

**FISCAL POLICY
PRACTICE QUESTIONS**

1. L1-00495 LOS6.26.a

If an economy is currently experiencing both full employment and price stability, a major tax reduction will probably cause an:

- a. Increase in unemployment in the near future.
- b. Acceleration in the inflation rate, unless government expenditures are also reduced.
- c. Increase in the interest rate, because individuals will reduce their saving in response to the tax cut.

2. L1-00577 LOS6.26.a

Which of the following statements *best* describes the effect of fiscal policies according to Keynesian theory?

- a. Use of a restrictive fiscal policy, including reduced government spending and/or increased taxes, is necessary to offset inflation and return the economy to the long-run full employment state.
- b. In a short-run equilibrium state, when the level of activity is below full employment, market forces provide a correction to the temporary state leading to a full-employment equilibrium state in the long run.
- c. Use of a restrictive fiscal policy, including reduced government spending and/or increased taxes, is necessary when private sector spending is too low to support full employment, and to return the economy to its long-run full employment equilibrium state.

3. L1-00487 LOS6.26.d

Which of the following is a logical conclusion of the Keynesian macroeconomic model?

- a. The economy is inherently quite stable.
- b. The government should always attempt to balance its budget.
- c. A high level of saving is both good and bad for purposes of achieving economic growth.

4. L1-00515 LOS6.26.b

Which conclusion is suggested by the "crowding-out" effect?

- a. Expansionary fiscal policy causes inflation.
- b. Restrictive fiscal policy is an effective weapon against inflation.
- c. The reduction in private spending, because of higher interest rates caused by a budget deficit, will largely offset the expansionary impact of a pure fiscal action.

5. L1-00550 LOS6.26.a

When considering potential Supply-Side effects on economic activity, the key relationship is between tax:

- a. Rates and output.
- b. Rates and tax revenues.
- c. Revenues and the business cycle.

6. L1-00560 LOS6.26.b

Most research indicates that there is, at best, only a weak relationship between budget deficits and interest rates; higher deficits may simply be matched by "high savings." This statement *most* closely reflects which one of the following views of fiscal policy?

- a. Keynesian theory.
- b. Crowding-out theory.
- c. Ricardo-Barro effect.

7.

L1-00563 LOS6.26.d

"A reduction in marginal tax rates will increase the incentive of individuals to: (i) save and invest and (ii) apply their productive energy in a manner that yields taxable income, while (iii) reducing tax-avoidance (sheltering) activities." Which group of economists would *likely* stress the importance of these factors?

- a. Keynesian economists.
- b. Supply-Side economists.
- c. Monetary economists.

8.

L1-00809 LOS6.26.b

Economic theory indicates that when the actual rate of inflation exceeds the rate anticipated by decision makers, then income will be redistributed from:

- a. Savers to borrowers.
- b. Debtors to bondholders.
- c. The government to private households.

9.

L1-00524 LOS6.26.e

When an economy enters a recession, automatic stabilizers tend to alter government revenue and taxation with the following effect:

- a. Enlarging the budget deficit (or reducing the surplus).
- b. Ensuring that the budget will remain in balance.
- c. Reducing the budget deficit (or increasing the surplus).

10.

L1-00519 LOS6.26.e

An example of an "automatic stabilizer" is:

- a. Congress legislating lower tax rates to increase consumption and investment.
- b. Unemployment compensation payments increasing as the unemployment rate rises.
- c. Tax rates increasing during a recession to maintain a balanced budget.