractionary fiscal policy to cause an increase in planned investment or planned consumption in the U.S. private sector.
 - B) the tendency of expansionary fiscal policy to cause an increase in planned investment but not in planned consumption in the U.S. private sector.
 - C) the tendency of expansionary fiscal policy to cause a decrease in planned investment or planned consumption in the U.S. private sector.
 - D) the tendency of contractionary fiscal policy to cause an increase in planned investment or planned consumption in the U.S. private sector.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 18) At tax rates higher than the tax rate that maximizes tax revenues along a Laffer curve,
- A) an increase in tax rates increases tax revenues.
 - B) a reduction in tax rates reduces tax revenues.
 - C) a reduction in tax rates increases tax revenues.
 - D) any variation in tax rates has no effect on tax revenues.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 19) If the government increases spending while holding taxes constant, we expect
- A) an increase in investment spending by businesses too, as they anticipate future economic growth.
 - B) a decrease in real saving as consumers follow suit and also increase borrowing.
 - C) planned real investment spending by businesses to increase.
 - D) interest rates to rise.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The tendency for expansionary fiscal policy to cause a reduction in planned real investment spending by the private sector is called
- A) the indirect effect.
 - B) the interest rate effect.
 - C) the crowding-out effect.
 - D) the Laffer effect.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 21) The crowding-out effect is
- A) due to the upward slope of the SRAS when the economy is operating to the right of the LRAS curve.
 - B) due to the government being more powerful in the markets when there is an increase in government spending.
 - C) a situation in which expansionary fiscal policy leads to a decrease in planned real investment or planned real consumption in the private sector.
 - D) only relevant when an inflationary gap is present.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 22) If the crowding-out effect is complete and the marginal propensity to save is 0.25, then an increase in government spending of \$100 billion will generate how much more real GDP?
- A) \$0
 - B) \$25 billion
 - C) \$100 billion
 - D) \$400 billion

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 23) A direct expenditure offset occurs when an increase in government spending
- A) results in an increase in household saving for retirement.
 - B) is followed by an increase in consumer spending
 - C) results in a decrease in private spending.
 - D) is followed by an increase in taxes.

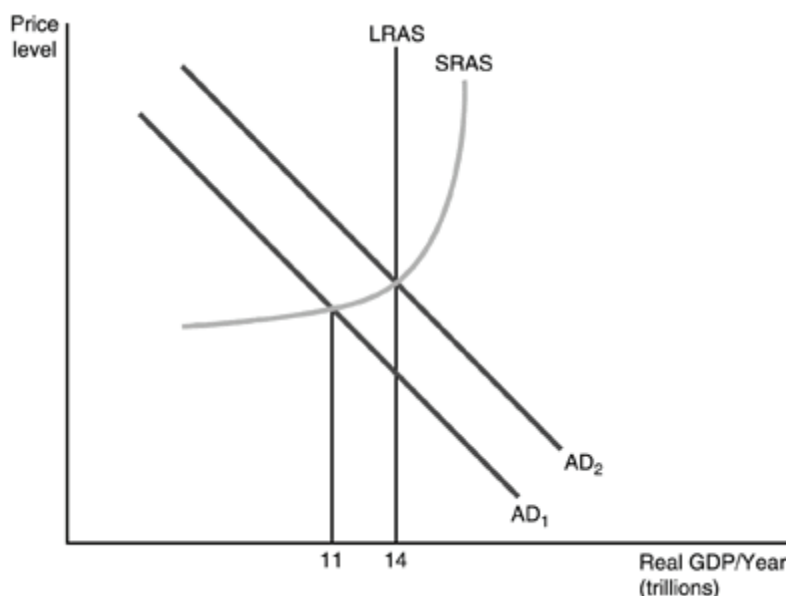
Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised



- 24) Refer to the above figure. The government has just engaged in expansionary fiscal policy shifting the aggregate demand curve from AD_1 to AD_2 . Interest rates have started to rise. Which of the following statements is true in the short run?
- A) Real GDP will be \$14 trillion since the effect of government spending is not influenced by interest rates.
 - B) Real GDP will fall back to \$11 trillion since the effect that increased government spending has on real GDP is short lived.
 - C) Real GDP will go beyond \$14 trillion as businesses and consumers react to the increase in interest rates.
 - D) Real GDP will end up somewhere between \$11 and \$14 trillion as businesses and consumers reduce their spending in response to the increase in interest rates.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 25) To the extent that a direct expenditure offset results from an expansionary fiscal policy,
- A) the stimulative effect will be less than anticipated.
 - B) the stimulative effect will be more than anticipated.
 - C) the fiscal policy will not be discretionary.
 - D) the time lags associated with the implementation of fiscal policy will shorten.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 26) Suppose that real GDP is initially \$14 trillion and the government attempts to increase real GDP to \$15 trillion. The marginal propensity to consume is 0.8, and every \$1.00 increase in real government spending crowds out \$0.50 in real planned investment expenditures. Which increase in government spending below could yield the desired level of real GDP?
- A) \$100 billion
 - B) \$125 billion
 - C) \$200 billion
 - D) \$400 billion

Answer: D

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 27) Suppose that real GDP is initially \$13 trillion and the government attempts to increase real GDP to \$14 trillion. The marginal propensity to consume is 0.75, and every \$1.00 increase in real government spending crowds out \$0.50 in real planned investment expenditures. How much increase in real government spending could lead to the desired level of real GDP?
- A) \$200 billion
 - B) \$250 billion
 - C) \$500 billion
 - D) \$1 trillion

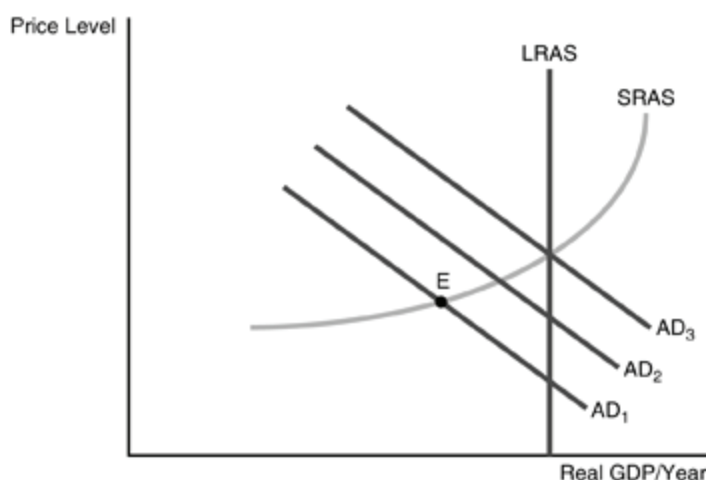
Answer: C

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised



- 28) Refer to the above figure. If the economy is at E and the government wants to increase aggregate demand to AD_3 , but the increase in spending only shifts the aggregate demand curve to AD_2 , then
- A) complete crowding out has occurred.
 - B) some crowding out has occurred.
 - C) the increased borrowing caused interest rates to fall.
 - D) the short-run aggregate supply curve is steeper than the figure indicates.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 29) Refer to the above figure. Suppose the economy is at E and the government uses an expansionary fiscal policy to move the aggregate demand curve to AD_2 . In the end, the aggregate demand curve is still AD_1 . A possible reason for this is that
- A) the economy is already at full employment.
 - B) the increased borrowing causes higher interest rates, which encourage people to save more and increase investment spending due to the extra saving.
 - C) people increase saving because they anticipate higher future taxes, resulting in a reduction in current consumption spending that offsets the increased government spending.
 - D) some of the increased government spending is not counted in GDP.

Answer: C

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 30) The Ricardian equivalence theorem states that
- A) an increase in government spending by the federal government leads to offsetting reductions in state government spending.
 - B) an increase in government spending financed by higher taxes has no effect on aggregate demand.
 - C) spending on national defense is a direct expenditure offset.
 - D) government spending financed by taxes is equivalent to government spending financed by borrowing.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 31) According to the Ricardian equivalence theorem, a tax cut that increases the government budget deficit will have
- A) no effect on aggregate demand because people realize that there will be a future tax liability so that there is no increase in consumption expenditures.
 - B) no effect on aggregate demand because people only look at changes in taxes or government spending in the present.
 - C) a positive effect on aggregate demand because people look at changes in taxes or government spending in the present.
 - D) an effect on aggregate demand. The magnitude the effect will have depends upon whether the increase is caused by a reduction in taxes or an increase in government spending.

Answer: A

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 32) A decrease in taxes will have no effect on real GDP if
- A) people look at changes in taxes only in the present.
 - B) there is no crowding out.
 - C) the Ricardian equivalence theorem holds.
 - D) the tax decrease is offset by an increase in government spending.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 33) The proposition that decreases in taxes that raise the government budget deficit has no effect on aggregate demand is called the
- A) open-economy effect.
 - B) federalism effect.
 - C) Ricardian equivalence theorem.
 - D) interest-rate effect.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 34) According to the Ricardian equivalence theorem, budget deficits resulting from tax cuts
- A) increase aggregate demand.
 - B) decrease aggregate demand.
 - C) have no effect on aggregate demand.
 - D) affect only aggregate supply.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 35) Expansionary fiscal policy falls short of its goal. Some economists claim it is due to indirect crowding out. What evidence would be consistent with this claim?
- A) An increase in consumer spending occurred.
 - B) The interest rate increased.
 - C) Saving decreased.
 - D) The price level decreased.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 36) Three candidates for political office disagree over the benefits of enlarging the federal budget deficit. Candidate C says the stimulation package is needed to increase employment and real GDP; Candidate D says it will only cause higher prices; and Candidate F says it will have no effect on either real GDP or the price level. How do the three candidates differ with respect to the condition of the economy and the effects of fiscal policy?
- A) Candidate C thinks the simple Keynesian model is applicable, while D thinks the expansionary policy will fully crowd out private investment. F believes the economy is experiencing a recessionary gap.
 - B) Candidate C thinks the simple Keynesian model is applicable; D thinks the short-run aggregate supply curve is horizontal; and F thinks the expansionary policy will generate lower interest rates.
 - C) Candidate C thinks the economy is below the full-employment real GDP and that the short-run aggregate supply curve is horizontal. Candidate D believes the economy is at full employment. Candidate F believes the expansionary policy will result only in direct fiscal offsets.
 - D) Candidate C thinks the short-run aggregate supply curve is upward sloping; D thinks interest rates will rise; and F thinks the economy is at full employment.

Answer: C

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

37) "Expansionary fiscal policy is always 100 percent effective when the short-run aggregate supply curve is horizontal." Is this statement true?

- A) Yes, because theoretically nothing else can offset the effects of fiscal policy.
- B) Yes, when the long-run aggregate supply curve is horizontal too.
- C) No, because crowding out could take place.
- D) No, because the increased spending may cause the price level to increase.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

38) Direct expenditure offsets are

- A) the discretionary changing of government expenditures to achieve a higher employment level.
- B) the decrease in planned investment that occurs as the result of an increase in interest rates.
- C) the same as the Ricardian equivalence theorem.
- D) the decrease in spending in the private sector in areas in which the government is competing.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

39) Whenever government spending is a substitute for private spending

- A) interest rates will rise.
- B) the Ricardian equivalence theorem holds.
- C) the effects of expansionary fiscal policy are dampened.
- D) there is a direct multiplier effect.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

40) The government has decided to give every person in the U.S. a \$5 coupon that they can use at the grocery store to purchase their choice of cheese. We would expect this policy to lead to

- A) an increase in aggregate demand equivalent to the full impact of all of the coupons redeemable.
- B) no increase in aggregate demand due to the Ricardian equivalence theorem.
- C) no increase in aggregate demand because there would be no direct expenditure offset.
- D) an increase in aggregate demand but not equivalent to the full impact of all of the coupons redeemed due to some direct expenditure offset.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

41) The Laffer curve

- A) initially slopes upward as increasing tax rates lead to increasing tax revenue but eventually will slope downward as increasing tax rates lead to decreasing tax revenue.
- B) slopes downward throughout its range since increasing tax rates will always lead to decreases in tax revenue.
- C) slopes upward throughout its range since increasing tax rates will always lead to increases in tax revenue.
- D) is horizontal because tax revenue is independent of the rate of interest.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

42) Supply-side economics focuses attention on how fiscal policy might be used to

- A) increase aggregate demand to the full-employment level of real GDP.
- B) shift the aggregate supply curve out.
- C) align aggregate demand and aggregate supply.
- D) increase consumption.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

43) The Laffer curve indicates which of the following?

- A) There is an ideal interest rate that will maximize investment spending.
- B) There is an ideal amount of government spending that will lead to full national employment.
- C) There is an ideal tax-revenue-maximizing tax rate for government taxes.
- D) There is an ideal tariff rate that will maximize exports and minimize imports.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

44) According to the Laffer curve, increases in the tax rate will lead to a(n)

- A) steady decrease in tax revenues.
- B) steady increase in tax revenues.
- C) initial decrease in tax revenues and then an increase in tax revenues.
- D) initial increase in tax revenues and then a decrease in tax revenues.

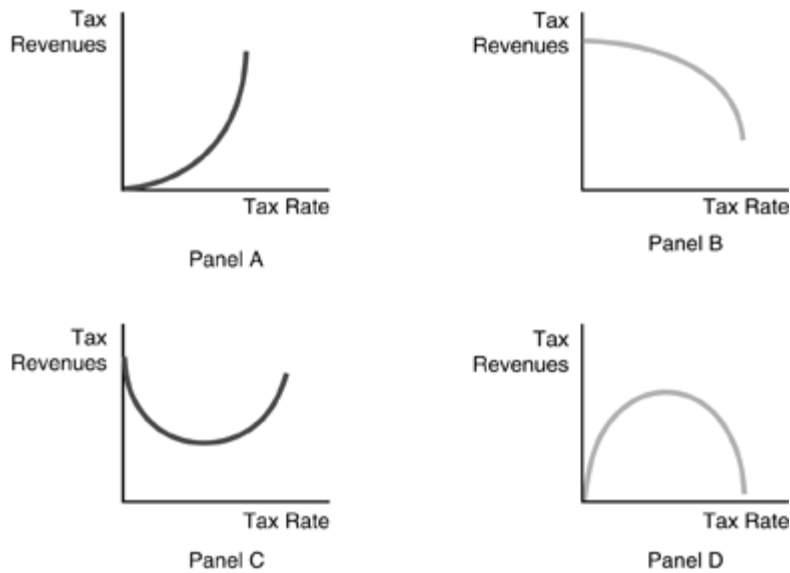
Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition



45) Refer to the above figure. Which panel is consistent with the Laffer curve?

- A) Panel A B) Panel B C) Panel C D) Panel D

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

46) If the government wishes to promote a higher rate of growth of real GDP, a supply-side economist would argue the appropriate policy is

- A) engaging in expansionary fiscal policy by lowering marginal tax rates.
 B) engaging in expansionary fiscal policy of increasing government spending.
 C) lowering marginal tax rates on people and raising them on corporations.
 D) leaving the economy alone and letting the natural forces bring it into a long-run equilibrium.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

47) According to supply-side economics, lower tax rates on wages

- A) generate higher revenues for the government and increased unemployment.
 B) create incentives to work more, which increases real GDP.
 C) are less productive than lower tax rates on consumers.
 D) have little effect on the economy.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 48) The idea that creating incentives for individuals and firms to increase productivity leading to an increase in long-run aggregate supply is
- A) supply-side economics.
 - B) demand-side economics.
 - C) the Ricardian equivalence theorem.
 - D) consistent with crowding out.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 49) Supply-side economics
- A) promotes expansionary fiscal policy by increasing government spending.
 - B) promotes reducing taxes to create incentives to increase productivity.
 - C) promotes increasing taxes to create additional revenue for government spending.
 - D) is based on the Ricardian equivalence theorem.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 50) A government proposal to increase marginal tax rates on the wealthiest 2 percent of U.S. residents is supposed to generate an additional \$100 billion in tax revenues. It is likely that
- A) the actual revenue raised will exceed the \$100 billion, because the other 98 percent of the population will increase their work effort with a more fair tax system.
 - B) the actual revenue raised will be more than \$100 billion, because the short-run aggregate supply curve is upward sloping.
 - C) the actual revenue raised will be less than \$100 billion, because some of the people will respond by working less and earning less income that can be taxed.
 - D) the actual revenue raised will be close to \$100 billion, because the wealthy don't respond to work incentives the way poorer workers do.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 51) An increase in government spending without an accompanying increase in taxes
- A) does not increase aggregate demand.
 - B) would effectively eliminate an inflationary gap.
 - C) causes investment spending to increase.
 - D) requires additional government borrowing.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

52) Which one of the following statements is NOT true?

- A) Expansionary fiscal policy is employed to offset recessionary gaps.
- B) Expansionary fiscal policy has an effect on interest rates.
- C) Crowding out dilutes the effect of expansionary fiscal policy.
- D) When crowding out occurs, fiscal policy is more effective.

Answer: D

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

53) In the extreme case of a complete crowding-out effect,

- A) an increase in interest rates will stimulate investment spending.
- B) an increase in tax rates will stimulate work effort.
- C) an increase in government spending will not increase aggregate demand.
- D) an increase in government spending will stimulate investment spending.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

54) Because of crowding out,

- A) expansionary fiscal policy during a recession must involve a tax increase.
- B) expansionary fiscal policy during a recession is reinforced by private investment spending.
- C) expansionary fiscal policy is diluted by the decline in investment spending caused by higher interest rates.
- D) expansionary fiscal policy is completely achieved even with a decline in investment spending.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

55) If an increase in government spending causes an increase in government borrowing, this could induce

- A) an increase in interest rates, which would cause private domestic investment to fall.
- B) an increase in interest rates, which would cause private domestic investment to rise.
- C) an increase in interest rates but no effect on private domestic investment.
- D) a decrease in interest rates, which would cause private domestic investment to rise.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 56) The crowding-out effect refers to
- A) an increase in the consumption of domestic goods at the expense of imported goods.
 - B) an increase in the consumption of imported goods at the expense of domestic goods.
 - C) a decrease in consumption and investment caused by an increase in government borrowing.
 - D) a decrease in consumer spending caused by a decrease in consumer confidence.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 57) Suppose that Congress passes a budget that increases government spending. Also, suppose that this increase in government spending causes an increase in interest rates and a reduction in planned investment. The effect of this fiscal policy action on planned investment is known as which of the following?
- A) cost-push inflation
 - B) demand-pull inflation
 - C) automatic stabilizers
 - D) none of the above

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 58) If the government pays for a new library in your neighborhood that you regularly visit, and you stop going to Barnes and Noble to buy books, this is an example of
- A) the free rider problem.
 - B) externalities.
 - C) laissez-faire.
 - D) a direct expenditure offset.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 59) To the extent that the Ricardian equivalence theorem is true, which of the conditions below will hold?
- A) Increases in the government budget deficit will not affect aggregate demand.
 - B) Exports will not be considered part of aggregate demand.
 - C) Investment spending will not be considered part of aggregate demand.
 - D) The long-run aggregate supply curve will not be vertical.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

60) Which of the following is true of the Ricardian equivalence theorem?

- A) The theorem is strongly supported by empirical evidence from the 1970s.
- B) The theorem is strongly supported by empirical evidence from the 1980s and 1990s.
- C) The theorem states that changes in the interest rate do not affect investment spending.
- D) The theorem states that the public will react to a tax cut by saving more.

Answer: D

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

61) If there is a dollar-for-dollar direct expenditure offset, then

- A) increases in aggregate demand will also increase long-run aggregate supply.
- B) increases in government spending will not increase aggregate demand.
- C) increases in aggregate demand will increase the price level, but leave real output unchanged.
- D) increases in aggregate demand will increase real output, but leave the price level unchanged.

Answer: B

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

62) The theory that government borrowing may function like an increase in taxes, that is, reducing current consumption and business expenditures, is known as

- A) the marginal propensity to consume.
- B) the Ricardian equivalence theorem.
- C) planned tax policy.
- D) Congressional Tax policy.

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

63) The theory that government borrowing may function like an increase in taxes, that is, reducing current consumption and business expenditures, was formulated by

- A) John Maynard Keynes
- B) Jean Baptiste Say.
- C) David Ricardo.
- D) Adam Smith.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 64) The idea that a tax reduction funded by government borrowing has no effect on aggregate demand is known as

A) the expenditure–offset theorem. B) the Keynesian Cross.
C) the balanced budget multiplier. D) the Ricardian equivalence theorem.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 65) Supply–side economists argue that changes in tax rates cause changes in

A) the full–employment level of output. B) labor supply.
C) saving. D) all of the above.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 66) Supply–side theory asserts that high marginal tax rates

A) encourage private saving. B) encourage business investment.
C) discourage government expenditures. D) discourage work effort.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 67) Supply–side theory suggests that

A) aggregate supply does not depend on labor productivity.
B) increased government spending does not increase aggregate demand.
C) lower tax rates may not reduce overall tax revenues.
D) increased labor productivity may not increase real output.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 68) Supply–side economists argue that decreasing marginal tax rates

A) increases productivity and shifts the AS curve to the right.
B) increases productivity and shifts the AS curve to the left.
C) increases productivity and shifts the AD curve to the left.
D) due to the Ricardian equivalence, has no impact on the economy.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

69) Supply-side economists argue cuts in tax rates

- A) always reduce tax revenues.
- B) may increase tax revenues.
- C) always increase budget deficits.
- D) have no effect on tax revenues.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

70) The notion that a decline in tax rates and other incentives will spur individuals and firms to increase productivity is typically referred to as

- A) demand-side economics.
- B) Ricardian equivalence.
- C) supply-side economics.
- D) Keynesian economics.

Answer: C

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

71) The Laffer curve shows that as tax rates increase

- A) initially tax revenues increase, then decrease.
- B) tax revenues decrease as the incidence of cheating on tax returns increases.
- C) tax revenues increase as more individuals and businesses have to pay taxes.
- D) tax revenues remain unchanged.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB:

Question Status: Previous Edition

72) According to the Laffer curve, we know with certainty that an increase in the tax rate will

- A) cause tax revenue to increase.
- B) cause tax revenue to decrease.
- C) have no effect on tax revenue.
- D) cause tax revenue to increase, decrease, or remain unchanged.

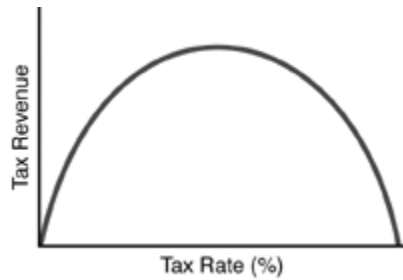
Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition



- 73) Consider the above figure. The curve shown is sometimes referred to as
- A) the Laffer curve.
 - B) the Ricardian curve.
 - C) the Keynesian curve.
 - D) the Phillips curve.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 74) Consider the above figure. This curve suggests that as the government raises the tax rate, a point will eventually be reached at which the revenues that are collected will
- A) increase.
 - B) decline.
 - C) approach infinity.
 - D) become negative.

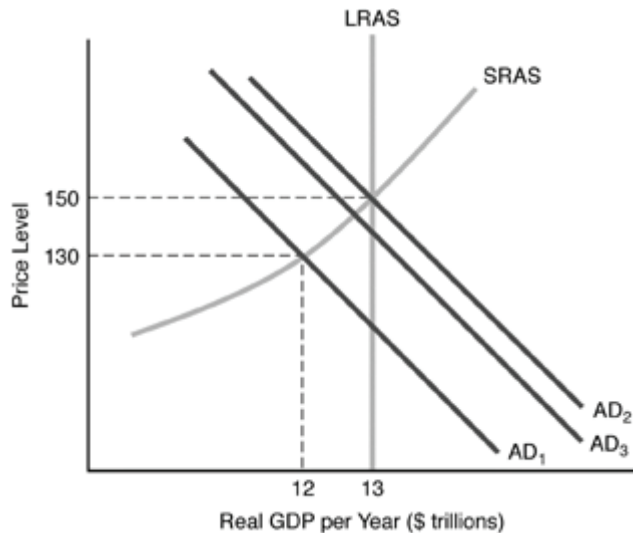
Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition



- 75) Refer to the above figure. Suppose that the economy initially is operating along AD_1 . If the government seeks to close the recessionary gap by raising government spending without any change in taxation, which moves the aggregate demand curve from AD_1 to AD_2 , then to AD_3 . Which of the following scenarios is true?

A) Interest rates fall and investment rises. B) Both interest rates and investment fall.
 C) Both interest rates and investment rise. D) Interest rates rise and investment falls.

Answer: D

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 76) Refer to the above figure. Suppose that the economy starts at AD_1 . If the government reduces taxes, then the economy goes to AD_2 , but then falls back to AD_3 . This is an example of
- A) partial crowding-out effect. B) Ricardian equivalence.
 C) laissez-faire. D) complete crowding-out effect.

Answer: A

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 77) Refer to the above figure. Suppose that the economy starts at AD_1 . If the government reduces taxes, then the economy goes to AD_2 , but then falls back to AD_1 . This is an example of
- A) partial crowding-out effect. B) the free rider problem.
 C) laissez-faire. D) complete crowding-out effect.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 78) If the federal government borrows from the private sector to pay for increased budget deficits and interest rates increase, this will cause
- A) a decrease in planned investment and planned consumption.
 - B) an increase in planned investment and planned consumption.
 - C) a decrease in planned investment and an increase in planned consumption.
 - D) an increase in planned investment and a decrease in planned consumption.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 79) The crowding out effect of expansionary fiscal policy refers to which of the following?
- A) a reduction in private sector planned investment
 - B) a reduction in the stock of inventories
 - C) the reduction in the size of the budget deficit
 - D) the reduction in the size of the recessionary gap

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 80) When private expenditures decrease as a result of increased government spending, this is known as
- A) the stabilizer effect.
 - B) the crowding out effect.
 - C) the multiplier effect.
 - D) government deficit spending.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 81) The crowding out effect is often associated with
- A) a temporary increase in taxes.
 - B) an increase in the interest rate caused by government borrowing.
 - C) the reinforcing impact of state and local tax changes on federal tax changes.
 - D) the impact of a tax rate increase when the aggregate supply function is horizontal.

Answer: B

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 82) Suppose policy makers pass a budget that results in a reduction in government spending and no change in taxes. This reduction in government spending will likely
- A) increase government borrowing and increase interest rates.
 - B) generate extra tax revenues to cover the extra spending.
 - C) reduce interest rates and increase planned investment.
 - D) reduce interest rates, increase in planned investment, and increase real GDP.

Answer: C

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 83) An increase in government spending that is not financed by an increase in taxes will cause which of the following?
- A) an increase in interest rates and an increase in planned investment
 - B) an increase in interest rates and a reduction in planned investment
 - C) a reduction in interest rates and an increase in planned investment
 - D) a reduction in interest rates and a reduction in planned investment

Answer: B

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 84) The crowding-out effect refers to the tendency of expansionary fiscal policy to
- A) cause decreases in planned investment or planned consumption.
 - B) cause households to save less.
 - C) replace low-skilled labor with higher-skilled labor.
 - D) cause firms to produce beyond capacity.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 85) To compensate for the possibility of indirect crowding out, a government engaging in expansionary policy aimed at eliminating a recessionary gap could
- A) increase spending less than the simplest Keynesian model would predict.
 - B) increase spending more than the simplest Keynesian model would predict.
 - C) reduce taxes rather than increase government spending.
 - D) both reduce taxes and reduce spending to be able to achieve full employment.

Answer: B

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 86) If other factors are held constant, what happens when the federal government finances a growing budget deficit by increasing the amount it borrows from the private sector?
- A) There will be an increase in the interest rate.
 - B) There will be a decrease in the interest rate.
 - C) The crowding out effect will be cancelled out.
 - D) There will be an increase in net exports.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 87) According to David Ricardo, an increase in government spending without any tax increase will not increase aggregate demand because
- A) consumers will consume less and save more to prepare for increased taxes in the future.
 - B) the private sector is more likely than the public sector to spend any extra income on national defense.
 - C) consumers will increase their consumption proportionately more than Keynesian economists believe they will.
 - D) consumers will save less than they otherwise would have.

Answer: A

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Revised

- 88) The Ricardian equivalence theorem suggests that an increase in the government budget deficit created by a tax cut will
- A) increase real Gross Domestic Product (GDP) in both the short and long run.
 - B) decrease real Gross Domestic Product (GDP) in both the short and long run.
 - C) decrease real Gross Domestic Product (GDP) in the short run, but increase it in the long run.
 - D) have no effect on aggregate demand.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 89) Which of the following is a basic assumption of the Ricardian equivalence theorem?
- A) Consumers pay no attention to government budget deficits.
 - B) Consumers think only in terms of the present.
 - C) If current tax cuts result in budget deficit increases, aggregate supply falls.
 - D) Consumers consider future tax payments when deciding how much to spend and save today.

Answer: D

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 90) The proposition that an increase in the federal budget deficit caused entirely by a current tax cut has no effect on aggregate demand is called the
- A) indirect effect.
B) interest rate effect.
C) open-economy effect.
D) Ricardian equivalence theorem.

Answer: D

Diff: 1

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 91) What is supply-side economics?

Answer: Supply-side economics is the idea that creating incentives for individuals and firms to increase productivity will cause the aggregate supply curve to shift outward. It focuses on reducing marginal tax rates to create incentives to increased productivity.

Diff: 1

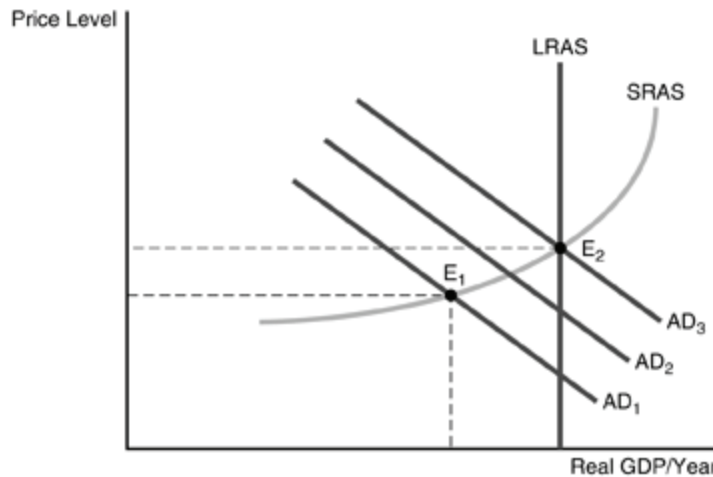
Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 92) Using graphs, explain how indirect crowding out can occur when the government increases spending in an attempt to stimulate the economy.

Answer:



See the above figure. The original equilibrium is E_1 , where there is a contractionary gap. The government pursues expansionary fiscal policy by increasing spending. Its goal is to reach E_2 . However, the increased borrowing causes the interest rate to increase, so private investment spending falls. The aggregate demand curve shifts back to AD_3 .

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

93) What are direct expenditure offsets and how do they influence the effects of fiscal policy?

Answer: When government spending competes with the private sector, direct expenditure offsets may occur. If the government provides lunches for children in school, families can reduce their expenditures on food to some extent. The impacts of fiscal policy actions on real GDP are reduced. In the extreme case, the government spending multiplier may be zero.

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

94) Suppose the government pursues expansionary fiscal policy by lowering taxes. What are the expected demand-side effects? What are the possible offsets to the demand-side effect? How might supply-side effects change these results?

Answer: Aggregate demand increases as consumption spending increases after the increase in disposable income. Crowding out and the effect of the Ricardian equivalence theorem can offset this if the government must borrow more and interest rates increase and if people anticipate higher future taxes they may increase saving. The supply-side effect may be to generate more productivity as people have a greater incentive to work with the lower tax rates. Tax revenues may not decrease. If the government does not have to borrow more, interest rates don't change, and there is no crowding out.

Diff: 3

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

95) Explain how indirect crowding out can offset expansionary fiscal policy.

Answer: If the government increases spending, it must pay for them some way. If it increases borrowing, interest rates increase. Firms will issue fewer bonds because of the higher interest rates, so private investment spending is reduced. This reduction in investment spending partially offsets the increased government spending.

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

96) Explain the Ricardian equivalence theorem.

Answer: The Ricardian equivalence theorem is the proposition that an increase in the government budget deficit has no effect on aggregate demand. When government spending increases without taxes, people expect future taxes to increase and so increase their saving to be ready to pay the higher future taxes. The reduction in consumption spending offsets the higher government spending, so that aggregate demand does not change.

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

- 97) Explain why proponents of supply-side effects of tax rate variations who also believe that tax-rate changes influence aggregate demand might claim that cuts in marginal income tax rates can potentially push up real Gross Domestic Product (GDP) without generating inflation.

Answer: According to supply-side economics, a reduction in marginal income tax rates causes the aggregate supply curve to shift rightward. If such tax-rate reductions also cause total planned expenditures to rise and generate an equal-sized rightward shift of the aggregate demand curve, then equilibrium real Gross Domestic Product (GDP) rises, but the equilibrium price level remains the same.

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

- 1) The period between the recognition of a problem and the implementation of a policy to solve the problem is
- A) the recognition lag.
 - B) the action time lag.
 - C) the effect time lag.
 - D) the fine tuning lag.

Answer: B

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

- 2) Which of the following are lags that fiscal policy makers must cope with?
- A) Recognition time lags.
 - B) Action time lags.
 - C) Effect time lags.
 - D) All of the above are correct.

Answer: D

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The effect time lag of fiscal policy refers to
- A) the time needed for Congress to enact a policy.
 - B) the delay in recognizing an economic problem.
 - C) the time between the onset of a policy and when the policy has impact on the economy.
 - D) the difficulty in getting the President and the Congress to agree on an appropriate policy.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

- 4) The time required to collect information about the current state of the economy is known as
- A) the recognition time lag.
 - B) the action time lag.
 - C) the effect time lag.
 - D) the fiscal lag.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

- 5) Fiscal policy may end up being destabilizing to an economy because
- A) there is never a long enough time lag.
 - B) the economy is almost always at full employment.
 - C) the President may have different goals than Congress.
 - D) various time lags associated with fiscal policy cause the policy changes to take effect too late to solve the problem it was supposed to solve.

Answer: D

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 6) The recognition time lag recognizes that it takes time
- A) to collect information about the state of the economy.
 - B) to get politicians to agree on the best policy to enact.
 - C) for any change in policy to take effect and for people to recognize that the policies are effective.
 - D) for the politicians to enact the policy once the need for change has been recognized.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 7) The amount of time that it takes to identify a national economic problem is
- A) fiscal policy.
 - B) the recognition time lag.
 - C) the effect time lag.
 - D) the action time lag.

Answer: B

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 8) The amount of time that it takes between recognizing an economic problem and implementing policy to solve it is
- A) fiscal policy.
 - B) the recognition time lag.
 - C) the effect time lag.
 - D) the action time lag.

Answer: D

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

9) The amount of time that elapses between the implementation of a policy and the results of that policy is

- A) fiscal policy.
- B) the recognition time lag.
- C) the effect time lag.
- D) the action time lag.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

10) Once either expansionary or contractionary fiscal policy has been undertaken,

- A) aggregate demand will respond quickly and the problems in the economy will be corrected.
- B) aggregate demand will respond quickly in the short run but the economy will not improve in the long-run.
- C) a time lag exists between implementation and the results of the policy.
- D) taxes will need to be adjusted because of the recognition time lag.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

11) The amount of time it takes Congress to debate the size of a tax cut is known as the

- A) action time lag.
- B) effect time lag.
- C) recognition time lag.
- D) Ricardian-equivalence time lag.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

12) The various time lags involved with fiscal policy imply that

- A) fiscal policy is effective only slowly, but the slowness ensures that it is effective in the long run.
- B) fiscal policy is most effective as a short-run measure to fine tune the economy's quarterly ups and downs.
- C) fiscal policy may often be destabilizing if the effects of the policy kick in after the need is over.
- D) when fiscal policy is carefully coordinated, it can quickly move to keep the economy at the full-employment level of real GDP.

Answer: C

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 13) In January 2009, the President submitted a bill to Congress that was designed to stimulate the economy and increase employment. The legislation was passed in March 2009, and the spending occurred from June 2009 to September 2010. Consequently,
- A) the economy should have been at full employment by December 2009.
 - B) the full impact of the bill would be felt by March 2009 because people anticipated the effects of the increased spending.
 - C) the full impact of the bill would be felt by the end of September 2010.
 - D) the full effect of the spending would be felt some time after September 2010 because the full multiplier effects could not be felt until all the increase in spending took place.

Answer: D

Diff: 3

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Revised

- 14) In January 2009, the President submitted a bill to Congress in order to stimulate the economy and increase employment. The legislation was passed in March 2009, and the spending occurred from June 2009 to March 2011. As a result,
- A) the full effect of the fiscal policy change would not be felt until after March 2011 because of the effect time lag.
 - B) the full effect of the fiscal policy change would not be felt until after March 2011 because of the recognition time lag.
 - C) the full effect of the fiscal policy change would be felt by March 2011 because people anticipated the spending and changed their behavior accordingly.
 - D) the full effect of the fiscal policy change would be felt when the last of the funds were spent by the government.

Answer: A

Diff: 3

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Revised

- 15) Discretionary fiscal policy
- A) may not have desired effects on real GDP because of the time lags.
 - B) may not have desired effects on real GDP because it leads to increases in aggregate demand.
 - C) may not have desired effects on real GDP because it leads to increases in aggregate demand.
 - D) would have a larger effect on real GDP if the multiplier was smaller.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 16) To the extent that the political process of moving legislation through Congress is slow,
- A) the effect time lag will be long.
 - B) the recognition time lag will be long.
 - C) the action time lag will be long.
 - D) automatic stabilizers will not be effective.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 17) The time required to acquire information about the state of the economy is referred to as
- A) the action time lag.
 - B) the recognition time lag.
 - C) the effect time lag.
 - D) the data lag.

Answer: B

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 18) The time that elapses between the implementation of a policy and its intended result is referred to as
- A) the action time lag.
 - B) the recognition time lag.
 - C) the effect time lag.
 - D) the data lag.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

- 19) A problem with using fiscal policy to fine-tune the economy is that
- A) agreeing on the appropriate fiscal policy is time consuming.
 - B) fiscal policy impacts the economy too fast.
 - C) fiscal policy impacts only urban areas of the nation.
 - D) fiscal policy impacts only the largest states in the nation.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The *recognition time lag* is the time that elapses between
- A) when an economic problem manifests itself and it is officially acknowledged.
 - B) the recognition of an economic problem and implementing policies to solve it.
 - C) implementing policies to solve an economic problem and when the results of that policy can be measured.
 - D) the beginning of the budgetary process and the final budget resolution.

Answer: A

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 21) The *action time lag* is the time period that elapses
- A) between when an economic problem manifests itself and it is officially acknowledged.
 - B) between the recognition of an economic problem and implementing policies to solve it.
 - C) between implementing policies to solve an economic problem and when the results of that policy can be measured.
 - D) between the beginning of the budgetary process and the final budget resolution.

Answer: B

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 22) The *effect time lag* is the time period that elapses
- A) between when an economic problem manifests itself and it is officially acknowledged.
 - B) between the recognition of an economic problem and implementing policies to solve it.
 - C) between implementing policies to solve an economic problem and when the results of that policy can be measured.
 - D) between the beginning of the budgetary process and the final budget resolution.

Answer: C

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

- 23) When data on the economy requires some time to gather and interpret, we have a(n)
- A) aggregate time lag.
 - B) action time lag.
 - C) recognition time lag.
 - D) effect time lag.

Answer: C

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

24) When it takes time for the president and Congress to change fiscal policy to act on economic data, we have a(n)

- A) aggregate time lag.
- B) action time lag.
- C) recognition time lag.
- D) effect time lag.

Answer: B

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

25) When there is an interval between when the fiscal policy changes and corresponding changes in aggregate spending, we have a(n)

- A) aggregate time lag.
- B) action time lag.
- C) recognition time lag.
- D) effect time lag.

Answer: D

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

26) When fiscal policy is used, time lags are variable and last anywhere from

- A) one to three weeks.
- B) one to three months.
- C) one to three years.
- D) one to three decades.

Answer: C

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

27) Fiscal policy time lags tend to be

- A) constant, always thirteen months long.
- B) variable, between one and three years.
- C) variable, between one and three weeks.
- D) variable, between one and three months.

Answer: B

Diff: 2

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB:

Question Status: Previous Edition

28) A recession begins in July but government policy makers do not reach a consensus that a recession had in fact begun until October. This is an example of a(n)

- A) recognition time lag.
- B) action time lag.
- C) effect time lag.
- D) quick time lag.

Answer: A

Diff: 2

Topic: 13.2 Possible Offsets to Fiscal Policy

AACSB: Analytic skills

Question Status: Previous Edition

29) What are the various time lags that affect discretionary fiscal policy, and what are their effects?

Answer: The recognition lag refers to the time it takes before economic problems can be identified; the action time lag is the time required between recognizing the problem and putting policy into effect; and the effect time lag is the time that elapses between the onset of policy and the results of that policy. The result is that the effects of a change in fiscal policy may take hold only after the problem no longer exists, and may have unintended effects.

Diff: 1

Topic: 13.3 Discretionary Fiscal Policy in Practice: Coping with Time Lags

AACSB: Analytic skills

Question Status: Previous Edition

13.4 Automatic Stabilizers

1) One characteristic of built-in or automatic stabilizers is that

- A) they require no new legislative action by Congress to have an effect.
- B) they automatically produce surpluses during recessions and deficits during inflation.
- C) they have no effect on the distribution of income.
- D) they reduce the size of the public debt during times of recession.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

2) Unemployment compensation programs are called automatic stabilizers because payments increase during

- A) expansionary periods.
- B) recessions.
- C) both recessions and expansions.
- D) wartime only.

Answer: B

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

3) All of the following are automatic fiscal stabilizers EXCEPT

- A) a congressionally mandated decrease in tax rates to stimulate the economy.
- B) a decrease in unemployment compensation payments during an expansion.
- C) a decrease in overall tax revenues during a recession.
- D) an increase in unemployment expenditures during a recession.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 4) When real Gross Domestic Product (GDP) falls, which of the following will automatically occur?
- A) A decrease in all tax rates
 - B) A decrease in income tax revenues
 - C) A decrease in unemployment compensation expenditures
 - D) An increase in income tax revenues

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 5) Automatic stabilizers are
- A) provisions that cause changes in government spending and taxes without new action by Congress or the President.
 - B) policies set by certain committees in Congress.
 - C) tools used by the President's Council of Economic Advisers.
 - D) provisions that cause the aggregate supply curve to be upward sloping.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 6) An example of an automatic stabilizer is
- A) unemployment compensation.
 - B) a newly enacted surtax to slow down an overheated economy.
 - C) a horizontal aggregate supply curve.
 - D) a change in the marginal tax rates.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 7) An advantage of automatic stabilizers over discretionary fiscal policy is that
- A) automatic stabilizers are not subject to the same time lags as discretionary fiscal policy.
 - B) automatic stabilizers can be easily fine-tuned to move the economy to full employment.
 - C) only the President is involved in implementing automatic stabilizers, instead of both the President and Congress.
 - D) the Ricardian equivalence theorem applies more readily to automatic stabilizers than to discretionary fiscal policy.

Answer: A

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

8) In the United States economy, the progressive income tax and unemployment compensation are both

- A) destabilizers.
- B) discretionary presidential effectors.
- C) automatic stabilizers.
- D) time lag factors.

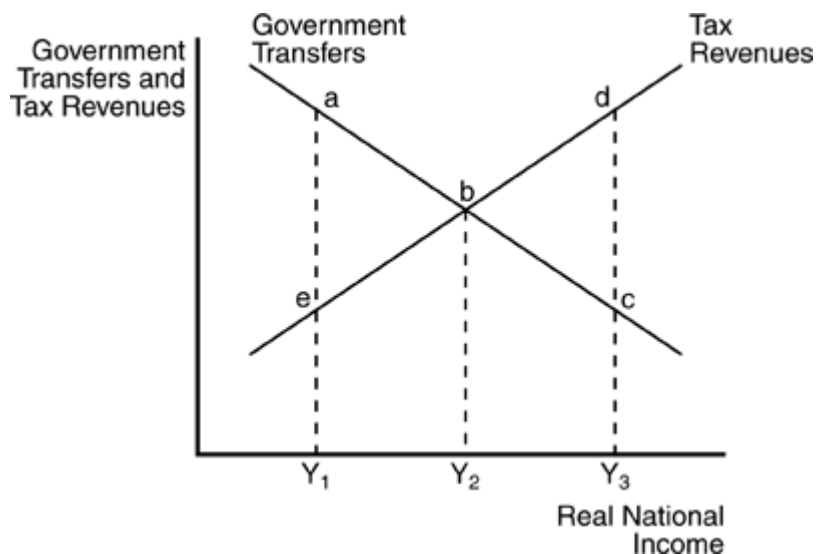
Answer: C

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition



9) Refer to the above figure. As the real national income expands from Y_2 to Y_3 ,

- A) a budget surplus occurs.
- B) a budget deficit occurs.
- C) tax revenues fall.
- D) government transfers rise.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Revised

10) Refer to the above figure. A budget deficit occurs when real national income is

- A) Y_1
- B) Y_2
- C) Y_3
- D) None of the above: cannot be determined given the information

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: New

- 11) Provisions that cause changes in government spending and taxes that do not require action of the President or Congress are called
- A) discretionary fiscal policy. B) discretionary stabilizers.
C) automatic stabilizers. D) private stabilization effects.

Answer: C

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Many government programs, such as unemployment compensation, operate on a deficit during recessions and a surplus during periods of economic expansion. The programs are referred to as
- A) discretionary fiscal policy. B) automatic stabilizers.
C) Ricardian equivalence. D) Recognition time lag.

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 13) The existence of automatic stabilizers will
- A) reduce the recognition lag of discretionary fiscal policy.
 - B) eliminate recessions.
 - C) reduce the size of recessionary and inflationary gaps.
 - D) cause the effects of shocks to aggregate demand to have a larger effect on GDP.

Answer: C

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 14) Which of the following is an example of an automatic stabilizer?
- A) cost of living adjustments to Social Security payments
 - B) unemployment benefits
 - C) a temporary tax rebate
 - D) all of the above

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

15) All of the following are automatic stabilizers EXCEPT

- A) discretionary increases in government spending.
- B) income transfer payments.
- C) progressive income tax system.
- D) unemployment compensation.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

16) Suppose there are two economies that are identical in every way with the following exception. Economy A has an unemployment compensation system while economy B does NOT have an unemployment compensation system. Now suppose both economies experience the same drop in planned investment. Which of the following is correct?

- A) Real GDP will fall more in economy A than in economy B.
- B) Real GDP will fall more in economy B than in economy A.
- C) Real GDP will fall the same in both economies.
- D) The effect on the relative size of the reduction in real GDP in the two economies is ambiguous.

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

17) What do automatic stabilizers attempt to stabilize?

- A) long-run aggregate supply
- B) aggregate demand
- C) exports
- D) imports

Answer: B

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

18) Which of the following might be considered an automatic fiscal stabilizer?

- A) government spending for the war effort
- B) 401(k) retirement program
- C) unemployment compensation
- D) government budgeting for education

Answer: C

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 19) Government-provided unemployment insurance is an example of
- A) a discretionary fiscal stabilizer.
 - B) an automatic fiscal stabilizer.
 - C) a monetary stabilizer.
 - D) an automatic monetary stabilizer.

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 20) Automatic stabilizers have the effect of
- A) increasing aggregate demand during a recessionary gap.
 - B) increasing aggregate demand during an inflationary gap.
 - C) increasing long-run aggregate supply during a recessionary gap.
 - D) increasing long-run aggregate supply during an inflationary gap.

Answer: A

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 21) Which one of the following is NOT an automatic stabilizer?
- A) the income tax system
 - B) the system of national defense procurement
 - C) the system of welfare payments
 - D) unemployment compensation programs

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 22) Automatic stabilizers are so-named because
- A) they are automatically undertaken by the Federal Reserve Bank to reduce budget deficits.
 - B) they occur automatically when real GDP changes.
 - C) the policy suggestions of the Council of Economic Advisors are automatically followed.
 - D) the policy suggestions of the Office of Management and Budget are automatically followed.

Answer: B

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 23) An example of an automatic stabilizer is
- A) the progressive tax system.
 - B) the decision of the President to cut taxes in a recession.
 - C) the Congressional decision to increase unemployment benefits in a recession.
 - D) the raising of taxes on cigarettes to discourage smoking to stabilize health-care costs.

Answer: A

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 24) The advantage of automatic stabilizers is that they
- A) help to balance the budget.
 - B) reduce the size of the net public debt.
 - C) reduce the fluctuations in the business cycle.
 - D) help reduce the inflation rate.

Answer: C

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 25) All of the following are automatic stabilizers EXCEPT
- A) the federal income tax system.
 - B) welfare payments.
 - C) discretionary tax cuts.
 - D) unemployment compensation.

Answer: C

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

- 26) Automatic stabilizers are fiscal policy measures that
- A) must be determined by the Congress in each budget.
 - B) do not require new legislation.
 - C) are determined by the Federal Reserve System.
 - D) are part of discretionary fiscal policy.

Answer: B

Diff: 1

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

27) Automatic stabilizers

- A) work counter-cyclically to moderate the business cycle.
- B) often make any downturn in the economy worse.
- C) must be determined by the Congress in each budget.
- D) are never altered.

Answer: A

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

28) Automatic stabilizers are designed to

- A) promote global trade.
- B) simplify the tax system.
- C) moderate changes in disposable income.
- D) stabilize the bi-partisan budget process.

Answer: C

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Revised

29) What are the automatic stabilizers the United States has in place, and how do they function differently from discretionary fiscal policy?

Answer: Automatic stabilizers are provisions of the tax law that cause changes in government spending or taxes without the action of Congress or the President. The progressive income tax takes more money out of the hands of people during inflationary times and less during recessions. Unemployment compensation gives spending power to people even when they are not working due to a recession. The key difference is that automatic stabilizers work without the lags associated with discretionary fiscal policy.

Diff: 2

Topic: 13.4 Automatic Stabilizers

AACSB: Analytic skills

Question Status: Previous Edition

13.5 What Do We Really Know About Fiscal Policy?

- 1) If the government increases aggregate demand when the economy is at both short-run and long-run equilibrium, the full long-run effect of this fiscal policy will be to
- A) increase real Gross Domestic Product (GDP).
 - B) increase the price level.
 - C) increase either the real Gross Domestic Product (GDP) or the price level, depending on the length of the time lag.
 - D) decrease both real Gross Domestic Product (GDP) and the price level.

Answer: B

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

- 2) During normal times, discretionary fiscal policy
- A) is more effective in influencing real GDP than at times of a recession.
 - B) is probably not very effective in influencing real GDP due to time lags.
 - C) is more effective in influencing real GDP than automatic stabilizers.
 - D) works well because there are no lag problems in influencing real GDP.

Answer: B

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Revised

- 3) Discretionary fiscal policy
- A) is not very effective in influencing real GDP during normal times because of time lags.
 - B) can be very effective in influencing real GDP during abnormal times, such as when a nation is at war.
 - C) may reassure investors and consumers that the federal government will be able to avert a major economic downturn.
 - D) all of the above

Answer: D

Diff: 2

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

- 4) During which time will fiscal policy be the most effective?
- A) Normal times
 - B) Times of war
 - C) In the middle of expansions
 - D) Times of stagflation

Answer: B

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

- 5) During normal times,
- A) fiscal policy is very effective because it the effects of fiscal policy will swamp automatic stabilizers and time lags can be.
 - B) fiscal policy can immediately correct problems in the economy.
 - C) the Ricardian equivalence theorem makes fiscal policy very effective.
 - D) fiscal policy is not effective because of the recognition time lag.

Answer: D

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

6) Deficit financing

- A) is when the government adjusts taxes to raise money to pay for government projects.
- B) is the mechanism behind the Laffer curve.
- C) is how the automatic stabilizers work.
- D) is when discretionary fiscal policy leads to spending more than is collected in taxes.

Answer: D

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

7) The traditional Keynesian approach to fiscal policy assumes

- A) the price level is constant.
- B) government expenditures are often substitutes for private expenditures.
- C) the Ricardian equivalence theorem is correct.
- D) the validity of supply-side economics.

Answer: A

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB:

Question Status: Previous Edition

8) The traditional Keynesian approach to fiscal policy assumes

- A) current taxes are the only taxes taken into account by firms and consumers.
- B) the focus of attention should be the long run.
- C) prices are flexible while interest rates are not.
- D) exchange rates are fixed.

Answer: A

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

9) The traditional Keynesian approach to fiscal policy assumes that

- A) the effect of unemployment compensation is to destabilize the economy.
- B) an equal income distribution ensures a stable economy.
- C) consumers spend more when their incomes are higher.
- D) cutting taxes is a more effective way to stimulate the economy than is increasing government spending.

Answer: C

Diff: 2

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Fiscal policy during periods of relatively low unemployment and low inflation have
- A) little effect due to time lags and the crowding-out effect.
 - B) significant effect due to the timely intervention of the president and congress.
 - C) significant effect because the changes in fiscal policy gives investors confidence in the economy.
 - D) little effect because the global market makes up fifty percent of aggregate spending.

Answer: A

Diff: 2

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

- 11) What are the effects of fiscal policy during normal times? What are the effects of fiscal policy during abnormal times?

Answer: During normal times, discretionary fiscal policy may not have its intended effects and, therefore, may actually cause more harm than good. The various time lags and the possible offsets make it fairly ineffective as a tool. During a major recession, fiscal policy is more likely to be effective, since the offsets are less likely.

Diff: 1

Topic: 13.5 What Do We Really Know About Fiscal Policy?

AACSB: Analytic skills

Question Status: Previous Edition

13.6 Appendix D: Changes in Government Spending

- 1) In the traditional Keynesian model, if the government increases spending, then
- A) real Gross Domestic Product (GDP) will rise and the price level will remain constant.
 - B) real Gross Domestic Product (GDP) will increase and the price level will fall.
 - C) both real Gross Domestic Product (GDP) and the price level will rise.
 - D) real Gross Domestic Product (GDP) will remain constant and the price level will rise.

Answer: A

Diff: 1

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 2) In the traditional Keynesian model, an increase in government spending
- A) causes the $C + I + G + X$ line to shift upward by the full amount of the increase in government spending.
 - B) causes the $C + I + G + X$ line to shift upward by an amount less than the increase in government spending.
 - C) causes the $C + I + G + X$ line to shift upward by more than the increase in government spending.
 - D) causes no change in the $C + I + G + X$ line.

Answer: A

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 3) In the traditional Keynesian model, if the government increases spending, then
- A) consumption will increase, and so real Gross Domestic Product (GDP) will increase by more than the increase in government spending.
 - B) consumption will decrease, and so real Gross Domestic Product (GDP) will increase by less than the increase in government spending.
 - C) consumption will remain the same, and so real Gross Domestic Product (GDP) will increase by the same amount of the increase in government spending.
 - D) consumption will increase or decrease, and so real Gross Domestic Product (GDP) will increase or decrease depending on the change in consumption.

Answer: A

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 4) According to the traditional Keynesian analysis, if the government increases spending by \$10 million, then
- A) consumption will increase, and so total expenditures will increase by more than \$10 million.
 - B) consumption will decrease, and so total expenditures will increase by less than the \$10 million.
 - C) consumption will remain the same, and so total expenditures will increase by exactly \$10 million.
 - D) consumption will increase or decrease, and so total expenditures will increase or decrease depending on the change in consumption.

Answer: A

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 5) In the traditional Keynesian model, if the government increases government spending,
- A) the $C + I + G + X$ line will shift down but the aggregate demand curve will not shift.
 - B) the $C + I + G + X$ line will shift down and the aggregate demand curve will shift to the left.
 - C) the $C + I + G + X$ line will shift up and the aggregate demand curve will shift to the right.
 - D) the $C + I + G + X$ line will shift up but the aggregate demand curve will not shift.

Answer: C

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 6) In the traditional Keynesian model, an increase in government spending raises total planned real expenditures by more than the original increase in government spending because
- A) consumption spending depends negatively on real GDP.
 - B) consumption spending depends positively on real GDP.
 - C) consumption spending is not related to real GDP.
 - D) of the crowding-out effect on consumption spending.

Answer: B

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 7) In the traditional Keynesian model, an increase in government spending leads to all of the following EXCEPT

- A) an increase in aggregate demand.
- B) a higher price level.
- C) an increase in consumption.
- D) higher real GDP.

Answer: B

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 8) The traditional Keynesian approach concludes that an increase in government spending
- A) generates a greater increase in investment spending.
 - B) generates an equal increase in total spending because government spending makes up part of total spending.
 - C) generates a greater increase in total spending because consumption spending increases as incomes increase.
 - D) has no effect on total spending because consumers increase saving by an equal amount.

Answer: C

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: Previous Edition

13.7 Appendix D: Changes in Taxes

- 1) According to the traditional Keynesian approach, if the government increases taxes, then
- A) real Gross Domestic Product (GDP) will fall and the price level will remain constant.
 - B) real Gross Domestic Product (GDP) will fall but the price level will rise.
 - C) both real Gross Domestic Product (GDP) and the price level will fall.
 - D) real Gross Domestic Product (GDP) will remain constant but the price level will rise.

Answer: A

Diff: 1

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 2) In the traditional Keynesian model, a tax cut
- A) causes the $C + I + G + X$ line to shift upward.
 - B) causes the $C + I + G + X$ line to shift downward.
 - C) causes a movement along the $C + I + G + X$ line.
 - D) does not affect the $C + I + G + X$ line.

Answer: A

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 3) In the traditional Keynesian model, an increase in current taxes
- A) increases disposable income but does not affect consumption.
 - B) decreases both disposable income and consumption.
 - C) decreases disposable income but increases consumption.
 - D) has no effect on either disposable income or consumption.

Answer: B

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 4) According to the traditional Keynesian approach, a tax cut raises aggregate demand because
- A) taxes are part of the $C + I + G + X$ line.
 - B) disposable income available to consumers increases.
 - C) taxpayers anticipate a tax increase in the future.
 - D) a tax cut always results in a balanced budget.

Answer: B

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 5) In the traditional Keynesian model, if the government cuts taxes, then
- A) both consumption and real Gross Domestic Product (GDP) will increase.
 - B) both consumption and real Gross Domestic Product (GDP) will decrease.
 - C) consumption will increase but Gross Domestic Product (GDP) will decrease.
 - D) consumption will decrease but Gross Domestic Product (GDP) will increase.

Answer: A

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 6) In the traditional Keynesian model, if the government cuts current taxes,
- A) the $C + I + G + X$ line will shift down but the aggregate demand curve will not shift.
 - B) the $C + I + G + X$ line will shift down and the aggregate demand curve will shift to the left.
 - C) the $C + I + G + X$ line will shift up and the aggregate demand curve will shift to the right.
 - D) the $C + I + G + X$ line will shift up but the aggregate demand curve will not shift.

Answer: C

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 7) In the traditional Keynesian model, an income tax cut raises real GDP because
- A) consumption spending depends negatively on after-tax income.
 - B) consumption spending depends positively on after-tax income.
 - C) consumption spending is not related to after-tax income.
 - D) of the crowding-out effects of taxes.

Answer: B

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: New

- 8) In the traditional Keynesian model, an increase in taxes leads to all of the following EXCEPT
- A) a decrease in aggregate demand.
 - B) a lower price level.
 - C) a decrease in consumption.
 - D) lower real GDP.

Answer: B

Diff: 2

Topic: 13.6 Appendix D: Changes in Government Spending

AACSB: Analytic skills

Question Status: New

- 9) According to the Keynesian approach, an increase in taxes
- A) will reduce consumption exactly by the amount of the taxes.
 - B) will reduce consumption by an amount less than the change in taxes.
 - C) will not impact consumption, as most consumption is autonomous.
 - D) will increase consumption, as the government will spend the extra tax revenue and that increases consumption.

Answer: B

Diff: 1

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: Previous Edition

- 10) According to the Keynesian approach, a decrease in taxes
- A) will increase consumption exactly by the amount of the taxes.
 - B) will increase consumption by an amount of less than the change in taxes.
 - C) will not impact consumption, as most consumption is autonomous.
 - D) will decrease consumption, as the government will have to spend less.

Answer: B

Diff: 1

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: Previous Edition

- 11) The Keynesian perspective on the effect of an increase in taxes is that this policy action
- A) generates reductions in consumption and in saving.
 - B) generates reductions in consumption and an increase in saving to pay for the new taxes.
 - C) has no impact on consumption.
 - D) increases current consumption and reduces future consumption.

Answer: A

Diff: 2

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Suppose there are two policy options facing a vote in the Senate. In the first, government spending will increase \$50 billion, while the second option is to cut taxes by \$50 billion. A Keynesian economist would argue for
- A) the tax option because it also affects the incentives workers face. Long-run aggregate supply will increase with the tax cut, but not with the spending increase.
 - B) the tax option because it is easier to pass. The effects on total spending would be identical.
 - C) the spending option because it won't affect the deficit the way the tax cut would.
 - D) the spending option because it has a bigger impact on total spending. The spending directly raises total spending plus it works through the multiplier, while the tax cut only works through the multiplier.

Answer: D

Diff: 3

Topic: 13.7 Appendix D: Changes in Taxes

AACSB: Analytic skills

Question Status: Previous Edition

13.8 Appendix D: The Balanced-Budget Multiplier

- 1) In Country Z, the government simultaneously increases its expenditures by \$25 billion and increases taxes by \$25 billion. If the MPS is equal to 0.2, the government's action _____ real GDP by _____.
- A) increases; \$125 billion
 - B) increases; \$25 billion
 - C) increases; \$100 billion
 - D) has no effect on; \$0

Answer: B

Diff: 2

Topic: 13.8 Appendix D: The Balanced-Budget Multiplier

AACSB: Analytic skills

Question Status: Previous Edition

- 2) In Country Z, the government simultaneously decreases its expenditures by \$20 billion and decreases taxes by \$20 billion. If the MPS is equal to 0.2, the government's action _____ real GDP by _____.

A) decreases; \$100 billion
B) decreases; \$20 billion
C) decreases; \$80 billion
D) has no effect on; \$0

Answer: B

Diff: 2

Topic: 13.8 Appendix D: The Balanced-Budget Multiplier

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The balanced-budget multiplier is equal to
- A) the percentage increase in government expenditures.
B) the reciprocal of the increase in government expenditures.
C) the percentage increase in taxes.
D) 1.

Answer: D

Diff: 1

Topic: 13.8 Appendix D: The Balanced-Budget Multiplier

AACSB: Analytic skills

Question Status: Previous Edition

- 4) According to the traditional Keynesian analysis, if the government increases spending and pays for all of it by raising current taxes, then
- A) aggregate demand will decrease.
B) a budget deficit will occur.
C) a budget surplus will occur.
D) aggregate demand will increase.

Answer: D

Diff: 1

Topic: 13.8 Appendix D: The Balanced-Budget Multiplier

AACSB: Analytic skills

Question Status: New

- 5) According to the traditional Keynesian approach, if the government increases spending by \$5 million and raises current taxes by \$5 million at the same time, then
- A) real GDP will increase by \$5 million.
B) real GDP will decrease by \$5 million.
C) real GDP will decrease by more than \$5 million.
D) real GDP will remain the same.

Answer: A

Diff: 1

Topic: 13.8 Appendix D: The Balanced-Budget Multiplier

AACSB: Analytic skills

Question Status: New

13.9 Appendix D: The Fixed Price Level Assumption

- 1) The Keynesian approach assumes that
- A) there is no unemployment in the economy.
 - B) the economy is self-regulating.
 - C) the government budget is always in deficit.
 - D) the price level is fixed.

Answer: D

Diff: 2

Topic: 13.9 Appendix D: The Fixed Price Level Assumption

AACSB: Analytic skills

Question Status: Previous Edition

- 2) If the price level is fixed, then an increase in government spending will lead to
- A) a larger increase in nominal GDP than in real GDP.
 - B) a smaller increase in nominal GDP than in real GDP.
 - C) no increase in either nominal GDP or real GDP.
 - D) an increase in nominal GDP by the same amount as an increase in real GDP.

Answer: D

Diff: 2

Topic: 13.9 Appendix D: The Fixed Price Level Assumption

AACSB: Analytic skills

Question Status: New

- 3) According the traditional Keynesian approach, an increase in government spending is effective in lowering unemployment if
- A) the price level is fixed.
 - B) the price level is flexible.
 - C) the price level does not exist.
 - D) Ricardian equivalence occurs, regardless of the price level.

Answer: A

Diff: 2

Topic: 13.9 Appendix D: The Fixed Price Level Assumption

AACSB: Analytic skills

Question Status: New