

14**FISCAL POLICY**

1. Monetary policy is *most accurately* described as actions that influence economic activity by increasing or decreasing:
 - (A) the supply of money and credit.
 - (B) currency exchange rates.
 - (C) tax rates on income and consumption.

2. Arguments for being concerned with the size of a fiscal deficit relative to GDP *least likely* include:
 - (A) a likely need for higher future taxes.
 - (B) higher interest rates due to government borrowing.
 - (C) a high proportion of government debt owed to the country's citizens.

3. Which of the following statements about achieving proper timing in fiscal policy is *least accurate*?
 - (A) Improvements in quantitative methods have made the occurrence of recessions or expansions quite predictable.
 - (B) Policy errors are inevitable due to unpredictable events.
 - (C) There is usually a time lag between when a change in policy is needed and when the need is recognized by policy makers.

4. The time it takes for a fiscal policy action to affect the economy is best described as:
 - (A) impact lag.
 - (B) action lag.
 - (C) recognition lag.

5. Robert Necco and Nelson Packard are economists at Economic Research Associates. ERA asks Necco and Packard for their opinions about the effects of fiscal policy on real GDP for an economy currently experiencing a recession. Necco states that real GDP is likely to increase if both government spending and taxes are increased by the same amount. Packard states that if both government spending and taxes are increased by the same amount, there is no expected net effect on real GDP.

Are the statements made by Necco and Packard CORRECT?

Necco Packard

- (A) Correct Incorrect
- (B) Incorrect Correct
- (C) Incorrect Incorrect

6. Discretionary fiscal policy refers to:

- (A) buying or selling securities in the open market to influence interest rates.
- (B) active decisions regarding spending and taxing to affect economic growth.
- (C) government spending programs that counteract the business cycle without the intervention of policymakers.

7. Which of the following statements best explains the importance of the timing of changes in discretionary fiscal policy? Changes in discretionary fiscal policy must be timed properly if they are going to:

- (A) enable the government to control the money supply.
- (B) exert a stabilizing influence on an economy.
- (C) help the government achieve a balanced budget.

8. The crowding-out effect suggests that:

- (A) government borrowing will lead to an increase in private savings.
- (B) as government spending increases, so will incomes and taxes, and the higher Taxes will reduce both aggregate demand and output.
- (C) greater government deficits will drive up interest rates, thereby reducing private investment.

9. An example of a contractionary fiscal policy change is a(n):

- (A) increase in a fiscal surplus.
- (B) decrease in a fiscal surplus.
- (C) increase in a fiscal deficit.

10. The government budget deficit of Country M is increasing. At the same time, the government budget surplus of Country N is decreasing. Are the fiscal policies of these countries expansionary or contractionary?

- (A) Both are contractionary.
- (B) Both are expansionary.
- (C) One is expansionary and one is contractionary.

11. When an economy dips into a recession, automatic stabilizers will tend to alter government spending and taxation so as to:
- (A) enlarge the budget deficit (or reduce the surplus).
 - (B) reduce the budget deficit (or increase the surplus).
 - (C) reduce interest rates, thus stimulating aggregate demand.
12. A government that is implementing a contractionary fiscal policy is most likely to:
- (A) decrease transfer payments to households.
 - (B) increase spending on public works.
 - (C) decrease income tax rates.
13. Attempting to influence economic growth and inflation by changing tax rates and government spending is best described as:
- (A) monetary policy.
 - (B) a combination of fiscal and monetary policy.
 - (C) fiscal policy.
14. The country of Zurkistan is experiencing both high interest rates and high inflation. The government passes laws that reduce government spending and increase taxes. It takes many months before interest rates fall and inflation is reduced. This is an example of:
- (A) action lag and automatic stabilizers.
 - (B) recognition lag in discretionary fiscal policy.
 - (C) impact lag in discretionary fiscal policy.
15. Arguments for being concerned about the size of a fiscal deficit least likely include:
- (A) a reduction in long-term economic growth.
 - (B) Ricardian equivalence.
 - (C) the crowding-out effect.
16. Assuming the federal government maintains a balanced budget, the most likely effects of a tax increase on government expenditures and real GDP are:
- | Government Expenditures | Real GDP |
|-------------------------|----------|
| (A) Decrease | Decrease |
| (B) Increase | Decrease |
| (C) Increase | Increase |
17. When the central bank increases short-term interest rates, its monetary policy is best described as:
- (A) expansionary.
 - (B) accommodative.
 - (C) contractionary.

18. Unemployment compensation is an example of:
- (A) a discretionary fiscal policy stabilizer.
 - (B) an automatic fiscal policy stabilizer.
 - (C) an automatic monetary policy stabilizer.
19. Which of the following statements best explains how automatic stabilizers work? Even without a change in fiscal policy, automatic stabilizers tend to promote:
- (A) a budget deficit during a recession but do not promote a budget surplus during an inflationary expansion.
 - (B) a budget surplus during a recession and a budget deficit during an inflationary expansion.
 - (C) a budget deficit during a recession and a budget surplus during an inflationary expansion.
20. The time it takes for policy makers to enact a fiscal policy action is best described as:
- (A) action lag.
 - (B) implementation lag.
 - (C) legislative lag.
21. A distinction between fiscal policy and monetary policy is that fiscal policy:
- (A) concerns taxes and government spending, while monetary policy concerns the money supply.
 - (B) is aimed at promoting economic growth, while monetary policy is aimed at promoting price stability.
 - (C) is typically expansionary, while monetary policy is typically contractionary.
22. The term "automatic stabilizers" refers to:
- (A) changes in taxes and expenditure programs legislators automatically enact in response to changes the level of economic activity in order to smooth economic cycles.
 - (B) increases in transfer payments and decreases in tax revenues that result from an economic contraction without new legislation.
 - (C) government expenditures and tax receipts that are required to balance over the course of the business cycle, although they may be out of balance in any single year.
23. The time it takes for policy makers to determine that the economy requires a fiscal policy action is best described as:
- (A) action lag.
 - (B) recognition lag.
 - (C) impact lag.

24. Promoting economic growth and price stability are the goals of:
- (A) fiscal policy, but not monetary policy.
 - (B) monetary policy, but not fiscal policy.
 - (C) both fiscal and monetary policy.
25. Policies that can be used as tools for redistribution of wealth and income include:
- (A) both fiscal policy and monetary policy.
 - (B) fiscal policy only.
 - (C) monetary policy only.
26. Policies used with the goal of maintaining stable prices and producing economic growth include:
- (A) both fiscal policy and monetary policy.
 - (B) monetary policy only.
 - (C) fiscal policy only.
27. An argument against being concerned with the size of a fiscal deficit is that a deficit can:
- (A) aid in increasing GDP and employment if the economy is operating at less than potential GDP.
 - (B) lead to higher future taxes that will increase government revenues.
 - (C) cause government borrowing to crowd out private borrowing.
28. The crowding-out model implies that a:
- (A) budget deficit will increase the real interest rate and thereby retard private investment.
 - (B) budget surplus will retard aggregate demand and trigger an economic downturn.
 - (C) budget deficit will stimulate aggregate demand and trigger a multiplier effect Which will lead to inflation.
29. Assuming the economy currently is experiencing high inflation, an example of appropriate discretionary fiscal policy is:
- (A) increase the federal funds target rate.
 - (B) reduce government expenditures on major government construction projects.
 - (C) reduce the money supply.
30. Arguments against being concerned about the size of a fiscal deficit include:
- (A) higher future taxes.
 - (B) Ricardian equivalence.
 - (C) the crowding-out effect

