Problem Set 5: Due Monday, November 8

1. When the expenditure schedule is too low, the result is
   a. an unemployment surplus.    b. an inflationary gap.    c. a recessionary gap.     d. a budgetary gap.

2. The combination of high unemployment and high inflation is termed
   a. reflation.                    b. stagflation.            c. depression.     d. unflation.

3. For most firms in the economy, the largest part of factor costs is the cost of
   a. capital.    b. land and natural resources.    c. labor.     d. property and machinery.

4. As a result of the Balkan wars, the populations of Serbia and Kosovo as well as their capital stocks were reduced. This can be illustrated by aggregate supply curve
   a. shifting outward.    b. becoming flatter.    c. shifting inward.     d. becoming more elastic.

5. The aggregate supply curve slopes ________ because firms can ________.
   a. downward; sell more at lower prices.                                       b. downward; hire more workers at lower prices.
   c. upward; hire more workers at higher wage levels.                           d. upward; hire labor at fixed wages for short-run periods.

6. Input prices are fixed for some period of time because
   a. some workers enter into long-term contracts.    b. firms purchase raw materials on set-price contracts.
   c. many workers get pay increases only once a year.                           d. All of the others are correct.

7. The slope of the aggregate supply curve increases as output increases because:
   a. the cost of resource-use increases as potential is reached.     b. consumers are willing to pay more as output expands.
   c. firms substitute capital for labor as prices increase.    d. firms substitute capital for labor as capacity is reached.

8. A decrease in the price of resources will cause the aggregate supply curve to
   a. shift outward.    b. shift inward.    c. become flatter.     d. become steeper.

9. An economist who claims that an increase in government spending would result mainly in a higher price level believes the economy is operating where
   a. the MPC is small.    b. the MPC is large.    c. aggregate supply curve is flat.     d. aggregate supply curve is steep.

10. If the price level rises, what will happen to aggregate supply?
    a. It will shift outward.    b. It will shift inward.    c. Nothing.    d. It will get steeper.    e. It will get flatter.

11. An increase in the money wage rate will cause
    a. the aggregate supply curve to shift outward, which means the quantity supplied at any price level decreases.
    b. the aggregate supply curve to shift outward, which means the quantity supplied at any price level increases.
    c. the aggregate supply curve to shift inward, which means the quantity supplied at any price level increases.
    d. the aggregate supply curve to shift inward, which means the quantity supplied at any price level decreases.

12. A technological breakthrough in the production of computer memory productivity will cause aggregate supply to
    a. shift inward and becomes flatter.  b. shift inward.  c. shift outward.  d. become flatter.

13. At levels of output close to full employment, the aggregate supply curve is probably
    a. very flat.    b. very steep.    c. sloped downward.    d. perfectly elastic.

14. The only factor that can cause movement along the aggregate supply curve is the
    a. labor force.    b. capital stock.    c. availability of resources.    d. price level.    e. All of the others are correct.
15. Why are many economists in favor of increased immigration of foreigners with high levels of skills and education? 
   a. Economists are very caring individuals.  
   b. Economists believe foreigners will work cheaper.  
   c. This will increase understanding among different ethnic groups.  
   d. Such immigration will increase aggregate supply.

<table>
<thead>
<tr>
<th>Table 11.1</th>
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<tbody>
<tr>
<td>Aggregate Demand</td>
<td>Price</td>
<td>Aggregate Supply</td>
</tr>
<tr>
<td>$3,500</td>
<td>65</td>
<td>$2,900</td>
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<tr>
<td>3,400</td>
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<td>3,250</td>
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<tr>
<td>3,100</td>
<td>130</td>
<td>3,400</td>
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</tbody>
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16. In Table 11.1, what is the equilibrium level of real output and the equilibrium price? 
   a. $3,100 real output and a price of 75.  
   b. $3,250 real output and a price of 110.  
   c. $3,350 real output and a price of 90.  
   d. $3,400 real output and a price of 75.

17. In Table 11.1, if full employment occurs at $3,100, then 
   a. the economy experiences a recessionary gap of $150.  
   b. the economy experiences a recessionary gap of $250.  
   c. the economy experiences an inflationary gap of $150.  
   d. the economy experiences an inflationary gap of $250.

18. In Table 11.1, if full employment occurs at $3,400, then 
   a. the economy experiences a recessionary gap of $150. 
   b. the economy experiences a recessionary gap of $250. 
   c. the economy experiences an inflationary gap of $150. 
   d. the economy experiences an inflationary gap of $250.

19. Most economists agree that the economy will adjust to a recessionary gap, but the adjustment process 
   a. is rapid and destabilizing.  
   b. is moderately quick, but not as rapid as necessary.  
   c. takes place solely on the supply side.  
   d. the adjustment process is very slow.

20. The reason that stagflation tends to follow an inflationary gap is that 
   a. output tends to fall even as prices continue to rise as part of the self-correcting mechanism.  
   b. government officials tend to overact in controlling inflation.  
   c. businesses try to increase profits by raising prices and increasing output.  
   d. workers accept pay cuts to maintain employment.

21. One reason the simplified multiplier is incorrect is that inflation _______ the multiplier by ______. 
   a. increases; increasing investment spending.  
   b. increases; increasing consumer spending.  
   c. decreases; increasing net exports.  
   d. decreases; by decreasing consumer spending.

22. The federal government increases spending by $50 billion and the main effect is an increase in the price level. It must 
   be true that the economy is operating on the 
   a. horizontal portion of the aggregate demand curve.  
   b. horizontal portion of the aggregate supply curve.  
   c. vertical portion of the aggregate supply curve.  
   d. vertical portion of the aggregate demand curve.

23. “Fiscal Policy” is the federal government’s plan 
   a. for international trade, designed to balance exports and imports.  
   b. for spending and taxes, designed to influence the level of aggregate demand.  
   c. for manipulating the money supply and the control of interest rates.  
   d. All of the above are correct.

24. An increase in taxes affects the expenditure schedule by causing 
   a. movement to the left along the schedule.  
   b. the schedule to shift upward.  
   c. movement to the right along the schedule.  
   d. the schedule to shift downward.
25. Why does a tax change affect aggregate demand?
   a. A tax change alters saving by an equal amount.
   b. A tax change alters imports and net exports.
   c. A tax change alters government spending by an equal amount.
   d. A tax change alters disposable income and consumption spending.

26. When we add a personal income tax to the macroeconomic model,
   a. the multiplier becomes larger.
   b. the multiplier becomes smaller.
   c. the expenditures schedule shifts upward.
   d. the expenditures schedule becomes steeper.

27. Personal income taxes act as automatic stabilizers because when incomes change, the change in consumption is:
   a. smaller
   b. larger
   c. the same
   d. magnified to a larger amount

28. You are a congressperson when the economy has a recessionary gap. To achieve full employment, you should vote for
   a. decreased government purchases, increased taxes, and a cut in transfer payments.
   b. a balanced federal budget.
   c. increased government purchases, decreased taxes, and an increase in transfer payments.
   d. increased government purchases and transfer payments, and an equal increase in taxes.

29. The Japanese economy is stuck in a recessionary gap. The proper fiscal policy could include
   a. a decrease in taxes.
   b. an increase in government purchases.
   c. an increase in transfer payments.
   d. All of the others are correct.

30. In 1999, many economists believe that the most serious macroeconomic problem confronting the U.S. economy was an
   inflationary gap. Which policies would be effective in dealing with this problem?
   a. Increase transfer payments.
   b. Increase government purchases.
   c. Decrease personal income taxes.
   d. Increase personal income taxes.

31. Compared to an economy’s self-correcting mechanism, active contractionary fiscal policy will
   a. work more slowly and calmly.
   b. work more quickly.
   c. have less deflationary effects.
   d. have a smaller effect on real GDP.

32. Which of the following will shift the aggregate demand curve outward?
   a. tax cuts and government spending cuts.
   b. tax increases and government spending increases
   c. tax cuts and government spending increases
   d. tax increases and government spending increases

33. Which of the following is a correct conclusion regarding the successful implementation of fiscal policy? Successful
   fiscal policy ______
   a. would be easy to achieve if Congress would permit natural market forces to restore full-employment equilibrium.
   b. is difficult to achieve because investment, net exports, and consumption schedules are constantly shifting.
   c. is easy to achieve today because economic models make economic forecasting very easy.
   d. As the income-expenditure model suggests, fiscal policy planners can move GDP to any level they please by changing
tax and spending levels.

34. A “conservative” would most likely argue in favor of
   a. tax increases when fiscal stimulus is necessary, and spending cuts when fiscal restraint is necessary.
   b. tax cuts when fiscal restraint is necessary, and spending cuts when fiscal stimulus is necessary.
   c. tax cuts when fiscal stimulus is necessary, and spending cuts when fiscal restraint is necessary.
   d. spending increases when fiscal expansion is necessary, and tax increases when fiscal stimulus is necessary.

35. The main idea behind supply-side tax cuts is that
   a. tax cuts increase spending, which increases supply.
   b. some tax cuts can increase aggregate supply.
   c. people like lower taxes and will spend more.
   d. it is easier to shift aggregate supply than aggregate demand.
36. Critics of supply-side economics argue that tax cuts favored by supply-siders will have the greatest effect on
a. aggregate supply.   b. tax receipts.   c. aggregate demand.   d. the money supply.

37. Supply-side tax cuts tend to benefit the rich because
a. tax cuts on income tend to benefit high income earners more than low income earners.
b. tax cuts on saving benefit high income earners who do most of the personal saving.
c. tax cuts for capital formation tend to benefit those with the means to accumulate capital.
d. tax cuts on capital gains tend to benefit those with larger financial assets.
e. All of the above are correct.

**Historical Questions**

38. The Gulf War of 1990–1991 increased energy prices and caused the aggregate supply curve to
a. shift outward.   b. shift inward.   c. become flatter.   d. become steeper.

39. Many economists describe the 1997–1999 period in the United States as being a condition of a(n)
a. deflationary gap.   b. recessionary gap.   c. inflationary gap.   d. reflationary gap.

40. When an inflationary gap exists, the job prospects of new college graduates are
a. very dim.   b. somewhat encouraging.   c. worse in comparison to a recessionary gap.   d. excellent.

41. Increases in energy prices in the 1970s and 1990 caused the
a. aggregate demand curve to shift outward.   b. aggregate demand curve to shift inward.
c. aggregate supply curve to shift outward.   d. aggregate supply curve to shift inward.

42. In 1999, many economists believe that the most serious macroeconomic problem confronting the U.S. economy was an inflationary gap. Which policies would be effective in dealing with this problem?
a. Increase transfer payments.   b. Increase government purchases.
c. Decrease personal income taxes.   d. Increase personal income taxes.

43. In the 1992 elections, Bill Clinton attacked two outcomes of Reagan supply-side economics. They were
a. income equality and inflation.   b. inflation and too rapid economic growth.
c. income inequality and budget deficits.   d. income inequality and foreign trade surpluses.

44. In contrast to Presidents Reagan and Bush, President Clinton’s economic program featured,
a. large budget deficits.   b. tax increases.
c. personal income tax cuts.   d. increased foreign trade surpluses.

45. The main way in which President Clinton’s economic policies differed from Reagan-Bush supply-side policies is that
a. Clinton stressed using tax policy to increase investment rather than to increase saving.
b. Clinton stressed improving the quality of the capital stock rather than the quality of the labor force.
c. Clinton stressed the need to increase income inequality in order to increase incentives to work and save.
d. Clinton stressed improving the quality of the labor force through better education and training rather than improving the capital stock.

46. One complication faced by President Clinton’s policy planners was that
a. Republicans focused more on plans to increase spending than on tax cuts.
b. the need to balance the budget took precedence over other objectives.
c. aggregate supply refused to budge even with the enactment of a full package of tax cuts.
d. aggregate demand would increase and lead to inflation if taxes were increased.

47. Reductions in the capital gains tax, long favored by Republicans, were achieved in 1997 leaving the top tax rate on capital gains at
a. 15 percent.   b. 20 percent.   c. 33 percent.   d. 39 percent