

CHAPTER 11

Fiscal Policy, Deficits, and Debt

1. The group of three economists appointed by the President to provide fiscal policy recommendations is the:
 - A) Council of Economic Advisers.
 - B) Joint Economic Committee.
 - C) Bureau of Economic Analysis.
 - D) Federal Reserve Board of Governors.

2. Fiscal policy is carried out primarily by:
 - A) the Federal government.
 - B) state governments alone.
 - C) state and local governments working together.
 - D) local governments alone.

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

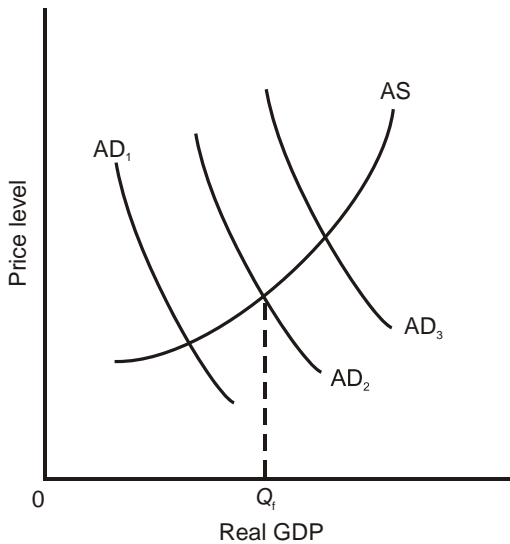
4. Countercyclical discretionary fiscal policy calls for:
 - A) surpluses during recessions and deficits during periods of demand-pull inflation.
 - B) deficits during recessions and surpluses during periods of demand-pull inflation.
 - C) surpluses during both recessions and periods of demand-pull inflation.
 - D) deficits during both recessions and periods of demand-pull inflation.

5. Fiscal policy refers to the:
 - A) manipulation of government spending and taxes to stabilize domestic output, employment, and the price level.
 - B) manipulation of government spending and taxes to achieve greater equality in the distribution of income.
 - C) altering of the interest rate to change aggregate demand.
 - D) fact that equal increases in government spending and taxation will be contractionary.

6. Discretionary fiscal policy is so named because it:
 - A) is undertaken at the option of the nation's central bank.
 - B) occurs automatically as the nation's level of GDP changes.
 - C) involves specific changes in T and G undertaken expressly for stabilization at the option of Congress.
 - D) is invoked secretly by the Council of Economic Advisers.

7. Expansionary fiscal policy is so named because it:
- A) involves an expansion of the nation's money supply.
 - B) necessarily expands the size of government.
 - C) is aimed at achieving greater price stability.
 - D) is designed to expand real GDP.
12. An economist who favored expanded government would recommend:
- A) tax cuts during recession and reductions in government spending during inflation.
 - B) tax increases during recession and tax cuts during inflation.
 - C) tax cuts during recession and tax increases during inflation.
 - D) increases in government spending during recession and tax increases during inflation.

Use the following to answer questions 40-45:



40. Refer to the above diagram, in which Q_f is the full-employment output. If aggregate demand curve AD_1 describes the current situation, appropriate fiscal policy would be to:
- A) increase taxes and reduce government spending to shift the aggregate demand curve rightward to AD_2 .
 - B) reduce taxes on businesses to shift the aggregate supply curve leftward.
 - C) reduce taxes and increase government spending to shift the aggregate demand curve from AD_1 to AD_2 .
 - D) do nothing since the economy appears to be achieving full-employment real GDP.

41. Refer to the above diagram, in which Q_f is the full-employment output. If aggregate demand curve AD_3 describes the current situation, appropriate fiscal policy would be to:
- do nothing since the economy appears to be achieving full-employment real output.
 - increase taxes and reduce government spending to shift the aggregate demand curve leftward from AD_3 to AD_2 .
 - increase taxes on businesses to shift the aggregate supply curve rightward to reduce the price level.
 - increase taxes and reduce government spending to shift the aggregate demand curve from AD_3 to AD_1 .
42. Refer to the above diagram, in which Q_f is the full-employment output. If aggregate demand curve AD_2 describes the current situation, appropriate fiscal policy would be to:
- do nothing since the economy appears to be achieving full-employment real output.
 - increase taxes and reduce government spending to shift the aggregate demand curve rightward from AD_2 to AD_3 .
 - increase taxes on businesses to shift the aggregate supply curve rightward to reduce the price level.
 - reduce taxes and increase government spending to shift the aggregate demand curve from AD_2 to AD_1 .
43. Refer to the above diagram, in which Q_f is the full-employment output. The shift of the aggregate demand curve from AD_3 to AD_2 is consistent with:
- | | |
|------------------------------------|---------------------------|
| A) an expansionary fiscal policy. | C) a major recession. |
| B) a contractionary fiscal policy. | D) demand-pull inflation. |
44. Refer to the above diagram, in which Q_f is the full-employment output. The shift of the aggregate demand curve from AD_1 to AD_2 is consistent with:
- | | |
|------------------------------------|----------------------------------|
| A) an expansionary fiscal policy. | C) a major recession. |
| B) a contractionary fiscal policy. | D) severe demand-pull inflation. |
112. The Federal budget deficit is found by:
- subtracting government tax revenues *plus* government borrowing from government spending in a particular year.
 - subtracting government tax revenues from government spending in a particular year.
 - cumulating the differences between government spending and tax revenues over all years since the nation's founding.
 - subtracting government revenues from the noninvestment-type government spending in a particular year.
113. The amount by which government expenditures exceed revenues during a particular year is the:
- public debt.
 - budget deficit.
 - full-employment.
 - GDP gap.

52. A major advantage of the built-in or automatic stabilizers is that they:
- A) simultaneously stabilize the economy and reduce the absolute size of the public debt.
 - B) automatically produce surpluses during recessions and deficits during inflations.
 - C) require no legislative action by Congress to be made effective.
 - D) guarantee that the Federal budget will be balanced over the course of the business cycle.
53. Which of the following best describes the built-in stabilizers as they function in the United States?
- A) The size of the balanced-budget multiplier varies inversely with the level of GDP.
 - B) Personal and corporate income tax collections automatically fall and transfers and subsidies automatically rise as GDP rises.
 - C) Personal and corporate income tax collections and transfers and subsidies all automatically vary inversely with the level of GDP.
 - D) Personal and corporate income tax collections automatically rise and transfers and subsidies automatically decline as GDP rises.
132. The crowding-out effect of expansionary fiscal policy 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 the U.S. economy.
 - D) consumer and investment spending always vary inversely.
133. The crowding-out effect of expansionary fiscal policy suggests that:
- A) government spending is increasing at the expense of private investment.
 - B) imports are replacing domestic production.
 - C) private investment is increasing at the expense of government spending.
 - D) saving is increasing at the expense of investment.
149. The U.S. public debt:
- A) refers to the debts of all units of government--Federal, state, and local.
 - B) consists of the total debt of U.S. households, businesses, and government.
 - C) refers to the collective amount that U.S. citizens and businesses owe to foreigners.
 - D) consists of the historical accumulation of all Federal government deficits less surpluses.
179. The most likely way the public debt burdens future generations, if at all, is by:
- A) reducing the current level of investment.
 - B) causing deflation.
 - C) causing future unemployment.
 - D) reducing real interest rates.

180. Other things equal, the stock of capital inherited by future generations is likely to be smaller when government spending:
- A) increases during a period of recession, rather than prosperity.
 - B) is primarily for capital-type goods.
 - C) is financed by borrowing.
 - D) is financed by taxation.
181. The crowding-out effect suggests that:
- A) tax increases are paid primarily out of saving and therefore are not an effective fiscal device.
 - B) government borrowing to finance the public debt increases the real interest rate and reduces private investment.
 - C) it is very difficult to have excessive aggregate spending in a capitalist economy.
 - D) consumer and investment spending always vary inversely.

1. Give a brief definition of fiscal policy? What are its economic goals?

5. Explain the aspects of expansionary and contractionary fiscal policy. During which phases of the business cycle would each be appropriate?

8. Explain what is meant by a built-in stabilizer and give two examples.

3. Explain the effect of a discretionary cut in taxes of \$40 billion on the economy when the economy's marginal propensity to consume is .75. How does this discretionary fiscal policy differ from a discretionary increase in government spending of \$40 billion?