

**Additional Help**  
**Practice Questions for Chapter 11**  
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1. If income falls below its potential and the income tax rate is reduced, this will
  - A) raise both the passive and structural deficits.
  - B) raise the passive deficit but reduce the structural deficit.
  - C) reduce the passive deficit but raise the structural deficit.
  - D) reduce both the passive and structural deficits.
  
2. A deficit is
  - A) the total amount of money that a country owes.
  - B) the shortfall of payments under revenues in a particular period.
  - C) the shortfall of revenues under payments in a particular period.
  - D) accumulated debt.
  
3. Suppose the nominal rate of interest is 10 percent and the annual rate of inflation is 5 percent. What is the real interest rate?
  - A) 5 percent.
  - B) -5 percent.
  - C) 15 percent.
  - D) 50 percent.
  
4. When revenues exceed payments, the government budget is
  - A) in deficit.
  - B) balanced.
  - C) in surplus.
  - D) not in equilibrium.
  
5. In its attempt to address the problem of the structural deficit in the 1990s, the federal government
  - A) lowered interest rates in order to reduce the cost of financing the debt.
  - B) increased government spending in order to create economic growth and higher tax revenues.
  - C) cut many social programs and raised taxes.
  - D) reduced taxes in order to increase the rate of growth of GDP.

6. Canadian government debt as a percentage of GDP has been
- A) falling steadily since World War II.
  - B) increasing steadily since World War II.
  - C) fluctuating since World War II.
  - D) unchanged since World War II.
7. Economists are
- A) more concerned about structural deficits than passive deficits.
  - B) equally concerned about structural and passive deficits.
  - C) more concerned about passive deficits than structural deficits.
  - D) not concerned about structural or passive deficits.
8. If the nominal deficit is \$200 billion, the real deficit is \$150 billion, and total debt is \$2 trillion, then inflation is
- A) 1 percent.
  - B) 2.5 percent.
  - C) 4 percent.
  - D) 5 percent.
9. Assume that prices are fixed and that the marginal propensity to consume is 0.2. Suppose the Canadian government spends \$100 million dollars on new heavy-lift helicopters for the military. If the government finances this expenditure through an increase in taxes, equilibrium income will increase by
- A) \$100 million.
  - B) \$500 million.
  - C) between \$100 and \$500 million.
  - D) impossible to say.
10. If high levels of government spending generate an appreciation of the Canadian currency, then
- A) net exports will tend to decline.
  - B) net exports will tend to increase.
  - C) exports will tend to increase.
  - D) imports will tend to decrease.

11. Assume that prices are fixed, marginal propensity to consume is 0.2, and Ricardian equivalence holds. Suppose the Government of Canada cuts taxes by \$100 million. They finance this tax cut by selling \$100 million in bonds. Equilibrium income will
- A) decrease by \$500 million.
  - B) decrease by \$100 million.
  - C) decrease by between \$100 million and \$500 million.
  - D) remain unchanged.
12. The debt service measure of the Canadian government debt suggests that over the past 50 years the debt has become
- A) more of a problem than the debt to GDP ratio would suggest, but less of a problem than the simple debt would suggest.
  - B) more of a problem than the simple debt would suggest, but less of a problem than the debt to GDP ratio would suggest.
  - C) more of a problem than either the debt to GDP ratio or the simple debt would suggest.
  - D) less of a problem than either the debt to GDP ratio or the simple debt would suggest.
13. In the 1990s the federal government's approach to federal deficit and debt reduction led to
- A) a breakdown in federal-provincial relations.
  - B) improved federal-provincial relations.
  - C) the elimination of all provincial government deficits, due to unexpected economic growth.
  - D) the “off-loading” of provincial social programs to the federal government.
14. The real deficit depends on the
- A) level of government expenditures and receipts only.
  - B) rate of inflation only.
  - C) nominal deficit, the rate of inflation, and the government debt.
  - D) rate of interest only.
15. Much of government debt is internal, which means it is owed to
- A) foreign residents.
  - B) multinational corporations.
  - C) its own citizens.
  - D) foreign governments.

16. If a \$6 billion economy is growing at a real rate of 5% a year and there is no inflation, the government must \_\_\_\_\_ to maintain a constant debt-to-GDP ratio.
- A) run a surplus of \$300 million
  - B) balance the budget
  - C) run a deficit of \$300 million
  - D) run a deficit of \$600 million
17. Assume that prices are fixed, marginal propensity to consume is 0.2, and Ricardian equivalence holds. Suppose the Canadian government spends \$100 million dollars on new heavy-lift helicopters for the military. They finance this expenditure by selling \$100 million in bonds. Equilibrium income will
- A) increase by \$500 million.
  - B) increase between \$100 and \$500 million.
  - C) increase by \$100 million.
  - D) \$0.
18. The nominal deficit is \$100 billion; inflation is 4 percent; total debt is \$2 trillion. The real deficit is
- A) zero.
  - B) \$20 billion.
  - C) \$80 billion.
  - D) \$100 billion.
19. The passive surplus
- A) is not affected by changes in equilibrium income.
  - B) falls as the economy expands and rises as it contracts.
  - C) is the surplus that exists if the economy is at potential income.
  - D) is that portion of the surplus that exists because the economy is operating above potential income.
20. Budget surpluses increase savings and investment
- A) due to the savings multiplier leading to increases in total savings greater than the increase in government savings.
  - B) but should never be run since they crowd out investment in the short run.
  - C) if governments are better savers than private individuals and firms.
  - D) because borrowers can pay the government lower returns than private savers.

21. Expected inflation is 4 percent, nominal interest rates are 7 percent, the real interest rate is
- A) 1 percent.
  - B) 2 percent.
  - C) 3 percent.
  - D) 7 percent.
22. Suppose the real rate of interest is 5 percent and nominal interest rate is 10 percent. What is the rate of inflation?
- A) 5 percent.
  - B) 15 percent.
  - C) 2 percent.
  - D) 50 percent.
23. Bond holders
- A) lose when actual inflation is less than was expected.
  - B) gain when actual inflation is more than was expected.
  - C) do not lose when the expected inflation built into the nominal interest rate is correct.
  - D) do not lose when the expected inflation built into the nominal interest rate is lower than actual inflation.
24. Paying interest on external government debt produces
- A) a net reduction in domestic income.
  - B) a redistribution of income within the country.
  - C) a net increase in domestic income.
  - D) no change in the level or distribution of domestic income.
25. Suppose potential income is \$60 billion, actual income is \$40 billion, and expenditures don't vary with income. If the actual budget deficit is \$4 billion and the marginal tax rate is 20 percent, the passive deficit
- A) is zero.
  - B) is between zero and \$4 billion.
  - C) is \$4 billion.
  - D) cannot be determined from the given information.

26. Suppose the nominal rate of interest is 8 percent and the annual rate of inflation is 3 percent. What is the real interest rate?
- A) 11 percent.
  - B) -5 percent.
  - C) 5 percent.
  - D) 24 percent.
27. Government debt is unlike individual debt for all of the following reasons *except*
- A) much of government debt is owed to its own citizens.
  - B) government can pay its debt by printing money.
  - C) inflation does not wipe away individual debt.
  - D) government never has to pay back its debt.
28. When the Canadian debt to GDP ratio has fallen, historically it has generally been because
- A) the budget deficit fell.
  - B) the budget deficit rose.
  - C) income fell.
  - D) income rose.
29. If the real deficit is \$200 billion, the inflation rate is 2.5 percent, and total debt is \$2 trillion, then the nominal deficit is
- A) \$100 billion.
  - B) \$250 billion.
  - C) \$300 billion.
  - D) \$350 billion.
30. The nominal deficit depends primarily on
- A) government's expenditures and receipts.
  - B) the rate of inflation.
  - C) the real deficit.
  - D) the debt.

## Answer Key for Chapter 11 Practice Questions

1. A
2. C
3. A
4. C
5. C
6. C
7. A
8. B
9. A
10. A
11. D
12. A
13. A
14. C
15. C
16. C
17. D
18. B
19. D
20. C
21. C
22. A
23. C
24. A
25. C
26. C
27. C
28. D
29. B
30. A