

Chapter 34

Five Debates over Macroeconomic Policy

Test B

1. If households and firms became more optimistic about the future real GDP
 - a. and unemployment would increase.
 - b. would increase and unemployment would decrease.
 - c. would decrease and unemployment would increase.
 - d. and unemployment would decrease.

ANSWER: b. would increase and unemployment would decrease.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

2. If unemployment increases, which of the following could the government do to try to decrease it?
 - a. decrease the money supply
 - b. decrease taxes
 - c. decrease government expenditures
 - d. None of the above would tend to decrease unemployment.

ANSWER: b. decrease taxes.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

3. Which of the following actions would be considered leaning against the wind?
 - a. In response to a recession, the government leaves fiscal and monetary policy unchanged.
 - b. In response to a recession, the government decreases the money supply.
 - c. In response to a boom, the government increases taxes.
 - d. None of the above is correct.

ANSWER: c. In response to a boom, the government increases taxes.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

4. In 1999 and 2000 the Federal Reserve raised interest rates several times. This policy implies the Fed
 - a. increased money supply growth due to concern about inflation.
 - b. increased money supply growth due to concern about unemployment.
 - c. decreased money supply growth due to concern about inflation.
 - d. decreased money supply growth due to concern about unemployment.

ANSWER: c. decreased money supply growth due to concern about inflation.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

5. An increase in the money supply affects output primarily by
 - a. decreasing interest rates which increases business investment.
 - b. decreasing interest rates which decreases business investment.
 - c. increasing interest rates which increases business investment.
 - d. increasing interest rates which decreases business investment.

ANSWER: a. decreasing interest rates which increases business investment.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

6. The principal lag in implementing fiscal policy is the time it takes
- for firms to change output in response to the change in the price level.
 - for fiscal policy to affect interest rates.
 - for government expenditures and taxes to affect consumer spending.
 - to pass legislation to change expenditures or taxes.

ANSWER: d. to pass legislation to change expenditures or taxes.

TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

7. The Federal Reserve
- has considerable discretion in determining monetary policy.
 - has little discretion, but not does not have to follow any specific rule.
 - must follow a monetary policy rule that requires it to be primarily concerned with inflation.
 - must follow a monetary policy rule that requires it to be primarily concerned with unemployment.

ANSWER: a. has considerable discretion in determining monetary policy.

TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

8. When the Fed has discretion, policy is time inconsistent which means inflation expectations are
- higher and the short-run Phillips curve is further to the right than otherwise.
 - higher and the short-run Phillips curve is further to the left than otherwise.
 - lower and the short-run Phillips curve is further to the right than otherwise.
 - lower and the short-run Phillips curve is further to the left than otherwise.

ANSWER: a. higher and the short-run Phillips curve is further to the right than otherwise.

TYPE: M KEY1: C OBJECTIVE: 2 SECTION: 2 RANDOM: Y

9. Either a constant growth rate of the money supply monetary rule, or a rule requiring the Fed to respond to changes in real GDP would reduce or eliminate
- the time inconsistency of monetary policy.
 - the monetary portion of the political business cycle.
 - both the time inconsistency of monetary policy and the monetary portion of the political business cycle.
 - neither the time inconsistency of monetary policy nor the monetary portion of the political business cycle.

ANSWER: c. both the time inconsistency of monetary policy and the monetary portion of the political business cycle.

TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

10. Consider the following two sentences. If the Fed is bound by a rule to decrease the money supply when prices increase, then when aggregate supply shifts left, their actions will reduce output further. Paul Volcker's monetary policy in 1979 caused a rise in Jimmy Carter's popularity.
- Only the first sentence is correct.
 - Only the second sentence is correct.
 - Both sentences are correct.
 - Neither sentence is correct.

ANSWER: a. Only the first sentence is correct.

TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

11. An economist would be more likely to support a program reducing inflation to zero if she believed that
- shoeleather and menu costs were high.
 - Fed policy to reduce inflation was credible.
 - the short-run Phillips curve was steep.
 - All of the above are correct.

ANSWER: d. All of the above are correct.

TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

12. A policy to reduce inflation is likely to increase unemployment in
- the short run and the long run.
 - the short run but not the long run.
 - the long run but not the short run.
 - neither the short nor long run.

ANSWER: b. the short run, but not the long run.

TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

13. If people believe a central bank's intention to decrease the inflation rate, the
- short-run Phillips curve shifts right.
 - short-run Phillips curve shifts left.
 - long-run Phillips curve shifts right.
 - long-run Phillips curve shifts left.

ANSWER: b. short-run Phillips curve shifts left.

TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

14. If people in countries that have had persistently high inflation are skeptical of efforts to reduce inflation the short-run Phillips curve will remain far to the
- right, and the sacrifice ratio will be low.
 - right, and the sacrifice ratio will be high.
 - left, and the sacrifice ratio will be low.
 - left, and the sacrifice ratio will be high.

ANSWER: d. left, and the sacrifice ratio will be high.

TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

15. Which of the following is incorrect?
- A credible inflation reduction program can lead to a low sacrifice ratio.
 - Inflation reduction programs are likely to lower employment, but unlikely to have much impact on the capital stock.
 - Living standards depend on productivity and not the price level.
 - Rewriting the tax laws could reduce some of the current costs of inflation.

ANSWER: b. Inflation reduction programs are likely to lower employment, but unlikely to have much impact on the capital stock.

TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

16. From 1980 to 1999 the debt of the U.S. federal government
- fell by about 80%.
 - fluctuated but ended up about the same.
 - rose by about 200%.
 - rose by about 400%.

ANSWER: d. rose by about 400%.

TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y

17. Budget deficits reduce national saving causing real interest rates
- and investment to fall.
 - and investment to rise.
 - to rise and investment to fall.
 - None of the above is correct.

ANSWER: c. to rise and investment to fall.

TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y

18. Consider the following two sentences. A policy that required a balanced budget would require the government to either increase taxes or reduce expenditures during recessions, which would tend to worsen the recessions. Funding more education spending rather than reducing the government debt could, all things considered, make future generations better-off.

- Only the first sentence is true.
- Only the second sentence is true.
- Both sentences are true.
- Neither sentence is true.

ANSWER: c. Both sentences are true.

TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y

19. Each person's share of the government debt is about
- 2% of lifetime income.
 - 10% of lifetime income.
 - 25% of lifetime income.
 - 40% of lifetime income.

ANSWER: a. 2% of lifetime income.

TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y

20. Suppose that a country has a real GDP growth rate of about 1% per year and an inflation rate of about 3%. If they have nominal GDP of about 100 billion units of currency, they can have a deficit of about

- 2 billion without increasing the ratio of debt to income.
- 3 billion without increasing the ratio of debt to income.
- 4 billion without increasing the ratio of debt to income.
- None of the above is correct.

ANSWER: c. 4 billion without increasing the ratio of debt to income.

TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y

21. Double taxation means that both
- the profits of corporations and the dividends shareholders receive are taxed, which is currently the case in the United States.
 - the profits of corporations and the dividends shareholders receive are taxed, which is not currently the case in the United States.
 - wage income and interest income are taxed, which they currently are in the United States.
 - wage income and interest income are taxed, which is not currently the case in the United States.

ANSWER: a. the profits of corporations and the dividends shareholders receive are taxed, which is currently the case in the United States.

TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y

22. U.S. public policy discourages saving because
- other things the same, taxes reduce the return from savings.
 - means tested programs such as Medicaid provide greater benefits to those who did not save.
 - at least some of the amount that parents bequest to their children is taxed.
 - All of the above are correct.

ANSWER: d. All of the above are correct.

TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y

23. Assuming the substitution effect is large relative to the income effect, tax reform designed to increase saving,
- decreases the interest rate and spending on capital goods.
 - decreases the interest rate and increases spending on capital goods.
 - increases the interest rate and decreases spending on capital goods.
 - increases the interest rate and increases spending on capital goods.

ANSWER: b. decreases the interest rate and increases spending on capital goods.

TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y

24. Tax changes that reduce taxes on interest and capital income may lower tax revenues which
- increases public saving and so increases national saving.
 - increases public saving and so decreases national saving.
 - decreases public saving and so increases national saving.
 - decreases public saving and so decreases national saving.

ANSWER: d. decreases public saving and so decreases national saving.

TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y

25. Which of the following is incorrect?
- Any tax change that favors people who save, tends to favor people with high income.
 - If saving were relatively elastic with respect to tax rates, a decrease in the tax rate on income from saving may not change saving very much.
 - A higher return from saving raises saving if the substitution effect is larger than the income effect.
 - Other things the same an increase in government surpluses would increase both public and national saving.

ANSWER: b. If saving were relatively elastic with respect to tax rates, a decrease in the tax rate on income from saving may not change saving very much.

TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y

- 1 ANSWER: b. would increase and unemployment would decrease.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 2 ANSWER: b. decrease taxes.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 3 ANSWER: c. In response to a boom, the government increases taxes.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 4 ANSWER: c. decreased money supply growth due to concern about inflation.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 5 ANSWER: a. decreasing interest rates which increases business investment.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 6 ANSWER: d. to pass legislation to change expenditures or taxes.
TYPE: M KEY1: D OBJECTIVE: 1 SECTION: 1 RANDOM: Y

- 7 ANSWER: a. has considerable discretion in determining monetary policy.
TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

- 8 ANSWER: a. higher and the short-run Phillips curve is further to the right than otherwise.
TYPE: M KEY1: C OBJECTIVE: 2 SECTION: 2 RANDOM: Y

- 9 ANSWER: c. both the time inconsistency of monetary policy and the monetary portion of the political business cycle.
TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

- 10 ANSWER: a. Only the first sentence is correct.
TYPE: M KEY1: D OBJECTIVE: 2 SECTION: 2 RANDOM: Y

- 11 ANSWER: d. All of the above are correct.
TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

- 12 ANSWER: b. the short run, but not the long run.
TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y

- 13 ANSWER: b. short-run Phillips curve shifts left.
TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y
- 14 ANSWER: d. left, and the sacrifice ratio will be high.
TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y
- 15 ANSWER: b. Inflation reduction programs are likely to lower employment, but unlikely to have much impact on the capital stock.
TYPE: M KEY1: D OBJECTIVE: 3 SECTION: 3 RANDOM: Y
- 16 ANSWER: d. rose by about 400%.
TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y
- 17 ANSWER: c. to rise and investment to fall.
TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y
- 18 ANSWER: c. Both sentences are true.
TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y
- 19 ANSWER: a. 2% of lifetime income.
TYPE: M KEY1: D OBJECTIVE: 4 SECTION: 4 RANDOM: Y
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- 21 ANSWER: a. the profits of corporations and the dividends shareholders receive are taxed, which is currently the case in the United States.
TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y
- 22 ANSWER: d. All of the above are correct.
TYPE: M KEY1: D OBJECTIVE: 5 SECTION: 5 RANDOM: Y
- 23 ANSWER: b. decreases the interest rate and increases spending on capital goods.
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