

Name: _____ Date: _____

Answer Key: Dissect the Laffer Curve and Multipliers: 10th Grade Fiscal Policy Quiz

Calculate economic impacts and evaluate budgetary trade-offs using real-world scenarios of tax elasticity and the marginal propensity to consume.

1. A government decides to increase infrastructure spending by \$500 million. If the Marginal Propensity to Consume (MPC) is 0.8, what is the total theoretical increase in Aggregate Demand based on the spending multiplier effect?

Answer: C) \$2.5 billion

The spending multiplier formula is $1 / (1 - MPC)$. In this case, $1 / (1 - 0.8) = 5$. Multiplying the initial \$500 million by 5 results in a total impact of \$2.5 billion.

2. According to the concept of 'Crowding Out,' increased government borrowing to fund a deficit can lead to higher interest rates, which reduces private sector investment.

Answer: A) True

Crowding out occurs when government deficit spending competes with the private sector for loanable funds, driving up interest rates and making it more expensive for businesses to borrow and invest.

3. When a government implements a _____, it collects more in tax revenue than it spends in a single fiscal year, often used to cool an overheating economy.

Answer: B) Budget Surplus

A budget surplus occurs when tax receipts exceed government outlays. It is a tool of contractionary fiscal policy aimed at reducing the money supply and curbing inflation.

4. Which of the following serves as an 'Automatic Stabilizer' that shifts fiscal policy without requiring new legislation during an economic downturn?

Answer: C) Progressive income tax brackets and unemployment insurance

Automatic stabilizers like unemployment benefits increase spending automatically when jobs are lost, while progressive taxes naturally take less from households as incomes fall, providing immediate stimulus.

5. The Laffer Curve suggests that if tax rates are too high, decreasing the tax rate could actually increase the total tax revenue collected by the government.

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Answer: A) True

The Laffer Curve illustrates the relationship between tax rates and revenue, arguing that beyond a certain point, high rates discourage work and investment, leading to lower overall revenue.

6. A 'Supply-Side' economist would most likely argue that a reduction in _____ is the best way to stimulate long-term economic growth.

Answer: A) Capital Gains Taxes

Supply-side economics focuses on incentivizing production. Reducing taxes on capital gains or corporate profits is seen as a way to encourage investment and expand the economy's productive capacity.

7. Which scenario best exemplifies 'Contractionary Fiscal Policy' used to combat demand-pull inflation?

Answer: D) Cutting government defense spending and raising corporate taxes

Contractionary fiscal policy involves reducing aggregate demand by decreasing government spending, increasing taxes, or a combination of both.

8. Proponents of Keynesian economics believe that because prices and wages are 'sticky' downward, the government must use active fiscal intervention to manage the business cycle.

Answer: A) True

Keynesian theory posits that markets do not always self-correct quickly because wages and prices respond slowly to changes, necessitating government spending to boost demand.

9. The _____ refers to the time it takes for the government to identify an economic problem, debate a response, and pass a law to implement fiscal change.

Answer: C) Administrative Lag

The administrative (or legislative) lag is the period between realizing an economic problem exists and the actual passage of a fiscal policy measure through the legislative body.

10. How does the 'Tax Multiplier' compare to the 'Spending Multiplier' in magnitude, and why?

Answer: B) It is smaller because some of the tax cut is saved rather than spent.

The tax multiplier is lower than the spending multiplier because an initial tax cut is partially saved by households (leakage), whereas initial government spending enters the circular flow entirely.