Chapter 23

Put into practice questions

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If value of the marginal propensity to consume domestically is 0.6, how much would national income increase if exports rise by £20bn?

Multiplier = 1/(1-mpc) = 1/(1-0.6)= 2.5
National income increases by 2.5 * 20 = £50 bn

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Which of the following statements are true and which are false? Explain your answer.

a. Interest rates are part of fiscal policy. FALSE
b. Government spending on final goods is an injection into the economy. TRUE
c. Taxation revenue is a withdrawal from the economy. TRUE
d. An increase in government spending boosts aggregate demand. TRUE

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An individual can earn up to £5,000 with 0 per cent income tax.
The marginal rate of tax after that is 25 per cent. What is the total tax paid if the individual earns:

- 20,000? 25% tax on £15,000 = £3,750
- 50,000? 25% tax on £45,000= £11,250
- What is the average rate of tax if the individual earns:
- 20,000? Tax paid = 25% on 15000= £3750 Average rate tax 3750/20000= 18.75%
- 50,000? Average tax= £11250/£50000= 22.5%

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Which of the following statements are true and which are false? Explain your answers.

a. Lower taxation revenue reduces withdrawals from the economy. TRUE
b. VAT is a direct tax. FALSE
c. Lower tax rates should increase aggregate demand. TRUE
d. Lower government spending on final goods reduces withdrawals into the economy FALSE

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Which of the following is a definition of the national debt?

Answer is: The total value of outstanding central government borrowing

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Which one of the following macroeconomic policies is a Keynesian economist most likely to recommend as to bring about a recovery in an economy that has been in a recession?

Answer is: Increasing government expenditure financed by increased government borrowing.

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If the government were trying to boost the aggregate demand, what changes might it make to the taxation system?

Reduce taxes to boost income, investment and consumption spending

End of chapter put into practice questions

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Is government spending an injection or withdrawal into the economy? Explain.

Injection; it increases aggregate demand.

Show using diagrams how an increase in government spending can increase income in the economy.

It increases aggregate demand. Aggregate demand shifts outwards.

Show using diagrams the effect on national income and output of fiscal policy that increases aggregate supply.

Aggregate supply shifts outwards. This should lead to a lower price and higher output.

To finance a budget deficit interest rates might have to increase. Show the effect of higher interest rates on aggregate demand.

Higher interest rates reduce investment and consumption; this reduces aggregate demand.

Imagine that income tax is charged at 40 per cent on all income earned above £20,000. If you earn £40,000 what is the total income tax you pay? The marginal rate of tax? The average rate of tax? What if you earn £200,000?

Income £40,000. 40% tax on £20,000 = £8000. Marginal rate of tax is 40%. Average rate = [£8000/£40000]*100= 20%

Imagine VAT is 20 per cent. Household A earns £100,000 and pays VAT on £20,000 of goods.

Household B earns £40,000 and pays VAT on £20,000 of goods. Explain why VAT is a regressive tax.

Both households pay the same amount of tax even though their incomes are very different. The tax is a lower proportion of the income for the higher income earners.

Fiscal policy involves the use of:

Answer is A. Direct and indirect taxes.

If government spending increases by £20 billion and national income increases by £100 billion what is the marginal propensity to consume?

The multiplier is 5. MPC = 0.8 [1/(1-0.8) = 5]