Question #1 of 30

Question ID: 1572977

Monetary policy is *most accurately* described as actions that influence economic activity by increasing or decreasing:

A) the supply of money and credit.

B) currency exchange rates.

C) tax rates on income and consumption.

Explanation

Monetary policy attempts to influence economic growth and inflation by increasing or decreasing the money supply and the availability of credit in the economy. Taxes and government spending are tools of fiscal policy. Monetary and fiscal policy can both influence currency exchange rates, but this is not typically their primary goal or tool.

(Module 14.1, LOS 14.a)

Question #2 of 30

Question ID: 1572992

Arguments for being concerned with the size of a fiscal deficit relative to GDP *least likely* include:

A) a likely need for higher future taxes.

B) higher interest rates due to government borrowing.

C) a high proportion of government debt owed to the country's citizens.

Explanation

That a government owes its own citizens much of its outstanding debt is an argument against being concerned about fiscal deficits. Arguments for being concerned about fiscal deficits include the need for higher future taxes and the potential for government borrowing to increase interest rates and crowd out private investment. (Module 14.1, LOS 14.b)

Question #3 of 30

Question ID: 1572999

Which of the following statements about achieving proper timing in fiscal policy is *least accurate*?

A) Improvements in quantitative methods have made the occurrence of recessions or expansions quite predictable.

B) Policy errors are inevitable due to unpredictable events.

C) There is usually a time lag between when a change in policy is needed and when the need is recognized by policy makers.

Explanation

One problem in achieving proper timing in fiscal policy is the inability to accurately predict a recession or expansion.

(Module 14.2, LOS 14.d)

Question #4 of 30

Question ID: 1572996

The time it takes for a fiscal policy action to affect the economy is *best* described as:

A) impact lag.

B) action lag.

C) recognition lag.

Explanation

The time it takes for a fiscal policy action, once implemented, to have its effect on the economy is referred to as impact lag. Recognition lag is the time it takes policymakers to realize a fiscal policy response is needed. Action lag is the time it takes policymakers to discuss, enact, and implement fiscal policy measures.

(Module 14.2, LOS 14.d)

Question #5 of 30

Question ID: 1572994

Robert Necco and Nelson Packard are economists at Economic Research Associates. ERA asks Necco and Packard for their opinions about the effects of fiscal policy on real GDP for an economy currently experiencing a recession. Necco states that real GDP is likely to increase if both government spending and taxes are increased by the same amount. Packard states that if both government spending and taxes are increased by the same amount, there is no expected net effect on real GDP.

Are the statements made by Necco and Packard CORRECT?

	Necco	Packard
A)	Correct	Incorrect
B)	Incorrect	Correct
C)	Incorrect	Incorrect

Explanation

Necco is correct because the multiplier effect is stronger for government expenditures versus government taxes. All of the increase in government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save). Packard is incorrect; the effect on real GDP of an increase in government spending combined with equal increase in taxes will be positive because the multiplier effect is stronger for government spending versus the tax increase.

(Module 14.2, LOS 14.c)

Question #6 of 30

Question ID: 1572982

Discretionary fiscal policy refers to:

A) buying or selling securities in the open market to influence interest rates.

B) active decisions regarding spending and taxing to affect economic growth.

C) government spending programs that counteract the business cycle without the intervention of policymakers.

Explanation

Discretionary fiscal policy, in contrast to automatic stabilizers, refers to active decisions by the government to affect economic growth through changes in government spending and taxation. Buying or selling securities in the open market is an example of monetary policy.

(Module 14.1, LOS 14.b)

Question #7 of 30

Question ID: 1573000

Which of the following statements *best* explains the importance of the timing of changes in discretionary fiscal policy? Changes in discretionary fiscal policy must be timed properly if they are going to:

A) enable the government to control the money supply. ✗

B) exert a stabilizing influence on an economy. ✓

C) help the government achieve a balanced budget. ✗

Explanation

Proper timing of discretional policy is needed to reduce economic instability. If timed incorrectly, the fiscal policy change could increase rather than reduce economic instability.

(Module 14.2, LOS 14.d)

Question #8 of 30

Question ID: 1572991

The crowding-out effect suggests that:

A) government borrowing will lead to an increase in private savings. ✗

B) as government spending increases, so will incomes and taxes, and the higher taxes will reduce both aggregate demand and output. ✗

C) greater government deficits will drive up interest rates, thereby reducing private investment. ✓

Explanation

The crowding-out effect refers to a reduction in private borrowing and investment as a result of higher interest rates generated by budget deficits that are financed by borrowing in the private loanable funds market. (Module 14.1, LOS 14.b)

Question #9 of 30

Question ID: 1573002

An example of a contractionary fiscal policy change is a(n):

A) increase in a fiscal surplus.

B) decrease in a fiscal surplus.

C) increase in a fiscal deficit.

Explanation

An increase in a fiscal surplus or a decrease in a fiscal deficit is contractionary. An increase in a fiscal deficit or a decrease in a fiscal surplus is expansionary.

(Module 14.2, LOS 14.d)

Question #10 of 30

Question ID: 1573004

The government budget deficit of Country M is increasing. At the same time, the government budget surplus of Country N is decreasing. Are the fiscal policies of these countries expansionary or contractionary?

A) Both are contractionary.

B) Both are expansionary.

C) One is expansionary and one is contractionary.

Explanation

Expansionary fiscal policy increases a budget deficit or decreases a budget surplus. Contractionary fiscal policy decreases a budget deficit or increases a budget surplus.

(Module 14.2, LOS 14.d)

Question #11 of 30

Question ID: 1572986

When an economy dips into a recession, automatic stabilizers will tend to alter government spending and taxation so as to:

A) enlarge the budget deficit (or reduce the surplus).

B) reduce the budget deficit (or increase the surplus).

C) reduce interest rates, thus stimulating aggregate demand.

Explanation

During a recession unemployment is high, so the government will pay out more in unemployment compensation at the exact time that tax receipts from corporations and individuals are low. This will increase the size of the deficit and also maintain aggregate demand during recessionary periods.

(Module 14.1, LOS 14.b)

Question #12 of 30

Question ID: 1573003

A government that is implementing a contractionary fiscal policy is *most likely* to:

A) decrease transfer payments to households.

B) increase spending on public works.

C) decrease income tax rates.

Explanation

Decreasing spending or increasing taxes are contractionary fiscal policy actions. Increasing spending or decreasing taxes are expansionary.

(Module 14.2, LOS 14.d)

Question #13 of 30

Question ID: 1572978

Attempting to influence economic growth and inflation by changing tax rates and government spending is *best* described as:

A) monetary policy.

B) a combination of fiscal and monetary policy.

C) fiscal policy.

Explanation

Fiscal policy refers to actions by a government to influence economic activity through changes in taxes and government spending.

(Module 14.1, LOS 14.a)

Question #14 of 30

Question ID: 1573001

The country of Zurkistan is experiencing both high interest rates and high inflation. The government passes laws that reduce government spending and increase taxes. It takes many months before interest rates fall and inflation is reduced. This is an example of:

A) action lag and automatic stabilizers.

B) recognition lag in discretionary fiscal policy.

C) impact lag in discretionary fiscal policy.

Explanation

This is an example of discretionary fiscal policy involving impact lag because it takes time for the impact of the change in taxing and spending to be felt throughout the economy.

(Module 14.2, LOS 14.d)

Question #15 of 30

Question ID: 1572988

Arguments for being concerned about the size of a fiscal deficit *least likely* include:

A) a reduction in long-term economic growth.

B) Ricardian equivalence.

C) the crowding-out effect.

Explanation

If Ricardian equivalence holds, private savings will increase in anticipation of the future taxes required by a fiscal deficit. The crowding-out effect of government borrowing on private investment and the reduction in long-term economic growth due to higher future taxes argue in favor of being concerned about the size of a fiscal deficit.

(Module 14.1, LOS 14.b)

Question #16 of 30

Question ID: 1572993

Assuming the federal government maintains a balanced budget, the *most likely* effects of a tax increase on government expenditures and real GDP are:

	Government Expenditures	Real GDP
A)	Decrease	Decrease
B)	Increase	Decrease
C)	Increase	Increase

Explanation

The amount of the spending program exactly offsets the amount of the tax increase, leaving the budget unaffected (balanced budget). The multiplier effect is stronger for government spending versus the tax increase. Therefore, the balanced budget multiplier will be positive. All of the government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save).

(Module 14.2, LOS 14.c)

Question #17 of 30

Question ID: 1572980

When the central bank increases short-term interest rates, its monetary policy is *best* described as:

A) expansionary.

B) accommodative.

C) contractionary.

Explanation

When the central bank increases short-term interest rates, it is attempting to decrease the growth rate of money and credit in an economy, and policy is said to be contractionary, restrictive, or tight. Accommodative or expansionary monetary policy attempts to increase the growth rate of money and credit (e.g., by decreasing short-term interest rates).

(Module 14.1, LOS 14.a)

Question #18 of 30

Question ID: 1572983

Unemployment compensation is an example of:

A) a discretionary fiscal policy stabilizer.

B) an automatic fiscal policy stabilizer.

C) an automatic monetary policy stabilizer.

Explanation

Unemployment compensation automatically rises and falls with the business cycle, therefore it is an example of an automatic fiscal policy stabilizer.

(Module 14.1, LOS 14.b)

Question #19 of 30

Question ID: 1572984

Which of the following statements *best* explains how automatic stabilizers work? Even without a change in fiscal policy, automatic stabilizers tend to promote:

A) a budget deficit during a recession but do not promote a budget surplus during an inflationary expansion.

B) a budget surplus during a recession and a budget deficit during an inflationary expansion.

C) a budget deficit during a recession and a budget surplus during an inflationary expansion.

Explanation

Automatic stabilizers such as unemployment compensation, corporate profits tax, and the progressive income tax run a deficit during a business slowdown but run a surplus during an economic expansion. Therefore, they automatically implement countercyclical fiscal policy without the delays associated with policy changes that require legislative action.

(Module 14.1, LOS 14.b)

Question #20 of 30

Question ID: 1572997

The time it takes for policy makers to enact a fiscal policy action is *best* described as:

A) action lag.

B) implementation lag.

C) legislative lag.

Explanation

The time it takes for fiscal policy actions to be proposed, approved, and implemented is referred to as action lag.

(Module 14.2, LOS 14.d)

Question #21 of 30

Question ID: 1572979

A distinction between fiscal policy and monetary policy is that fiscal policy:

A) concerns taxes and government spending, while monetary policy concerns the money supply.

B) is aimed at promoting economic growth, while monetary policy is aimed at promoting price stability.

C) is typically expansionary, while monetary policy is typically contractionary.

Explanation

The distinction between fiscal and monetary policy is that a country's government determines fiscal policy through taxes and spending, but its central bank determines monetary policy by controlling the money supply. Both fiscal and monetary policy can be used to promote economic growth and price stability. Either fiscal policy or monetary policy can be expansionary or contractionary.

(Module 14.1, LOS 14.a)

Question #22 of 30

Question ID: 1572985

The term "automatic stabilizers" refers to:

A) changes in taxes and expenditure programs legislators automatically enact in response to changes the level of economic activity in order to smooth economic cycles.

B) increases in transfer payments and decreases in tax revenues that result from an economic contraction without new legislation.

C) government expenditures and tax receipts that are required to balance over the course of the business cycle, although they may be out of balance in any single year.

Explanation

Automatic stabilizers refers the increase (decrease) in transfer payments such as unemployment compensation and the decrease (increase) in tax revenue that result from a decrease (increase) in the level of economic activity. These effects tend to move the fiscal budget toward a deficit when economic activity decreases and toward surplus when economic activity increases, and tend to dampen economic cycles.

(Module 14.1, LOS 14.b)

Question #23 of 30

Question ID: 1572998

The time it takes for policy makers to determine that the economy requires a fiscal policy action is *best* described as:

A) action lag.

B) recognition lag.

C) impact lag.

Explanation

Recognition lag refers to the time it takes for fiscal policy makers to determine the need for a policy action. Action lag is the time it takes policymakers to discuss, enact, and implement fiscal policy measures. Impact lag is the time it takes for a fiscal policy measure to have its effect on the economy.

(Module 14.2, LOS 14.d)

Question #24 of 30

Question ID: 1572981

Promoting economic growth and price stability are the goals of:

A) fiscal policy, but not monetary policy.

B) monetary policy, but not fiscal policy.

C) both fiscal and monetary policy.

Explanation

Both monetary and fiscal policies are used by policymakers with the goals of maintaining stable prices and producing positive economic growth.

(Module 14.1, LOS 14.a)

Question #25 of 30

Question ID: 1572975

Policies that can be used as tools for redistribution of wealth and income include:

A) both fiscal policy and monetary policy.

B) fiscal policy only.

C) monetary policy only.

Explanation

Fiscal policy can be used as a tool for redistribution of income and wealth, through a variety of taxation and spending policies.

(Module 14.1, LOS 14.a)

Question #26 of 30

Question ID: 1572976

Policies used with the goal of maintaining stable prices and producing economic growth include:

A) both fiscal policy and monetary policy.

B) monetary policy only.

C) fiscal policy only.

Explanation

Both fiscal and monetary policies are used to maintain stable prices and produce economic growth. Fiscal policy does so by mechanisms that involve spending and taxation, and monetary policy uses central bank tools to modify the availability of money and credit.

(Module 14.1, LOS 14.a)

Question #27 of 30

Question ID: 1572987

An argument against being concerned with the size of a fiscal deficit is that a deficit can:

A) aid in increasing GDP and employment if the economy is operating at less than potential GDP. ✓

B) lead to higher future taxes that will increase government revenues. ✗

C) cause government borrowing to crowd out private borrowing. ✗

Explanation

One potential argument against being concerned about the size of fiscal deficits is that a deficit can help increase GDP and employment if output is below potential GDP and the spending does not divert capital from productive uses. Higher deficits that lead to crowding out or higher future taxes that result in lower long-term economic growth are arguments for concern about the size of fiscal deficits.

(Module 14.1, LOS 14.b)

Question #28 of 30

Question ID: 1572989

The crowding-out model implies that a:

A) budget deficit will increase the real interest rate and thereby retard private investment. ✓

B) budget surplus will retard aggregate demand and trigger an economic downturn. ✗

C) budget deficit will stimulate aggregate demand and trigger a multiplier effect which will lead to inflation. ✗

Explanation

Increased budget deficits will increase the demand for loanable funds and lead to higher interest rates and thus lower private investment. Crowding-out implies that an increase in government spending will choke off private investment and reduce the intended impact of fiscal policy changes on aggregate demand.

(Module 14.1, LOS 14.b)

Question #29 of 30

Question ID: 1572995

Assuming the economy currently is experiencing high inflation, an example of appropriate discretionary fiscal policy is:

A) increase the federal funds target rate.

B) reduce government expenditures on major government construction projects.

C) reduce the money supply.

Explanation

Discretionary fiscal policy refers to the federal government's decisions regarding government spending and taxing. A reduction in government spending on major government construction projects is likely to lead to a reduction in aggregate demand and less pressure on prices, reducing inflation.

(Module 14.2, LOS 14.c)

Question #30 of 30

Question ID: 1572990

Arguments against being concerned about the size of a fiscal deficit include:

A) higher future taxes.

B) Ricardian equivalence.

C) the crowding-out effect.

Explanation

Ricardian equivalence suggests that it does not matter whether a government finances its spending with debt or a tax increase because the effect on the total level of demand in the economy is the same. Arguments for being concerned about the size of the fiscal deficit include the crowding-out effect of government borrowing taking the place of private sector borrowing and the negative effects on work incentives and entrepreneurship from higher future taxes.

(Module 14.1, LOS 14.b)