Sample Questions for Chapters 12 & 13
Inflation Unemployment & Business Cycles
Fiscal Policy

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Inflation can be started by
   A) a decrease in aggregate supply or a decrease in aggregate demand.
   B) an increase in aggregate supply or a decrease in aggregate demand.
   C) a decrease in aggregate supply or an increase in aggregate demand.
   D) an increase in aggregate supply or an increase in aggregate demand.

2) Which of the above figures best shows the start of a demand–pull inflation?
   A) Figure A    B) Figure B    C) Figure C    D) Figure D

3) Which of the following could start a demand–pull inflation?
   A) an increase in government expenditure
   B) a decrease in the quantity of money
   C) an increase in imports
   D) an increase in the money prices of raw materials

4) Which of the following is NOT a potential start of a demand–pull inflation?
   A) an increase in exports
   B) an increase in the quantity of money
   C) an increase in government expenditure
   D) an increase in taxes
5) In the above figure, suppose that the economy is at point A when the quantity of money increases. In the short run, the economy will move to point _______.
   A) A, that is, the price level and level of real GDP will not change.
   B) B
   C) C
   D) D

6) As the money wage rate rises, _______.
   A) the short-run aggregate supply curve shifts rightward.
   B) the short-run aggregate supply curve shifts leftward.
   C) the long-run aggregate supply curve shifts rightward.
   D) both the long-run aggregate supply curve and the short-run aggregate supply curve shift leftward.
7) In the above figure, the economy initially is at point A and then an increase in the quantity of money moves the economy to point D. At point D, the real wage rate has
   A) risen.
   B) risen by the same percentage as the price level.
   C) remained constant.
   D) fallen.

8) In the above figure, the economy initially is at point A and then an increase in the quantity of money moves the economy to point D. The money wage rate will
   A) rise because a labor shortage now exists.
   B) fall because a labor shortage now exists.
   C) fall because a labor surplus now exists.
   D) rise because a labor surplus now exists.

9) Assuming that GDP currently equals potential GDP, a cost-push inflation could result from which of the following?
   A) an increase in the labor force
   B) an increase in the nation’s capital stock
   C) a large crop failure that boosts the prices of raw food materials
   D) a decrease in tax rates

10) An increase in the money wage rate shifts the SAS curve _______ and an increase in the money prices of raw materials shifts the SAS curve _______.
    A) leftward; leftward
    B) leftward; rightward
    C) rightward; rightward
    D) rightward; leftward

11) A one-time increase in the price of oil followed by a one-time increase in aggregate demand produce
    A) continuing demand-pull inflation.
    B) continuing cost-push inflation.
    C) a one-time increase in the price level.
    D) a one-time decrease in the price level.
12) In the above figure, which path represents a cost-push inflation?

A) point A to C to D to F to G  
B) point A to B to D to F to G  
C) point A to C to D to E to G  
D) point A to B to D to E to G

13) In the above figure, the economy is initially at point A. If workers and firms correctly anticipate the increase in aggregate demand and the resulting inflation rate, the economy will move to point

A) A, that is, the price level and level of real GDP will not change.  
B) B.  
C) C.  
D) D.
14) Phillips curves show the relationship between the
A) nominal interest rate and the real interest rate.
B) real interest rate and the unemployment rate.
C) unemployment rate and the inflation rate.
D) expected rate of inflation and the nominal interest rate.

15) Moving along a short-run Phillips curve,
A) the expected inflation rate is constant.
B) the price level is constant.
C) the inflation rate is constant.
D) unemployment is constant.

16) Movements upward along the short-run Phillips curve result from
A) expected increases in the inflation rate.
B) unexpected decreases in the inflation rate.
C) unexpected increases in the inflation rate.
D) expected decreases in the inflation rate.

17) In the above figure, suppose the economy is at point A. An unexpected increase in the inflation rate to 6 percent will result in a movement to point
A) A, that is, there is no movement.
B) B.
C) C.
D) D.

18) The long-run Phillips curve is
A) the vertical sum of the short-run Phillips curves.
B) vertical at the natural unemployment rate.
C) the horizontal sum of the short-run Phillips curves.
D) vertical at potential GDP.

19) If the natural unemployment rate increases, then the short-run Phillips curve shifts _______ and the long-run Phillips curve shifts _______.
A) leftward; rightward
B) leftward; leftward
C) rightward; rightward
D) rightward; leftward
20) In the above figure, suppose that the economy currently is at point A. If the inflation rate rises and this rise is NOT expected by the public, the economy moves to a point such as point
A) B. B) D. C) C. D) E.

21) Keynes used the term "animal spirits" to represent
   A) the ease of forecasting. B) investment based on hard facts about the future. C) changes in people's consumption expenditures. D) fluctuations in business confidence.

22) Real business cycle theory says that the factor leading to the business cycle is changes in
   A) only aggregate demand. B) productivity. C) the growth rate of the quantity of money. D) animal spirits.

23) According to the real business cycle theory, an increase in the price of a resource, such as oil, that decreases the demand for loanable funds will ______ employment and ______ real GDP.
   A) increase; increase B) decrease; increase C) decrease; decrease D) increase; decrease

24) If the real interest rate is 4 percent and workers expect real wages to be 2 percent year higher next year, according to real business cycle theory, workers will work
   A) less this year and less next year. B) less this year and more next year. C) more this year and more next year. D) more this year and less next year.

25) The largest source of government revenues is ______.
   A) personal income taxes B) social security taxes C) corporate income taxes D) indirect taxes
26) Rank the following federal government outlays from the largest to the smallest.
   I. debt interest
   II. transfer payments
   III. expenditure on goods and services
   A) II, III, I    B) III, II, I    C) III, I, II    D) I, II, III

27) Federal government outlays as a percentage of GDP are approximately
   A) 66 percent.    B) 10 percent.    C) 50 percent.    D) 25 percent.

28) A government incurs a budget deficit when
   A) exports are less than imports.
   B) exports are greater than imports.
   C) taxes are less than government outlays.
   D) taxes are greater than government outlays.

<table>
<thead>
<tr>
<th>Year</th>
<th>Government tax revenues (billions of dollars)</th>
<th>Government expenditures (billions of dollars)</th>
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<tbody>
<tr>
<td>1</td>
<td>240</td>
<td>240</td>
</tr>
<tr>
<td>2</td>
<td>250</td>
<td>245</td>
</tr>
<tr>
<td>3</td>
<td>260</td>
<td>255</td>
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<tr>
<td>4</td>
<td>300</td>
<td>320</td>
</tr>
<tr>
<td>5</td>
<td>325</td>
<td>340</td>
</tr>
</tbody>
</table>

29) 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) $240 billion
   B) $0
   C) $25 billion
   D) Not enough information is provided to answer the question.

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

31) The supply side effects of a change in taxes on labor income means that ________ in taxes on labor income shift the ________.
   A) an increase; labor supply curve leftward
   B) a decrease; labor demand curve rightward
   C) an increase; labor supply curve rightward
   D) a decrease; labor demand curve leftward

32) The difference between the before-tax and after-tax rates is referred to as the
   A) taxation penalty.    B) tax plug.
   C) tax wedge.    D) deadweight gain.
33) The Laffer curve is the relationship between
   A) tax rates and potential GDP.
   B) tax revenue and potential GDP.
   C) tax rates and tax revenue.
   D) government purchases and potential GDP.

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

35) An increase in the tax on interest income ______ the supply of loanable funds and ______ the equilibrium investment.
   A) decreases; decreases
   B) decreases; increases
   C) increases; increases
   D) increases; decreases

36) Taxes and government expenditures that, without need for additional government action, change in response to changes in the level of economic activity are examples of
   A) discretionary fiscal variables.
   B) built-in monetary stabilizers.
   C) cyclically balanced budgets.
   D) automatic fiscal policy.

37) The tax rebates passed by Congress in 2008 to help move the economy more rapidly toward potential GDP are an example of
   A) lump-sum taxes.
   B) contractionary fiscal policy.
   C) automatic fiscal policy.
   D) discretionary fiscal policy.

38) Government transfer payments ______ during expansions and ______ during recessions.
   A) decrease; decrease
   B) increase; decrease
   C) increase; increase
   D) decrease; increase

39) During an expansion, tax revenues ______ and government transfer payments ______.
   A) decrease; decrease
   B) decrease; increase
   C) increase; decrease
   D) increase; increase

40) The structural deficit is the deficit
   A) that would occur at full employment.
   B) during an expansion.
   C) caused by the business cycle.
   D) during a recession.
41) Using the above figure, if full employment occurs at $15$ trillion and the economy is actually producing $15$ trillion, then there is a
   A) structural deficit. 
   B) cyclical deficit. 
   C) cyclical surplus. 
   D) structural surplus.

42) In the above figure, if actual GDP = $15$ trillion, there is a budget ________ equal to ________.
   A) surplus; $0.2$ trillion 
   B) surplus; $1.3$ trillion 
   C) deficit; $1.1$ trillion 
   D) deficit; $0.2$ trillion
43) Which of the following are a limitation of fiscal policy?
   I. There is a lag between recognizing that fiscal policy might be needed and when it actually takes effect.
   II. Economic forecasts might be incorrect.
   III. Monetary policy might counter fiscal policy.
   A) I and II  B) I, II and III  C) I only  D) I and III

44) In the above figure,
   A) any surpluses are cyclical surpluses.
   B) the structural deficit equals zero.
   C) any deficits are cyclical deficits.
   D) All of the above answers are correct.
45) Using the above figure, if full employment occurs at $13$ trillion, but the economy is actually producing $15$ trillion, then there is a structural deficit. 

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

46) In the above figure, suppose the economy is at point A. An expected increase in the inflation rate to 6 percent will result in a movement to point

- A) A, that is, there is no movement.
- B) B.
- C) C.
- D) D.
47) In the above figure, suppose that the economy is at point A when foreign countries begin an expansion and buy more U.S.-made goods. In the short run, this change creates a movement to point ______ and an eventual increase in ______.

A) D; the natural unemployment rate  
B) B; the natural unemployment rate  
C) D; money wage rates  
D) B; money wage rates

48) An initial increase in aggregate demand that is NOT followed by an increase in the quantity of money results in a long-run equilibrium with

A) a higher price level but the same real GDP.  
B) the same price level and a lower level of real GDP.  
C) a higher price level and an increased level of real GDP.  
D) None of the above answers are correct.
Testname: SAMPLE QUESTION FOR CH 12 & 13

1) C
2) A
3) A
4) D
5) B
6) B
7) D
8) A
9) C
10) A
11) C
12) D
13) C
14) C
15) A
16) C
17) B
18) B
19) C
20) A
21) D
22) B
23) C
24) D
25) A
26) A
27) D
28) C
29) C
30) D
31) A
32) C
33) C
34) D
35) A
36) D
37) D
38) D
39) C
40) A
41) D
42) A
43) A
44) D
45) C
46) C
47) D
48) A