

Name: \_\_\_\_\_ Date: \_\_\_\_\_

## Answer Key: Will the Budget Balance? 11th Grade Fiscal Policy Quiz

Examine 10 scenarios analyzing the structural deficit and the Laffer Curve's impact on revenue beyond simple tax rate adjustments.

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**1. If the federal government implements a contractionary fiscal policy during a period of high inflation, which of the following combinations is most likely?**

**Answer:** B) Decreasing infrastructure spending and increasing personal income tax rates.

Contractionary fiscal policy aims to reduce aggregate demand to combat inflation by either decreasing government spending or increasing taxes.

**2. When tax revenues are consistently lower than government expenditures over a fiscal year, the resulting annual shortfall is known as a \_\_\_\_\_.**

**Answer:** C) Budget Deficit

A budget deficit refers specifically to the annual gap between spending and revenue, whereas the national debt is the accumulation of all past deficits.

**3. Automatic stabilizers, such as progressive income taxes and unemployment insurance, require new legislation from Congress to take effect during a recession.**

**Answer:** B) False

Automatic stabilizers are 'built-in' features of the economy that trigger automatically without new legislative action to cushion economic swings.

**4. Which economic theory suggests that reducing tax rates can actually increase total tax revenue by incentivizing work and investment?**

**Answer:** B) The Laffer Curve

The Laffer Curve represents the relationship between tax rates and tax revenue, suggesting there is an optimal rate that maximizes revenue without disincentivizing productivity.

**5. The 'crowding-out effect' occurs when high levels of government borrowing lead to \_\_\_\_\_.**

**Answer:** C) Higher interest rates and reduced private investment

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Crowding out happens when government deficit spending competes with the private sector for loans, driving up interest rates and making it harder for businesses to borrow.

**6. Discretionary fiscal policy involves intentional changes to the law regarding taxing and spending by the government.**

**Answer:** A) True

Unlike automatic stabilizers, discretionary policy requires specific action (like passing a new stimulus bill) by the legislative branch.

**7. If the marginal propensity to consume (MPC) is 0.8, what is the value of the spending multiplier?**

**Answer:** C) 5

The spending multiplier is calculated as  $1/(1-MPC)$ . Therefore,  $1/(1-0.8) = 1/0.2 = 5$ .

**8. A tax that takes a larger percentage of income from high-income earners than from low-income earners is described as \_\_\_\_\_.**

**Answer:** C) Progressive

Progressive taxes, like the U.S. federal income tax, use brackets where the rate increases as the taxable amount increases.

**9. Expansionary fiscal policy is most effective at closing an 'inflationary gap' in the business cycle.**

**Answer:** B) False

Expansionary policy is used to close a 'recessionary gap.' Contractionary policy is used to close an inflationary gap by cooling down the economy.

**10. Which of these is a major criticism of using fiscal policy to manage the economy?**

**Answer:** B) Legislative 'lags' mean the policy might take effect after the economic problem has changed.

Recognition, legislative, and implementation lags often mean that by the time fiscal policy is enacted, the economy may have already entered a different phase of the cycle.