

Name: _____ Date: _____

Answer Key: Master the Market: Fiscal Feats for 12th Grade Pros

Analyze tax structures and legislative spending to predict how national policy shifts will impact your future purchasing power and career path.

1. Which economic phenomenon identifies the situation where aggressive government borrowing to fund a deficit leads to increased interest rates, subsequently reducing private sector investment?

Answer: B) Crowding Out

Crowding out occurs when government deficit spending forces interest rates up, making it more expensive for private businesses to borrow and invest, potentially offsetting the stimulus.

2. True or False: Evaluation of 'Automatic Stabilizers' suggests that progressive income taxes and unemployment benefits naturally mitigate economic fluctuations without requiring new legislative action.

Answer: A) True

Automatic stabilizers are built-in features of the budget that increase spending or decrease taxes during a recession without explicit intervention from policymakers.

3. If the Marginal Propensity to Consume (MPC) is 0.8, the government spending multiplier is _____, meaning an initial \$100 billion in spending could theoretically increase GDP by \$500 billion.

Answer: C) 5

The formula for the spending multiplier is $1/(1-MPC)$. In this case, $1/(1-0.8) = 5$.

4. According to the Ricardian Equivalence hypothesis, why might a tax cut fail to stimulate consumer spending as predicted by traditional Keynesian models?

Answer: A) Consumers save the tax cut in anticipation of future tax increases to pay off the debt.

Ricardian Equivalence suggests that forward-looking consumers realize today's deficit-funded tax cuts must be paid for later, so they save rather than spend.

5. True or False: A 'Recognition Lag' refers to the specific time period between when a fiscal policy is signed into law and when it actually impacts the unemployment rate.

Answer: B) False

Name: _____ Date: _____

A 'Recognition Lag' is the time it takes for policymakers to realize an economic problem exists; the impact phase is known as the 'Effectiveness Lag'.

6. Supply-side fiscal policy focuses on shifting the ___ curve to the right by reducing corporate taxes and deregulating industries to foster long-term growth.

Answer: C) Aggregate Supply (AS)

Supply-side economics aims to increase the productive capacity of the economy, which is represented by shifting the Aggregate Supply curve.

7. In a scenario involving high inflation and low unemployment, which combination of fiscal actions would a 'Hawkish' fiscal conservative most likely advocate?

Answer: B) Running a budget surplus by cutting infrastructure spending and raising taxes.

To combat inflation, contractionary fiscal policy (surplus) is used to reduce the money supply and aggregate demand.

8. The ___ tax, often debated in the context of fairness, imposes a higher percentage burden on low-income earners than on high-income earners, often seen with sales taxes.

Answer: B) Regressive

Regressive taxes take a larger percentage of income from low-income earners because they spend a larger share of their income on taxable goods.

9. True or False: The 'Decision Lag' in fiscal policy is generally shorter than the decision lag for monetary policy because Congress can vote faster than the Federal Reserve can meet.

Answer: B) False

The decision lag for fiscal policy is much longer due to political debate and the legislative process, whereas the Fed can change interest rates relatively quickly.

10. A nation is experiencing a 'Deflationary Gap.' Which fiscal policy intervention would most likely lead to a Right-ward shift in Aggregate Demand while avoiding an increase in the long-term structural deficit?

Answer: B) A temporary investment tax credit for green energy installations.

Temporary tax credits stimulate immediate investment (shifting AD) without creating the permanent spending obligations that contribute to long-term structural deficits.