2.03 Fiscal Policy

Question 1
Which of the following is *most likely* a long-run objective of fiscal policy?
A. Stabilize GDP growth rates
B. Maximize growth and minimize unemployment
C. Minimize the amount of government borrowing

Question 2
An economy is experiencing a recession and rising rates of unemployment. If income tax cuts are used to stimulate more rapid GDP growth, which of the following factors is *most likely* to impede the effectiveness of that fiscal policy?
A. Consumers may decide to increase savings.
B. Businesses may not be able to increase output to meet rising demand.
C. Government spending will be reduced to offset the decline in tax revenues.

Question 3
Which of the following is *most likely* to be considered a type of indirect tax?
A. Taxes on corporate profits
B. Inheritance taxes on estates
C. Excise taxes on sales of fuel

Question 4
A country with an independent central bank experiences an unanticipated recession and responds with an expansionary monetary policy rather than a discretionary fiscal policy. Which of the following is the *best* rationale for the country's response?
A. Monetary policy can be implemented more rapidly.
B. Monetary policy is more powerful than fiscal policy.
C. Fiscal policy is ineffective at stimulating economic activity.

Question 5
An extended period of GDP growth causes a country's budget balance to change from a slight deficit to a substantial surplus. Due to the budget surplus, the impact of fiscal policy on the future course of the economy is *most likely*:
A. neutral.
B. expansionary.
C. contractionary.

Question 6
Which of the following statements is *most likel*y an appropriate description of indirect taxes? When used as a fiscal policy tool, in the short run indirect taxes:
A. are difficult to implement.
B. have little impact on spending behavior.
C. generate tax revenue at little cost to the government.

Question 7
Which of the following statements *best* describes a disadvantage of using fiscal policy as a short-run economic tool?
A. Indirect taxes are difficult to implement and have a delayed impact.
B. Capital spending plans take a long time to formulate and implement.
C. Direct taxes have very small expectational effects and long lead times.

Question 8
An economist states: "Fiscal deficits and tax cuts have no net effect on the economy since the private sector offsets these policy actions by increasing savings to pay for future tax increases." The economist's statement *best* reflects which of the following?
A. Fisher effect
B. Money neutrality
C. Ricardian equivalence

Question 9
Country A is a small country, with very low per capita GDP, running a large fiscal deficit. The government has substantially increased its debt burden over the last 10 years, and, as a result, investment flowing into the private sector has declined. This situation *best* describes:
A. the Fisher effect.
B. Ricardian equivalence.
C. the crowding out effect.

Question 10
Which of the following *most likely* limits the effectiveness of fiscal policy in stabilizing aggregate demand? The government's inability to:
A. run a budget deficit large enough to stimulate the economy.
B. slow an overheated economy by reducing government spending.
C. borrow during recessions due to investor preference for corporate debt.

Question 11
As opposed to fiscal policy, monetary policy is used to:
A. maintain price stability.
B. raise revenue through taxation.
C. determine the level of government spending.

Question 12
Governments have numerous fiscal policy tools at their disposal. Which of the following statements *best* describes an advantage of using a specific fiscal policy tool?
A. Indirect taxes can be adjusted quickly.
B. Direct taxes can target certain products to modify consumer behavior.
C. Capital spending programs are one of the fastest ways to provide fiscal stimulus.

Question 13
The advantage of automatic stabilizers over discretionary fiscal policy is that they *most likely*:
A. affect real GDP growth rates more rapidly.
B. have a greater impact on GDP per unit of fiscal expenditure.
C. can be more precisely calibrated to achieve the desired impact.

Question 14
Which of the following is the *most appropriate* argument in support of larger government budget deficits during a recession, despite high levels of government debt relative to GDP?
A. Higher taxes can be imposed to pay the debt.
B. Increased debt can result in the utilization of idle resources.
C. Governments can borrow at lower rates than businesses or consumers.

Question 15
An economist reads the following statement in a research article: "If a country's national debt is financed by borrowing, the size of its national debt relative to GDP may not matter, in the long run." This statement is *most likely* supported if:
A. government borrowing discourages private borrowing.
B. most of the debt is owed to the country's own citizens.
C. the debt reduces incentives for consumers to increase savings.