The Federal Budget

1) Which of the following is considered a purpose of the federal budget?

I. To help the economy achieve full employment.
II. To finance the activities of the federal government.
III. To promote sustained economic growth.

A) I and II.
B) I and III.
C) II and III.
D) I, II and III.

Answer: D

2) Which branches of the government play a role in enacting the federal budget?

I. the President.
II. the House of Representatives.
III. the Senate.

A) I and II.
B) II and III.
C) I, II and III.
D) I.

Answer: C

Fiscal Policy

3) Fiscal policy includes

A) only decisions related to the purchase of government goods and services.
B) only decisions related to the purchase of government goods and services and the value of transfer payments.
C) only decisions related to the value of transfer payments and tax revenue.
D) decisions related to the purchase of government goods and services, the value of transfer payments, and tax revenue.

Answer: D

4) The purpose of fiscal policy is to

A) achieve full employment.
B) promote economic growth.
C) maintain price level stability.
D) All of the above answers are correct.

Answer: D

The Employment Act of 1946

5) The purpose of the Employment Act of 1946 was to

A) establish goals for the federal government that would promote maximum employment, purchasing power, and production.
B) establish an unemployment compensation system.
C) set up the Federal Reserve System.
D) set targets for the unemployment rate to be achieved by the president.

Answer: A

* This is Chapter 31 in Economics.
**Topic: Tax Revenues**

**Skill: Recognition**

6) Which of the following is NOT a revenue source for the Federal government?

A) Personal income taxes.
B) Indirect taxes.
C) Interest on corporate bond holdings.
D) Social security taxes.

**Answer: C**

**Topic: Tax Revenues**

**Skill: Recognition**

7) The largest source of government revenues is ____.

A) personal income taxes
B) indirect taxes
C) corporate income taxes
D) social security taxes

**Answer: A**

**Topic: Government Expenditures**

**Skill: Recognition**

8) Which of the following is NOT a government expenditure item?

A) Transfer payments.
B) Purchases of goods and services.
C) Debt interest on the government’s debt.
D) Purchases of foreign bonds.

**Answer: D**

**Topic: Government Expenditures**

**Skill: Recognition**

9) All of the following are government expenditure items EXCEPT

A) interest on the government’s debt.
B) transfer payments.
C) purchases of corporate bonds.
D) purchases of goods and services.

**Answer: C**

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<table>
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<tr>
<th>Component</th>
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<tr>
<td>Personal income taxes</td>
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<tr>
<td>Social security taxes</td>
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<tr>
<td>Debt interest</td>
<td>75</td>
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</table>

**Topic: Tax Revenues**

**Skill: Analytical**

10) Consider the above table with data for a country’s government budget. The country has government revenues of ____ billion.

A) $900
B) $1125
C) $725
D) $1700

**Answer: B**

**Topic: Government Expenditures**

**Skill: Analytical**

11) Consider the above table with data for a country’s government budget. Government expenditures for the economy equal ____ billion.

A) $1200
B) $1275
C) $1500
D) $1425

**Answer: C**

**Topic: Budget Surplus and Deficit**

**Skill: Analytical**

12) Consider the above table with data for a country’s government budget. The data show the government is running a ____ billion.

A) budget surplus of $300
B) budget deficit of $375
C) budget deficit of $550
D) budget surplus of $650

**Answer: B**
Topic: Budget Surplus and Deficit  
Skill: Recognition  
13) The government’s budget deficit or surplus equals the  
A) change in expenditure divided by change in revenue.  
B) average expenditure divided by average revenue.  
C) change in revenue minus change in purchases.  
D) total tax revenue minus total government expenditure.  
Answer: D  

Topic: Budget Surplus and Deficit  
Skill: Recognition  
14) A balanced budget occurs when government  
A) expenditure exceeds revenue.  
B) revenue exceeds expenditure.  
C) revenue equals expenditure.  
D) revenue is expenditure.  
Answer: C  

Topic: Budget Surplus and Deficit  
Skill: Recognition  
15) A budget surplus occurs when government  
A) expenditure exceeds tax revenue.  
B) tax revenue exceeds expenditure.  
C) tax revenue equals expenditure.  
D) tax revenue is expenditure.  
Answer: B  

Topic: Budget Surplus and Deficit  
Skill: Conceptual  
16) Whenever the federal government spends more than it receives in tax revenue, then by definition it  
A) runs a budget surplus.  
B) operates a balanced budget.  
C) runs a budget deficit.  
D) increases economic growth.  
Answer: C  

Topic: Budget Surplus and Deficit  
Skill: Recognition  
17) The budget deficit  
A) is the total outstanding borrowing by the government.  
B) is the difference between government expenditures and revenues.  
C) decreased during the Reagan Administration.  
D) reached its peak during the Vietnam War.  
Answer: B  

Topic: Budget Surplus and Deficit  
Skill: Recognition  
18) Which of the following statements regarding the U.S. government’s budget surpluses and deficits is correct?  
A) If tax revenues exceed expenditures, the government has a budget deficit.  
B) Since 1970, federal revenues have generally exceeded expenditures.  
C) Budget deficits tend to shrink during periods of recession.  
D) During the 1980s large deficits arose from a combination of tax cuts and expenditure increases.  
Answer: D  

Topic: Budget Surplus and Deficit  
Skill: Conceptual  
19) In 2003, the U.S. government budget registered a deficit. By definition, then,  
A) tax revenues were less than government expenditure.  
B) tax revenues were equal to government expenditure.  
C) tax revenues were greater than government expenditure.  
D) the government debt became negative.  
Answer: A  

Topic: Budget Surplus and Deficit  
Skill: Conceptual  
20) Suppose the only revenue taken in by the government is in the form of income tax, and the tax rate is 10 percent. If aggregate income is $800 billion, and government expenditures are $100 billion then the government budget has  
A) a deficit of $20 billion.  
B) a surplus of $20 billion.  
C) neither a surplus nor a deficit.  
D) a deficit of $80 billion.  
Answer: A  

Topic: Deficits and Debt  
Skill: Recognition  
21) The sum of accumulated annual federal budget deficits in excess of budget surpluses refers to  
A) the national debt.  
B) the cyclically unbalanced budget.  
C) the trade deficit.  
D) the federal government net worth.  
Answer: A
22) If the government has a balanced budget, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: C

23) If the government runs a surplus, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: B

24) If the government runs a deficit, the total amount of government debt is
A) increasing.
B) decreasing.
C) constant.
D) zero.
Answer: A

25) When the government’s expenditures exceed its revenues
A) it needs to borrow.
B) it incurs a budget deficit.
C) the federal government debt increases.
D) All of the above answers are correct.
Answer: D

26) An increase in the government _____ reduces the government’s _____.
A) budget deficit; debt
B) budget surplus; debt
C) debt; budget deficit
D) None of the above answers is correct.
Answer: B

27) The difference between the government debt and the budget deficit is
A) the government debt shows the annual discrepancy between government spending and tax revenue and the budget deficit shows the accumulated balance of past government debts.
B) the budget deficit shows the annual discrepancy between government spending and tax revenue and the government debt shows the accumulated balance of past government debts.
C) not significant because both move in the same direction.
D) none.
Answer: B

28) Suppose a country has been running a persistent government budget deficit. If the deficit is reduced, but remains positive,
A) government debt will increase.
B) government debt will decrease.
C) the country will experience a budget surplus.
D) interest payments on the debt immediately will decrease.
Answer: A

29) If tax revenue equal $1.5 billion and government expenditures equal $1.6 billion, then
A) the government budget has a deficit of $0.1 billion.
B) the government budget has a surplus of $0.1 billion.
C) the government debt is equal to $0.1 billion.
D) the government debt declines by $0.1 billion.
Answer: A
<table>
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<th>Year</th>
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<th>Government expenditures (billions of dollars)</th>
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<td>325</td>
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</table>

**Topic: Budget Surplus or Deficit**  
**Skill: Analytical**

30) What is the amount of the surplus or deficit incurred in year 1 by the government shown in the above table?  
   A) $0.  
   B) $25 billion deficit.  
   C) $25 billion surplus.  
   D) $240 billion surplus.  

**Answer: A**

31) What is the amount of the surplus or deficit incurred in year 2 by the government shown in the above table?  
   A) $0.  
   B) $5 billion surplus.  
   C) $5 billion deficit.  
   D) $250 billion surplus.  

**Answer: B**

32) What is the amount of the surplus or deficit incurred in year 3 by the government shown in the above table?  
   A) $0.  
   B) $5 billion surplus.  
   C) $5 billion deficit.  
   D) $260 billion surplus.  

**Answer: B**

33) What is the amount of the surplus or deficit incurred in year 4 by the government shown in the above table?  
   A) $20 billion deficit.  
   B) $35 billion surplus.  
   C) $5 billion surplus.  
   D) $320 billion surplus.  

**Answer: A**

34) What is the amount of the surplus or deficit incurred in year 5 by the government shown in the above table?  
   A) $15 billion deficit.  
   B) $35 billion surplus.  
   C) $5 billion surplus.  
   D) $325 billion surplus.  

**Answer: A**

**Topic: Deficits and Debt**  
**Skill: Analytical**

35) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 1?  
   A) $0.  
   B) $25 billion.  
   C) $240 billion.  
   D) Not enough information is provided to answer the question.  

**Answer: B**

36) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 2?  
   A) $245 billion.  
   B) $5 billion.  
   C) $250 billion.  
   D) $20 billion.  

**Answer: D**
CHAPTER 15

Topic: Deficits and Debt
Skill: Analytical

37) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 3?
   A) $15 billion.
   B) $5 billion.
   C) $20 billion.
   D) $260 billion.
   Answer: A

38) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 4?
   A) –$20 billion (The government has net saving rather than debt).
   B) $35 billion.
   C) $5 billion.
   D) $320 billion.
   Answer: B

39) The government begins year 1 with $25 billion of debt. Based on the information in the above table, what is the amount of debt following year 5?
   A) –$20 billion (The government has net saving rather than debt).
   B) $35 billion.
   C) $50 billion.
   D) $325 billion.
   Answer: C

The Supply Side: Employment and Potential GDP

Topic: Supply Side Effects
Skill: Conceptual

40) Looking at the supply-side effects on aggregate supply shows that a tax hike on labor income
   A) weakens the incentive to work.
   B) decreases potential GDP.
   C) will increase potential GDP because people work more to pay the higher taxes.
   D) Both answers A and B are correct.
   Answer: D

Topic: Supply Side Effects
Skill: Conceptual

41) Once supply side effects are taken into account, tax cuts for labor income can change
   I. the supply of labor
   II. potential GDP.
   A) I only.
   B) I and II.
   C) II only.
   D) Neither I nor II.
   Answer: B

Topic: Tax Wedge
Skill: Recognition*

42) If we compare the United States to France, the U.S. tax wedge is ____ the French tax wedge.
   A) larger than
   B) equals to
   C) smaller than
   D) not comparable to
   Answer: C

Topic: Laffer Curve
Skill: Conceptual*

43) According to the Laffer curve, raising the tax rate
   A) always increases the amount of tax revenue.
   B) always decreases the amount of tax revenue.
   C) does not change the amount of tax revenue.
   D) might increase, decrease, or not change the amount of tax revenue.
   Answer: C

Topic: Laffer Curve
Skill: Conceptual*

44) The Laffer curve shows that increasing ____ increases ____ when ____ low.
   A) tax revenue; potential GDP; tax revenue is
   B) tax rates; tax revenue; tax rates are
   C) potential GDP; tax revenue; tax revenue is
   D) None of the above answers is correct.
   Answer: D
### The Supply Side: Investment, Saving, and Economic Growth

**Topic:** Fiscal Policy and Aggregate Supply  
**Skill:** Conceptual

45) The supply side effects of a cut in tax rates include ____ in the supply of labor and ____ in the supply of capital.

A) an increase; an increase  
B) an increase; a decrease  
C) a decrease; an increase  
D) a decrease; a decrease

**Answer:** A

---

**Topic:** Fiscal Policy and Aggregate Supply  
**Skill:** Conceptual

49) When government saving is negative,

A) the real interest rate increases if the Ricardo-Barro effect does not apply.  
B) the real interest rate decreases if the Ricardo-Barro effect does not apply.  
C) investment is required to increase.  
D) the real interest rate falls if the crowding-out effect applies.

**Answer:** A

---

**Topic:** Direct Effect of Government Saving  
**Skill:** Conceptual

50) If the government has a budget deficit and the Ricardo-Barro effect does not apply,  

A) the real interest rate increases.  
B) investment decreases by the same amount as the deficit.  
C) investment decreases, but by an amount less than the deficit.  
D) Both answers A and C are correct.

**Answer:** D

---

**Topic:** Direct Effect of Government Saving  
**Skill:** Conceptual

51) The idea that a government budget deficit decreases investment is called

A) government dissaving.  
B) the crowding-out effect.  
C) the Ricardo-Barro effect.  
D) the capital investment effect.

**Answer:** B

---

**Topic:** Crowding Out  
**Skill:** Recognition

52) The term “crowding out” relates to

A) an effect of government dissaving.  
B) increases in the real interest rate due to government budget deficit.  
C) decreases in private investment because of government dissaving.  
D) All of the above answers are correct.

**Answer:** D
Topic: Crowding Out
Skill: Analytical
53) If the government begins to run a larger budget deficits, then assuming there is no Ricardo-Barro effect,
A) saving decreases and the real interest rate falls.
B) saving decreases and the real interest rate rises.
C) saving increases and the real interest rate rises.
D) saving increases and the real interest rate falls.
Answer: B

Topic: Crowding Out
Skill: Analytic
54) In the absence of the Ricardo-Barro effect, an increase in the government deficit results in a ____ real interest rate and a ____ equilibrium quantity of investment.
A) higher; higher
B) higher; lower
C) lower; higher
D) lower; lower
Answer: B

Topic: Crowding Out
Skill: Conceptual
55) If government saving is negative (that is, if government is running a budget deficit), crowding out might occur. Crowding out leads to all of the following EXCEPT
A) a higher real interest rate.
B) a decreased quantity of investment.
C) a smaller capital stock in the future.
D) decreased private saving.
Answer: D

Topic: Ricardo-Barro Effect
Skill: Recognition
57) The Ricardo-Barro effect holds that
A) equal increases in taxes and government purchases have no effect on equilibrium real GDP.
B) government budget deficits have no effect on the real interest rate.
C) a government budget deficit crowds out private investment.
D) a government budget deficit induces a decrease in saving that magnifies the crowding out effect.
Answer: B

Topic: Ricardo-Barro Effect
Skill: Recognition
58) According to the Ricardo-Barro effect, government deficits
A) lead to a rise in the equilibrium real interest rate, crowding out investment.
B) lead to simultaneous increases in private saving and no effect on the equilibrium real interest rate and investment.
C) lead to simultaneous decreases in private saving and decreases in the equilibrium real interest rate and investment.
D) lead to a fall in the equilibrium real interest rate and a rise in investment.
Answer: B

Topic: Ricardo-Barro Effect
Skill: Recognition
59) According to the Ricardo-Barro effect,
A) the government budget has no effect on the real interest rate.
B) a government budget deficit crowds out private investment.
C) financing government spending with taxes has a less severe effect on private investment than financing through government borrowing.
D) None of the above answers are correct.
Answer: A

Topic: Ricardo-Barro Effect
Skill: Conceptual*
60) The Ricardo-Barro effects assets that government
A) saving affects private saving.
B) budget deficits crowd out private borrowing.
C) spending affects private spending.
D) taxation raises interest rates.
Answer: A
61) If the Ricardo-Barro effect is present, a government budget deficit raises the equilibrium real interest rate by ____ and decreases the equilibrium quantity of investment by ____ than if the Ricardo-Barro effect is absent.
   A) more; more
   B) more; less
   C) less; more
   D) less; less
Answer: D

Generational Effects of Fiscal Policy

62) The ____ the interest rate, the ____ the present value of a given future amount.
   A) higher; larger
   B) higher; smaller
   C) lower; lower
   D) None of the above answers is correct because the interest rate has nothing to do with the present value.
Answer: C

Fiscal Imbalance

63) Splitting the fiscal imbalance between current and future generations is called
   A) genealogical accounting.
   B) actuarial accounting.
   C) generational imbalance.
   D) actuarial balance.
Answer: C

64) Comparing the fiscal imbalance for the current generation versus future generations, it is the case that
   A) future generations pay a larger share of the fiscal imbalance.
   B) the current generation pays a larger share of the fiscal imbalance.
   C) each generation pays half of the fiscal imbalance.
   D) each generation pays all of its fiscal imbalance.
Answer: A

International Debt

65) In order for the United States to repay its international debt, the United States would need to
   A) have a current account deficit.
   B) cut taxes.
   C) have a surplus of imports over exports.
   D) have a surplus of exports over imports.
Answer: D

Stabilizing the Business Cycle

66) A discretionary fiscal policy is a fiscal policy that
   A) involves a change in government defense spending.
   B) is triggered by the state of the economy.
   C) requires action by the Congress.
   D) involves a change in corporate tax rates.
Answer: C

67) An example of a discretionary fiscal policy is when
   A) tax receipts fall as incomes fall.
   B) unemployment compensation payments rise with unemployment rates.
   C) food stamp payments rise when the economy is in a recession.
   D) Congress passes a law that raises personal marginal tax rates.
Answer: D

68) The tax cuts passed by Congress in 2003 to help move the economy more rapidly toward potential GDP are an example of
   A) automatic fiscal policy.
   B) discretionary fiscal policy.
   C) lump-sum taxes.
   D) contractionary fiscal policy.
Answer: B
69) The effects of a change in government purchases is multiplied throughout an economy
A) only when there is an increase in purchases.
B) only when there is a decrease in purchases.
C) because these purchases generate changes in consumption expenditure.
D) because taxes are left unchanged.
Answer: C

70) The effect of a change in taxes is less than the same sized change in government purchases because
A) the amount by which consumption initially changes is the MPC times the tax change.
B) the amount by which taxes change is affected by the MPC.
C) changes in government spending do not directly affect consumption.
D) tax rates are the same regardless of income levels.
Answer: A

71) The tax multiplier is
A) larger than the government purchases multiplier.
B) smaller than the government purchases multiplier.
C) equal to the government purchases multiplier.
D) negative.
Answer: B
77) If the government wants to engage in fiscal policy to increase real GDP, it could
A) increase government purchases in order to increase aggregate supply.
B) decrease government purchases in order to increase aggregate supply.
C) increase government purchases in order to increase aggregate demand.
D) decrease government purchases in order to decrease aggregate demand.
Answer: C

78) An economy has real GDP of $300 billion and potential GDP of $240 billion. To move the economy to potential GDP, the government should ____ taxes and/or ____ government purchases.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: B

79) Using the AD-AS model, an increase in government spending
A) has no impact on real GDP.
B) has no impact on real GDP, but will increase potential GDP.
C) increases both real GDP and the price level.
D) has a full multiplier effect on real GDP, leaving unchanged the price level in the short run.
Answer: C

80) The government increases its purchases. The steeper the SAS curve, the ____ will be the increase in the price level and the ____ will be the increase in real GDP.
A) larger; larger
B) larger; smaller
C) smaller; larger
D) smaller; smaller
Answer: B
84) In the above figure, if the economy is initially at point $B$ and taxes are cut, if potential GDP does not change then the economy will move to point

A) move to point $C$.
B) move to point $A$.
C) move to point $D$.
D) stay at point $B$.

Answer: B

85) In the above figure, if the economy initially is at point $A$ and government purchases increase, in the short run the economy will move to point

A) $B$.
B) $C$.
C) $A$, that is, the equilibrium will NOT change.
D) None of the above answers is correct.

Answer: A
**Topic: Automatic Stabilizer**  
**Skill: Conceptual**

90) An example of an automatic fiscal policy stabilizer is when
A) tax revenues decrease as real GDP decreases.
B) Congress passes a law that raises tax rates.
C) Congress decides to cut government spending.
D) the president drafts a bill to reduce defense spending.

**Answer: A**

**Topic: Automatic Stabilizer**  
**Skill: Conceptual**

91) Because of automatic stabilizers, when real GDP decreases
A) government expenditures decrease and tax revenues increase.
B) government expenditures increase and tax revenues decrease.
C) government expenditures equal tax revenues.
D) the economy will automatically go to full employment.

**Answer: B**

**Topic: Automatic Stabilizer**  
**Skill: Conceptual**

92) Because of automatic stabilizers, when real GDP increases
A) government expenditures decrease and tax revenues increase.
B) government expenditures increase and tax revenues decrease.
C) government expenditures equal tax revenues.
D) the economy will automatically go to full employment.

**Answer: A**

**Topic: Automatic Stabilizer**  
**Skill: Conceptual**

93) Because of automatic stabilizers, when GDP fluctuates the
A) government’s budget remains in balance.
B) government’s deficit fluctuates directly with GDP so that it is larger when GDP increases.
C) government’s deficit fluctuates inversely with GDP so that it is larger when GDP decreases.
D) the economy will automatically go to full employment.

**Answer: C**

**Topic: Induced Taxes**  
**Skill: Recognition**

94) The term “induced taxes” refers to
A) the taxes that we are forced to pay.
B) sales taxes that we pay but could avoid if we choose not to purchase the item.
C) the rise in taxes due to a rise in GDP.
D) local property taxes that we pay in addition to the federal income tax.

**Answer: C**

**Topic: Induced Taxes**  
**Skill: Recognition**

95) Induced taxes
A) are autonomous.
B) are independent of real GDP.
C) vary with real GDP.
D) are fixed over time.

**Answer: C**

**Topic: Induced Taxes**  
**Skill: Conceptual**

96) Induced taxes
A) decrease during recessions and expansions.
B) decrease during recessions and increase during expansions.
C) increase during recessions and decrease in expansions.
D) increase during recessions and expansions.

**Answer: B**

**Topic: Needs-Tested Spending**  
**Skill: Conceptual**

97) Needs-tested spending
A) decreases during recessions and expansions.
B) decreases during recessions and increases during expansions.
C) increases during recessions and decreases in expansions.
D) increases during recessions and expansions.

**Answer: C**

**Topic: Induced Taxes and Needs-Tested Spending**  
**Skill: Conceptual**

98) The size of the government purchases multiplier is ____ by induced taxes and ____ by entitlement spending.
A) increased; increased
B) increased; decreased
C) decreased; increased
D) decreased; decreased

**Answer: D**
99) ____ taxes and transfer payments ____ the size of the government purchases multiplier.
A) Induced; decrease
B) Induced; increase
C) Lump-sum; decrease
D) Lump-sum; increase
Answer: A

100) Government transfer payments
A) increase during expansions and recessions.
B) increase during expansions and decrease during recessions.
C) decrease during expansions and increase during recessions.
D) decrease during expansions and recessions.
Answer: C

101) During an expansion, tax revenues ____ while during a recession, tax revenues ____.
A) decrease; increase
B) increase; decrease
C) remain stable; decrease
D) fail to cover expenditures; fail to match transfer payments
Answer: B

104) During an expansion, tax revenues ____ and government transfer payments ____.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: B

105) The structural deficit or surplus is the
A) difference between actual government expenditures and actual government receipts.
B) change in national debt that will result from current budgetary policies.
C) government budget deficit or surplus that would occur if the economy were at potential GDP.
D) actual government budget deficit or surplus minus expenditures for capital improvements.
Answer: C

106) The structural deficit is the deficit
A) during a recession.
B) during a recovery.
C) that would occur at full employment.
D) caused by the business cycle.
Answer: C

107) The structural surplus is the surplus
A) during a recession.
B) during a recovery.
C) that would occur at full employment.
D) caused by the business cycle.
Answer: C
**Topic: Cyclical and Structural Balances**

**Skill: Recognition**

108) A structural deficit occurs when the government budget has a deficit
A) even though real GDP is less than potential GDP.
B) even though real GDP is greater than structural GDP.
C) even though real GDP is equal to potential GDP.
D) that is nominal, as opposed to a real budget deficit.

**Answer: C**

109) The structural deficit is the deficit that occurs when
A) real GDP departs from potential GDP.
B) real GDP equals potential GDP.
C) aggregate demand is greater than short-run aggregate supply.
D) short-run aggregate supply is greater than aggregate demand.

**Answer: B**

110) A cyclical surplus is a
A) budget surplus only because real GDP is less than potential GDP.
B) budget surplus only because real GDP is greater than potential GDP.
C) budget surplus only because real GDP is equal to potential GDP.
D) nominal, as opposed to real, budget surplus.

**Answer: B**

**Skill: Conceptual**

111) Which of the following relationships is correct?
A) actual budget deficit = structural deficit − cyclical deficit
B) cyclical surplus = actual budget deficit − cyclical deficit
C) actual budget deficit = structural deficit + cyclical deficit
D) cyclical deficit = actual budget deficit + structural deficit

**Answer: C**

112) The actual budget deficit is equal to the
A) structural deficit.
B) cyclical deficit.
C) structural deficit minus the cyclical deficit.
D) structural deficit plus the cyclical deficit.

**Answer: D**

113) If the budget deficit is $50 billion and the structural deficit is $10 billion, the cyclical deficit is
A) $10 billion.
B) $40 billion.
C) $60 billion.
D) $50 billion

**Answer: B**

114) If the economy has a structural deficit of $25 billion and a cyclical deficit of $75 billion, we can conclude that the current budget deficit is ____ billion.
A) $25
B) $50
C) $75
D) $100

**Answer: D**
115) Economic data for a mythical economy in the years 2000-2004 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is at full employment, the government has a
A) budget surplus.
B) balanced budget.
C) budget deficit.
D) procyclical policy.
Answer: B

116) Economic data for a mythical economy in the years 2000-2004 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is above full employment, the government has a
A) budget surplus.
B) balanced budget.
C) budget deficit.
D) procyclical policy.
Answer: A

117) Economic data for a mythical economy in the years 2000-2004 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is at less than full employment, the government has a
A) budget surplus.
B) balanced budget.
C) budget deficit.
D) procyclical policy.
Answer: C

118) Using the above figure, if full employment occurs at $12 trillion and the economy is actually producing $12 trillion, then there is a
A) cyclical deficit.
B) cyclical surplus.
C) structural deficit.
D) structural surplus.
Answer: D
### Topic: Cyclical and Structural Deficits
**Skill: Analytical**
119) Using the above figure, if full employment occurs at $10 trillion, but the economy is actually producing $12 trillion, then there is a

A) cyclical deficit.
B) cyclical surplus.
C) structural deficit.
D) structural surplus.

**Answer: B**

### Study Guide Questions

#### Topic: Study Guide Question, Budget Surplus and Deficit
**Skill: Conceptual**
120) If the government’s expenditures are $1.5 trillion and its tax revenues are $2.2 trillion, the government is running a budget

A) surplus of $0.7 trillion.
B) surplus of $3.7 trillion.
C) deficit of $0.7 trillion.
D) deficit of $3.7 trillion.

**Answer: A**

#### Topic: Study Guide Question, Government Purchases Multiplier
**Skill: Analytical**
121) Which of the following reduces the size of the government purchases multiplier?

A) A decrease in the marginal propensity to import.
B) A decrease in the marginal tax rate.
C) A decrease in the marginal propensity to consume.
D) An increase in the marginal propensity to consume.

**Answer: C**

#### Topic: Study Guide Question, Government Purchases Multiplier
**Skill: Analytical**
122) If the MPC is 0.75, what is the government purchases multiplier?

A) 4.0.
B) 7.5.
C) –4.0.
D) –7.5.

**Answer: A**

#### Topic: Study Guide Question, Government Purchases Multiplier
**Skill: Analytical**
123) If the MPC is 0.9, what is the government purchases multiplier?

A) –5.0.
B) 10.0.
C) 5.0.
D) –9.0.

**Answer: B**

#### Topic: Study Guide Question, Government Purchases Multiplier
**Skill: Analytical**
124) If the government purchases multiplier is 2.5 and government purchases increase by $10 billion but prices do not change, equilibrium expenditure

A) increases by $25 billion.
B) increases by more than $25 billion.
C) increases by less than $25 billion.
D) is unaffected.

**Answer: A**

#### Topic: Study Guide Question, Lump-Sum Tax Multiplier
**Skill: Analytical**
125) If the MPC is 0.6, what is the lump-sum tax multiplier?

A) 2.5.
B) –2.5.
C) –1.5.
D) 1.5.

**Answer: C**

#### Topic: Study Guide Question, Multipliers
**Skill: Conceptual**
126) Which of the following policies shifts the AD curve the farthest leftward?

A) A rise in taxes of $10 billion.
B) A cut in taxes of $10 billion.
C) A decrease in government purchases of $10 billion.
D) A decrease in both government purchases and taxes of $10 billion.

**Answer: C**
127) How do higher marginal tax rates affect the size of the government purchases multiplier?
A) They increase its size.
B) They have no effect on its size.
C) They reduce its size.
D) The answer depends on the presence of lump-sum taxes in the economy in addition to income taxes.
Answer: C

128) If the government’s budget is in surplus even when the economy is at full employment, the surplus is said to be
A) persisting.
B) cyclical.
C) discretionary.
D) structural.
Answer: D

129) Prior to the Great Depression, the purpose of the federal budget was to ____.  
A) stabilize the economy  
B) finance the activities of the government  
C) maintain low interest rates  
D) decrease unemployment  
Answer: B

130) Fiscal policy attempts to achieve all of the following objectives except ____.  
A) a stable money supply  
B) price level stability  
C) full employment  
D) sustained economic growth  
Answer: A

131) The Council of Economic Advisors have the following roles except ____.  
A) proposing the federal government’s budget to Congress  
B) making forecasts of where the economy is heading  
C) monitoring the U.S. economy  
D) keeping the President informed about the current state of the economy  
Answer: A

132) When tax revenues exceed expenditures, the government has a ____, and when expenditures exceed tax revenues, the government has a ____.  
A) budget surplus; budget debt  
B) budget deficit; budget surplus  
C) budget debt; budget surplus  
D) budget surplus; budget deficit  
Answer: D

133) The government debt is equal to the ____, plus ____.  
A) current deficit; the current surplus  
B) current surplus; the sum of past deficits  
C) sum of past deficits; the current deficit  
D) sum of past deficits; the sum of past surpluses  
Answer: C

134) A fall in income that results in a decrease in tax revenues is an example of ____.  
A) automatic fiscal policy  
B) lump-sum taxes  
C) a recession  
D) discretionary fiscal policy  
Answer: A
Topic: Discretionary Fiscal Policy
Level 1: Definitions and Concepts
135) An increase in the income tax rates is an example of ____.
A) discretionary fiscal policy
B) increasing the government debt
C) increasing the government deficit
D) needs-tested taxing change.
Answer: A

Topic: Government Purchases Multiplier
Level 1: Definitions and Concepts
136) The amount by which a change in government purchases of goods and services is multiplied to determine the change in aggregate demand that it generates is the ____.
A) goods and services multiplier
B) government purchases multiplier
C) slope of the $AE$ curve
D) increase in real GDP
Answer: b

Topic: Budget Surplus and Deficit
Level 2: Using Definitions and Concepts
137) A government that currently has a budget deficit can balance its budget by ____.
A) increasing tax revenues by more than it increases expenditures
B) increasing both tax revenues and expenditures by the same amount
C) decreasing tax revenues by more than it decreases expenditures
D) decreasing tax revenues by more than it increases expenditures
Answer: A

Topic: The Federal Budget
Level 2: Using Definitions and Concepts
138) The largest item of government expenditure is ____.
A) debt interest
B) transfer payments
C) purchases of goods and services
D) debt reduction
Answer: B

Topic: Needs-Tested Spending
Level 2: Using Definitions and Concepts
139) Spending on programs that result in transfer payments that depend on the economic state of individuals and businesses is called ____.
A) transfer spending
B) welfare
C) needs-tested spending
D) business subsidies
Answer: C

Topic: Automatic Stabilizers
Level 2: Using Definitions and Concepts
140) An automatic stabilizer is at work if as real GDP increases, ____.
A) transfer payments decrease and interest rates decrease
B) transfer payments increase and tax revenues decrease
C) tax revenues increase and transfer payments decrease
D) tax revenues decrease and interest rates increase
Answer: C

Topic: Cyclical and Structural Balances
Level 2: Using Definitions and Concepts
141) A structural deficit is a deficit that exists ____.
A) even if the economy is at full employment
B) only because real GDP is less than potential GDP
C) during a business cycle expansion
D) only during a recession
Answer: A

Topic: Cyclical and Structural Balances
Level 2: Using Definitions and Concepts
142) When an economy is above full employment and the government has a budget deficit, that deficit ____.
A) exceeds the structural deficit
B) is equal to the structural deficit minus the cyclical deficit
C) is equal to the cyclical deficit minus the structural deficit
D) is less than the structural deficit
Answer: D
**Topic: Contractionary Fiscal Policy**

**Level 2: Using Definitions and Concepts**

143) A decrease in government purchases of goods and services is an example of ____.

A) expansionary fiscal policy  
B) decreasing structural deficit  
C) increasing induced taxes  
D) contractionary fiscal policy

**Answer: D**

**Topic: Contractionary Fiscal Policy**

**Level 2: Using Definitions and Concepts**

144) Contractionary fiscal policy ____ aggregate demand and in the short run ____ real GDP.

A) decreases; decreases  
B) increases; increases  
C) decreases; increases  
D) increases; decreases

**Answer: A**

**Topic: Budget Surplus and Deficit**

**Level 3: Calculations and Predictions**

145) In 2004, the federal government of Happy Isle had tax revenues of $1 million, and spent $500,000 on transfer payments, $250,000 on goods and services and $300,000 on debt interest. In 2004, the government of Happy Isle had a ____.

A) balanced budget  
B) budget deficit of $50,000  
C) budget surplus of $50,000  
D) budget deficit of $1,050,000

**Answer: B**

**Topic: Deficits and Debt**

**Level 3: Calculations and Predictions**

146) A country has been in existence for only two years. In the first year, tax revenues were $1.0 million and expenditures were $1.5 million. In the second year, tax revenues were $1.5 million and expenditures were $2.0 million. At the end of the second year, the government had issued debt worth ____.

A) $0.5 million  
B) $1 million  
C) $2.5 million  
D) $3.5 million

**Answer: B**

**Topic: Government Purchases Multiplier**

**Level 3: Calculations and Predictions**

147) The ____ , the smaller is the government purchases multiplier.

A) larger the investment  
B) smaller the marginal propensity to consume  
C) larger the marginal propensity to consume  
D) larger the total amount of government purchases

**Answer: B**

**Topic: Equilibrium GDP and the Price Level**

**Level 3: Calculations and Predictions**

148) In an economy, the government purchases multiplier is 3. If government purchases increase by $1 million, then in the short run, the price level ____ and real GDP ____ $3 million.

A) falls; decreases by less than  
B) rises; equals  
C) rises; increases by less than  
D) rises; decreases by less than

**Answer: C**

**Topic: Crowding Out**

**Level 3: Calculations and Predictions**

149) A fiscal policy that decreases government saving ____ saving, ____ the real interest rate, and ____ investment.

A) increases; decreases; crowds out  
B) increases; decreases; increases  
C) decreases; increases; increases  
D) decreases; increases; crowds out

**Answer: D**
FISCAL POLICY

150) The figure above shows tax revenues and govern-
ment expenditures in the economy of Meadow-
lake. Potential GDP is $10 trillion. If real GDP is
$10 trillion, then the government has a ____.
A) cyclical surplus
B) structural surplus
C) balanced budget
D) cyclical deficit
Answer: C

151) The figure above shows tax revenues and govern-
ment expenditures in the economy of Meadow-
lake. Potential GDP is $12 trillion. If real GDP is
$8 trillion, then the government has a ____.
A) cyclical deficit
B) structural deficit
C) structural surplus
D) cyclical surplus
Answer: A

Topic: Equilibrium GDP and the Price Level
Level 4: Advanced Calculations and Predictions

152) The figure above illustrates the aggregate demand,
short-run aggregate supply, and long-run aggre-
gate supply in Lotus Land. The economy is cur-ently at point D. Now the government increases
its purchases of goods and services. The economy
will move to ____. The price level will ____, and
the change in real GDP will be ____ the increase
in aggregate demand.
A) point A; fall; less than
B) point D; rise; less than
C) point C; rise; less than
D) point B; remain constant; the same as
Answer: C

153) The figure above illustrates the aggregate demand,
short-run aggregate supply, and long-run aggre-
gate supply in Lotus Land. The economy is cur-
rently at point D. Now the government decreases
its taxes. The economy will move to ____. The
price level will ____, and the change in real GDP
will be ____ the increase in aggregate demand.
A) point A; fall; less than
B) point D; rise; less than
C) point C; rise; less than
D) point B; remain constant; the same as
Answer: C