

Assignment 4

Part A **Multiple-Choice Questions** **[30 marks]**

Each question is worth 1.5 marks. There is no negative marking for wrong answers

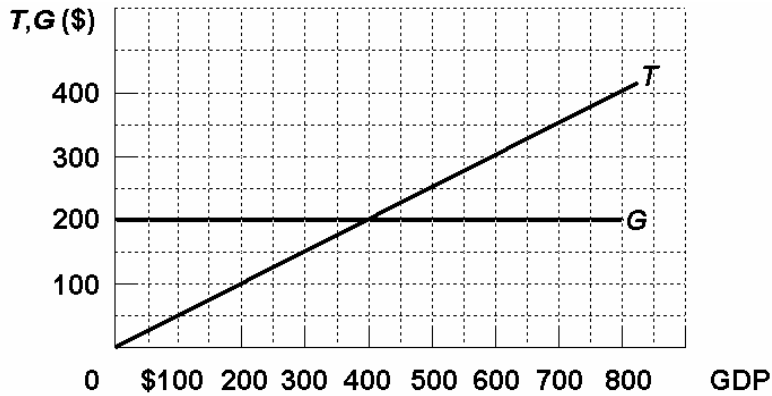
To answer each question correctly, you have to choose the best answer from the given four choices.

1. Discretionary fiscal policy refers to:
 - A) any change in government spending or taxes which destabilizes the economy.
 - B) the authority which Parliament has to change personal income tax rates.
 - C) changes in taxes and government expenditures made by Parliament to stabilize the economy.
 - D) the changes in taxes and transfers which occur as GDP changes.

2. In an aggregate demand and aggregate supply graph, an expansionary fiscal policy can be illustrated by a:
 - A) leftward shift in the aggregate demand curve.
 - B) rightward shift in the aggregate demand curve.
 - C) leftward shift in the aggregate supply curve.
 - D) change in the price level.

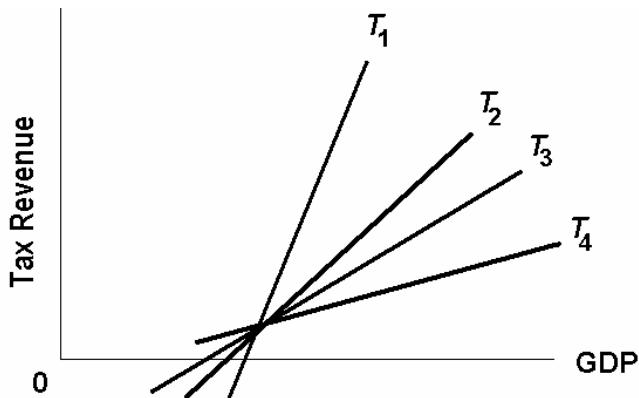
3. If the MPS in an economy is .1, government could shift the aggregate demand curve rightward by \$40 billion at each price level by:
 - A) increasing government spending by \$4 billion.
 - B) increasing government spending by \$40 billion.
 - C) decreasing taxes by \$4 billion.
 - D) increasing taxes by \$4 billion.

Use the following to answer question 4:



4. Refer to the above diagram wherein T is tax revenues and G is government expenditures. All figures are in billions. The budget will entail a deficit:
- A) at all levels of GDP.
 - B) at any level of GDP above \$400.
 - C) at any level of GDP below \$400.
 - D) only when GDP is stable.

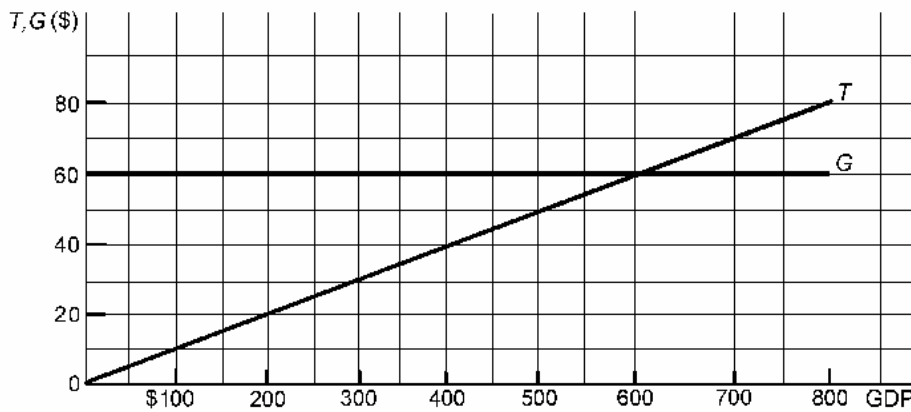
Use the following to answer question 5:



5. Refer to the above diagram. Which tax system has the most built-in stability?
- A) T₄
 - B) T₃
 - C) T₂
 - D) T₁

6. The "cyclically adjusted budget" refers to:
- A) the inflationary impact which the automatic stabilizers have in a full-employment economy.
 - B) that portion of a full-employment GDP which is not consumed in the year it is produced.
 - C) the size of the federal government's budgetary surplus or deficit when the economy is operating at full employment.
 - D) the number of workers who are underemployed when the level of unemployment is 7 to 8 percent.

Use the following to answer question 7:



7. Refer to the above diagram where T is tax revenues and G is government expenditures. All figures are in billions of dollars. If the full-employment GDP is \$400 billion while the actual GDP is \$200 billion, the full-employment or cyclically adjusted deficit is:
- A) \$40 billion.
 - B) zero.
 - C) \$60 billion.
 - D) \$20 billion.
8. The "crowding-out effect" suggests that:
- A) tax increases are paid primarily out of saving and therefore are not an effective fiscal device.
 - B) increases in government spending financed through borrowing will increase the interest rate and thereby reduce investment.
 - C) it is very difficult to have excessive aggregate spending in our economy.
 - D) consumer and investment spending always vary inversely.

9. International flows of financial capital in response to interest rate changes in Canada:
- A) weaken domestic fiscal policy through an offsetting net export effect.
 - B) strengthen domestic fiscal policy through a supporting net export effect.
 - C) strengthen domestic fiscal policy through an offsetting net export effect.
 - D) do none of the above.
10. An expansionary fiscal policy in Canada might unintentionally cause demand-pull inflation if:
- A) the dollar unexpectedly appreciates while the expansionary policy is in place.
 - B) the dollar unexpectedly depreciates while the expansionary policy is in place.
 - C) the policy produces severe crowding out.
 - D) our trading partners experience recession during the time of the fiscal policy action.

Use the following to answer questions 11-12:

The following budget information is for a hypothetical economy. All data are in billions of dollars.

	<u>Government</u> <u>spending</u>	<u>Tax revenues</u>	<u>GDP</u>
Year 1	\$450	\$425	\$2000
Year 2	500	450	3000
Year 3	600	500	4000
Year 4	640	620	5000
Year 5	680	580	4800

11. Refer to the above data. If year 1 is the first year of this nation's existence and year 5 is the present year, this nation's public debt is:
- A) \$295 billion.
 - B) \$100 billion.
 - C) \$3540 billion.
 - D) \$230 billion.
12. Refer to the above data. The budget deficit in year 3 is:
- A) \$175 billion.
 - B) \$3050 billion.
 - C) \$100 billion.
 - D) \$295 billion.

13. An annually balanced budget is:
- A) countercyclical because tax revenue reductions associated with prosperity will require cuts in government spending.
 - B) countercyclical because tax revenue reductions associated with recession will require cuts in government spending.
 - C) procyclical because tax revenue reductions associated with prosperity will require cuts in government spending.
 - D) procyclical because tax revenue reductions associated with recession will require cuts in government spending.
14. A cyclically balanced budget philosophy would:
- A) lower taxes and increase government spending during a recession.
 - B) raise taxes and increase government spending during a recession.
 - C) raise taxes and decrease government spending during a recession.
 - D) lower taxes and decrease government spending during a recession.
15. One reason the public debt will not bankrupt the Federal government is that the:
- A) cost is shifted to future generations.
 - B) debt has a procyclical effect on the economy.
 - C) debt can be refinanced by selling new bonds.
 - D) burden of the debt will be crowded-out by new investment.
16. Money functions as:
- A) a store of value.
 - B) a unit of account.
 - C) a medium of exchange.
 - D) all of the above.
17. What function is money serving when you buy a ticket to a movie?
- A) a store of value
 - B) a unit of account
 - C) a transaction demand
 - D) a medium of exchange

18. Functional finance is the notion that:
- A) the basic purpose of the Federal budget is to stabilize the economy without worrying about budget balances.
 - B) the Federal budget should exert a countercyclical influence and be balanced over the business cycle.
 - C) there should be an annual balance in the Federal budget to keep the economy functioning.
 - D) public debt is bad for the functioning of the economy and that good fiscal policy requires a reduction of the public debt.
19. An increase in the public debt will:
- A) increase incentives to work and bear risk.
 - B) increase the inequality in the distribution of income.
 - C) decrease the Canadian debt held by citizens and institutions in foreign nations.
 - D) decrease the potential for higher taxation in Canada
20. The crowding-out effect from government borrowing to finance the public debt is reduced when:
- A) the economy is experiencing a period of high inflation.
 - B) the economy is operating at the full-employment level of output.
 - C) public investment complements private investment.
 - D) the distribution of income becomes more equal.

Part B**True/ False/ Uncertain Questions****[20 marks]**

Each question is worth 5 marks.

Explain why the following statement is True, False, or Uncertain according to economic principles. Use diagrams and / or numerical examples where appropriate. Unsupported answers will receive no marks. It is the explanation that is important.

- B-1 A contractionary fiscal policy can control a demand-pull inflation in a closed economy.
- B-2 A net export effect may partially reinforce an expansionary fiscal policy.
- B-3 The crowding-out effect from government borrowing to finance the public debt is reduced when public investment complements private investment.
- B-4 The pursuit of an annually balanced budget policy can stabilize the business cycle to some extent.