Multiple Choice Questions

1. Which of the following statements is incorrect?
   A. Given the economy's MPS, a $15 billion reduction in government spending will reduce the equilibrium GDP by more than would a $15 billion increase in taxes.
   B. Other things unchanged, a tax reduction of $10 billion will increase the equilibrium GDP by $25 billion when the MPS is 0.4.
   C. If the MPC is 0.8 and GDP has declined by $40 billion, this was caused by a decline in aggregate expenditures of $8 billion.
   D. A government surplus is anti-inflationary; a government deficit is expansionary.

2. A lump-sum tax means that:
   A. the tax only applies to one time period.
   B. the same amount of tax revenue is collected at each level of GDP.
   C. tax revenues vary directly with GDP.
   D. tax revenues vary inversely with GDP.

3. If the dollar appreciates relative to foreign currencies, we would expect:
   A. the multiplier to decrease.
   B. a country's exports and imports to both fall.
   C. a country's net exports to rise.
   D. a country's net exports to fall.

4. (Last Word) Classical macroeconomics was dealt severe blows by:
   A. the Great Depression and Keynes's macroeconomic theory.
   B. the Second World War and the writings of Milton Friedman.
   C. Adam Smith and his idea of the invisible hand.
   D. the strong recovery after the Second World War and Alvin Hansen's stagnation thesis.

5. Suppose the economy is operating at its full-employment-noninflationary GDP and the MPC is 0.75. The Federal government now finds that it must increase spending on military goods by $21 billion in response to deterioration in the international political situation. To sustain full-employment-noninflationary GDP government must:
   A. reduce taxes by $28 billion.
   B. reduce transfer payments by $21 billion.
   C. increase taxes by $21 billion.
   D. increase taxes by $28 billion.
6. The MPC and MPS in the above economy:
A. are .4 and .6 respectively.
B. are .6 and .4 respectively.
C. are .8 and .2 respectively.
D. cannot be determined from the information given.

The following information is for a closed economy:

<table>
<thead>
<tr>
<th>GDP</th>
<th>C</th>
<th>S</th>
<th>Ig</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>100</td>
<td>0</td>
<td>80</td>
</tr>
<tr>
<td>200</td>
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</tr>
<tr>
<td>700</td>
<td>460</td>
<td>240</td>
<td>80</td>
</tr>
</tbody>
</table>

7. Refer to the above information. If government now spends $80 billion at each level of GDP and taxes remain at zero, the equilibrium GDP:
A. will rise to $700.
B. will rise to $600.
C. will rise to $500.
D. may either rise or fall.

8. Assume that in a private closed economy consumption is $240 billion and investment is $50 billion, both at the $280 billion level of domestic output. Thus:
A. saving is $10 billion.
B. unplanned decreases in inventories of $10 billion will occur.
C. the MPC is .80.
D. unplanned increases in inventories of $10 billion will occur.
9. Refer to the above diagrams. Curve A:
A. is an investment schedule and curve B is a consumption of fixed capital schedule.
B. is an investment demand curve and curve B is an investment schedule.
C. and B are totally unrelated.
D. shifts to the left when curve B shifts upward.

10. Suppose that the level of GDP increased by $100 billion in a private closed economy where the marginal propensity to consume is 0.5. Aggregate expenditures must have increased by:
A. $100 billion.
B. $50 billion.
C. $500 billion.
D. $5 billion.

11. What do investment and government expenditures have in common?
A. both represent injections to the circular flow
B. both represent leakages from the circular flow
C. neither is subject to the multiplier effect
D. both represent a decline in indebtedness

12. Unintended changes in inventories:
A. cause the economy to move away from the equilibrium GDP.
B. are treated as components of consumption.
C. bring actual investment and saving into equality only at the equilibrium level of GDP.
D. bring actual investment and saving into equality at all levels of GDP.

(Advanced analysis) Answer the next question(s) on the basis of the following information for a private closed economy.
\[ S = -20 + .4Y \]
\[ I_g = 25 - 3i \]
where \( S \) is saving, \( I_g \) is gross investment, \( i \) is the real interest rate, and \( Y \) is GDP.
13. Refer to the above information. In equilibrium the level of saving will be:
A. $10.
B. $15.
C. $20.
D. $30.

14. Which of the following would increase GDP by the greatest amount?
A. a $20 billion reduction in taxes
B. $20 billion increases in both government spending and taxes
C. $20 billion decreases in both government spending and taxes
D. a $20 billion increase in government spending

15. Refer to the above information. The addition of a $100 billion lump-sum tax:
A. reduces the MPC and increases the multiplier.
B. increases the MPC and decreases the multiplier.
C. increases both the MPC and the multiplier.
D. has no effect on either the MPC or the multiplier.

16. Refer to the above diagram. The change in aggregate expenditures as shown from \((C + I_g + X_{n1})\) to \((C + I_g + X_{n2})\) will produce:
A. a decrease in real GDP.
B. an inflationary expenditure gap if \(0D\) is this nation's full-employment level of GDP.
C. an increase in real GDP if \(0B\) is this nation's full-employment level of GDP.
D. an inflationary expenditure gap if \(0B\) is this nation's full-employment level of GDP.
The following schedule contains data for a private closed economy. All figures are in billions. Use these data in answering the next question(s).

<table>
<thead>
<tr>
<th>GDP</th>
<th>C</th>
</tr>
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<tbody>
<tr>
<td>$140</td>
<td>$1.50</td>
</tr>
<tr>
<td>180</td>
<td>1.80</td>
</tr>
<tr>
<td>220</td>
<td>2.10</td>
</tr>
<tr>
<td>260</td>
<td>2.40</td>
</tr>
<tr>
<td>300</td>
<td>2.70</td>
</tr>
</tbody>
</table>

17. Refer to the above data. If a lump-sum tax of $20 is imposed, the consumption schedule will become:

<table>
<thead>
<tr>
<th>GDP</th>
<th>C</th>
<th>GDP</th>
<th>C</th>
<th>GDP</th>
<th>C</th>
<th>GDP</th>
<th>C</th>
</tr>
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<td>300</td>
<td>2.55</td>
<td>300</td>
<td>2.50</td>
</tr>
</tbody>
</table>

A. A Above.  
B. B Above.  
C. C Above.  
D. D Above.
18. Refer to the above diagram for a private closed economy. At the equilibrium level of GDP the APC and APS:
A. are 5/6 and 1/6 respectively.
B. are equal to the MPC and MPS respectively.
C. are 4/5 and 1/5 respectively.
D. cannot be determined from the information given.

19. An increase in taxes will have a greater effect on the equilibrium GDP:
A. if the tax revenues are redistributed through transfer payments.
B. the larger the MPS.
C. the smaller the MPC.
D. the larger the MPC.

20. If the MPS is .25 and the economy has a recessionary expenditure gap of $5 billion, then equilibrium GDP is:
A. $5 billion below the full-employment GDP.
B. $5 billion above the full-employment GDP.
C. $20 billion below the full-employment GDP.
D. $20 billion above the full-employment GDP.

(Advanced analysis) Answer the next question(s) on the basis of the following information for a private closed economy, where \( I_g \) is gross investment, \( S \) is saving, and \( Y \) is gross domestic product (GDP).

\[
I_g = 80
\]
\[
S = -80 + .4Y
\]

21. Refer to the above information. In equilibrium consumption will be:
A. $400.
B. $280.
C. $320.
D. $360.

22. If the MPC in an economy is .9, a $1 billion increase in government spending will ultimately increase consumption by:
A. $1 billion.
B. $.9 billion.
C. $10 billion.
D. $9 billion.

23. In a private closed economy, when aggregate expenditures exceed GDP:
A. GDP will decline.
B. business inventories will rise.
C. saving will decline.
D. business inventories will fall.
24. If an unintended increase in business inventories occurs:
A. we can expect aggregate production to be unaffected.
B. we can expect businesses to increase the level of production.
C. we can expect businesses to lower the level of production.
D. aggregate expenditures must exceed the domestic output.

25. The inflationary expenditure gap in the United States in the late 1980s was caused by:
A. a rapid decline of net exports.
B. a major tax increase.
C. rising aggregate expenditures.
D. cost-push inflationary forces.

26. In a private closed economy, when aggregate expenditures equal GDP:
A. consumption equals investment.
B. consumption equals aggregate expenditures.
C. planned investment equals saving.
D. disposable income equals consumption minus saving.

27. In a mixed open economy, if aggregate expenditures exceed GDP:
A. $I_g + X + G = C_d$
B. $C_d + I_g + X_n + G < \text{domestic output}$
C. $I_g > S$.
D. $I_g + X + G > S_d + M + T$.

Complete the following table and answer the next question(s) on the basis of the resulting data. All figures are in billions of dollars.

<table>
<thead>
<tr>
<th>Domestic output (GDP = PI)</th>
<th>Aggregate expenditures, closed economy</th>
<th>Aggregate expenditures, open economy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exports</td>
<td>Imports</td>
</tr>
<tr>
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<td>$230$</td>
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</tr>
<tr>
<td>$250$</td>
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<td>$430$</td>
<td>$30$</td>
</tr>
<tr>
<td>$500$</td>
<td>$470$</td>
<td>$30$</td>
</tr>
</tbody>
</table>

28. Refer to the above table. For the open economy the equilibrium GDP and the multiplier are:
A. $300$ and $2.5$.
B. $450$ and $5$.
C. $400$ and $4$.
D. $400$ and $5$.
29. Which of the following is correct?
A. Government expenditures and taxes both increase GDP.
B. Government expenditures and taxes both decrease GDP.
C. Government expenditures increase, but taxes decrease, GDP.
D. Government expenditures decrease, but taxes increase, GDP.

30. In the aggregate expenditures model, a reduction in taxes may:
A. increase saving.
B. decrease real GDP.
C. increase unemployment.
D. reduce consumption.

Pre-Test Chapter 9 ed17 Key

1. B  
2. B  
3. D  
4. A  
5. D  
6. B  
7. C  
8. B  
9. B  
10. B  
11. A  
12. D  
13. A  
14. D  
15. D  
16. D  
17. C  
18. A  
19. D  
20. C  
21. C  
22. D  
23. D  
24. C  
25. C  
26. C  
27. D  
28. D  
29. C  
30. A