Principles of Macroeconomics
Homework Assignment 9

Multiple Choice

____ 1. Fiscal policy refers to the idea that aggregate demand is changed by changes in
- a. the money supply.
- b. government spending and taxes.
- c. trade policy.
- d. All of the above are correct.

____ 2. An increase in government spending initially and primarily shifts
- a. aggregate demand right.
- b. aggregate demand left.
- c. aggregate supply right.
- d. neither aggregate demand nor aggregate supply.

____ 3. In the short run an increase in government expenditures
- a. raises the price level, but not real GDP.
- b. raises real GDP, but not the price level.
- c. raises real GDP and the price level.
- d. raises neither real GDP nor the price level.

____ 4. The government buys a bridge. The owner of the company that builds the bridge pays her workers. The workers increase their spending. Firms that the workers buy goods from increase their output. This type of effect on spending illustrates
- a. the multiplier effect.
- b. the crowding-out effect.
- c. the Fisher effect.
- d. None of the above is correct.

____ 5. The marginal propensity to consume (*MPC*) is defined as the fraction of
- a. extra income that a household consumes rather than saves.
- b. extra income that a household either consumes or saves.
- c. total income that a household consumes rather than saves.
- d. total income that a household either consumes or saves.

____ 6. The government-spending multiplier is defined as
- a. *MPC*.
- b. 1 - *MPC*.
- c. 1/*MPC*.
- d. 1/(1 - *MPC*).

____ 7. If the *MPC* = 0.6, then the government spending multiplier is
- a. 1.67.
- b. 2.5.
- c. 5.
- d. 15.

____ 8. Expansionary fiscal policy includes
- a. reduction of government spending and increase in tax.
- b. reduction of both government spending and tax.
- c. increase in both government spending and tax.
- d. increase in government spending and cutting tax.

____ 9. Assume that the *MPC* is 0.6. An increase in government spending of $200 billion will
a. decrease aggregate demand by $500 billion.
b. increase aggregate demand by $120 billion.
c. increase aggregate demand by $500 billion.
d. increase aggregate demand by $333.33 billion.

____ 10. If taxes
a. increase, consumption increases, aggregate demand shifts right.
b. increase, consumption decreases, aggregate demand shifts left.
c. decrease, consumption increases, aggregate demand shifts left.
d. decrease, consumption decreases, aggregate demand shifts right.

____ 11. When the government reduces taxes, which of the following decreases?
a. consumption
b. take-home pay
c. household saving
d. None of the above is correct.

____ 12. Which of the followings is not included in fiscal policy?
(a) Households spending on consumption.
(b) Federal spending on security.
(c) Georgia state income tax.
(d) Coffee county sales tax.

_____ 13. If the economy is operating at full employment,
(a) the government should increase spending and cut tax.
(b) the government should decrease spending and cut tax.
(c) the government should increase both spending and tax.
(d) the government should not do anything to this economy.

_____ 14. Suppose you are the Economic Advisor of the President. Also suppose the economy is in recession. What fiscal policy should you recommend to the President?
(a) Cut tax and cut government spending.
(b) Raise tax and cut government spending.
(c) Raise tax and government spending.
(d) Cut tax and increase government spending.

_____ 15. Suppose the households in an economy tend to spend $70 on consumption whenever they receive $100 increase in income. This economy’s marginal propensity to consume is
(a) 1.4
(b) $170.
(c) 0.7
(d) $30.

_____ 16. If the spending multiplier for an economy is 10, it means
(a) every dollar the government spent would increase GDP by $10.
(b) every dollar the government spent would increase GDP by $9.
(c) every dollar the government spent would increase GDP by $1.
(d) every dollar the government spent would increase GDP by $0.1.

_____ 17. According to the Keynesian theory, if an economy's MPC is 0.6 and if there is a tax cut of $20 million, the real GDP in the economy would

(a) decrease by $30 million.
(b) increase by $30 million.
(c) decrease by $50 million.
(d) not change.

_____ 18. If an economy is overheat, which of the following fiscal policy should be used to subside the inflation?

a. Supply-side policy such as increasing government spending and cutting tax.
b. Contractionary fiscal policy such as increasing government spending and cutting tax.
c. Contractionary fiscal policy such as cutting government spending and raise tax.
d. Expansionary fiscal policy such as increasing government spending and cutting tax.

_____19. Budget deficit occurs when

(a) government tax revenue exceeds government expenditure.
(b) government expenditures match government tax revenue.
(c) government expenditures exceed government tax revenue.
(d) none of the above.

_____ 20. Which of the following is true?

(a) Keynes suggests the government to cut tax and to raise government spending during recession and therefore his theory is all about running deficit.
(b) Keynes suggests the government to cut tax and to raise government spending to stimulate the economy and therefore his theory brings a country into national debt.
(c) Keynes explains that the budget would be balanced because the budget deficit occurring during recession would be offset by the budget surplus during expansion.
(d) Keynes argues that during recession the government should still run a balanced budget.