Chapter 17 Exercises

Self-Check Questions

1. When governments run budget deficits, how do they make up the difference between tax revenue and spending?
2. When governments run budget surpluses, what is done with the extra funds?
3. Is it possible for a nation to run budget deficits and still have its debt-to-GDP ratio fall? Is it possible for a nation to run budget surpluses and still have its debt-to-GDP ratio rise? Explain your answers.
4. Suppose gifts are taxed at a rate of 10% for amounts up to $100,000 and 20% for anything over that amount. Is this tax regressive or progressive?
5. If an individual owns a corporation for which they are the only employee, which types of federal taxes will they have to pay?
6. What taxes would an individual pay if they are self-employed and the business is not incorporated?
7. The Social Security tax is 6.2% on income earned below $147,000. Is this tax progressive, regressive, or proportional?
8. What is the main reason for employing contractionary fiscal policy in a time of strong economic growth?
9. What is the main reason for employing expansionary fiscal policy during a recession?
10. In a recession, does the actual budget surplus or deficit fall above or below the standardized employment budget?
11. What is the main advantage of automatic stabilizers over discretionary fiscal policy?
12. Explain how automatic stabilizers work, both on the taxation side and on the spending side, first in a situation where the economy is producing less than potential GDP and then in a situation where the economy is producing more than potential GDP.
13. What would happen if contractionary fiscal policy was implemented during an economic boom but, due to lag, did not take effect until the economy slipped into recession?
14. Do you think the typical time lag for fiscal policy is likely to be longer or shorter than the time lag for monetary policy? Explain your answer.
15. How would a balanced budget amendment affect a decision by Congress to grant a tax cut during a recession?
16. How would a balanced budget amendment change the effect of automatic stabilizer programs?

Review Questions

17. Give some examples of changes in federal spending and taxes by the government that are discretionary fiscal policy and some that are not.

18. Have the spending and taxes of the U.S. federal government generally had an upward or downward trend in the last few decades?

19. What are the main categories of U.S. federal government spending?

20. What is the difference between a budget deficit, a balanced budget, and a budget surplus?

21. What are the main categories of U.S. federal government taxes?

22. What is the difference between a progressive tax, a proportional tax, and a regressive tax?

23. What has been the general pattern of U.S. budget deficits in recent decades?

24. What is the difference between a budget deficit and the national debt?

25. What is the difference between expansionary fiscal policy and contractionary fiscal policy?

26. Under what general macroeconomic circumstances might a government use expansionary fiscal policy? When might it use contractionary fiscal policy?

27. What's the difference between discretionary fiscal policy and automatic stabilizers?

28. Why do automatic stabilizers function "automatically"?

29. What is the standardized employment budget?

30. What are some practical weaknesses of discretionary fiscal policy?

31. What are some of the arguments for and against a requirement that the federal government budget be balanced every year?

Critical Thinking Questions

32. Why is government spending typically measured as a percentage of GDP rather than in nominal dollars?

33. Why are expenditures like crime prevention and education typically done at the state and local level rather than at the federal level?

34. Why is spending by the U.S. government on scientific research at NASA considered fiscal policy, while spending by the University of Illinois is not fiscal policy? Why is a cut in the payroll tax considered fiscal policy, whereas a cut in a state income tax is not fiscal policy?

35. Excise taxes on tobacco and alcohol and state sales taxes are often criticized for being regressive. Although everyone pays the same rate regardless of income, why might this be so?

36. What is the benefit of having state and local taxes on income instead of collecting all such taxes at the federal level?

37. In a booming economy, is the federal government more likely to run surpluses or deficits? What are the various factors at play?

38. Economist Arthur Laffer famously pointed out that, in some cases, income tax revenue can actually go up when tax rates go down. Why might this be the case?

39. Is it possible for a nation to run budget deficits and still have its debt-to-GDP ratio fall? Explain your answer. Is it possible for a nation to run budget surpluses and still have its debt-to-GDP ratio rise? Explain your answer.

40. How will cuts in state budget spending affect federal expansionary policy?

41. Is expansionary fiscal policy more attractive to politicians who believe in a larger government or politicians who believe in a smaller government? Explain your answer.

42. Is Medicaid (federal government aid to low-income families and individuals) an automatic stabilizer?

43. What is a potential problem with a temporary tax decrease designed to increase aggregate demand if people know that it is temporary?

44. If the government gives a $300 tax cut to everyone in the country, explain the mechanism by which this will cause interest rates to rise.

45. Consider this statement: “It is in the best interest of our economy for Congress and the president to run a balanced budget each year.” Do you agree or disagree? Explain your answer.

46. During the Great Recession of 2008–2009, what actions would have been required of Congress and the president if a balanced budget amendment to the Constitution had been ratified? What impact would that have had on the unemployment rate?

Problems

47. A government starts off with a total debt of \$3.5 billion. In Year 1, the government runs a deficit of \$400 million. In Year 2, the government runs a deficit of \$1 billion. In Year 3, the government runs a surplus of \$200 million. What is the total debt of the government at the end of Year 3?

48. If a government runs a budget deficit of \$10 billion dollars each year for ten years, then a surplus of \$1 billion for five years, and then a balanced budget for another ten years, what is the government debt?

49. Specify whether expansionary or contractionary fiscal policy is most appropriate in response to each of the following situations, and sketch a diagram using aggregate demand and aggregate supply curves to illustrate your answer:

a. A recession

b. A stock market collapse that hurts consumer and business confidence

c. Extremely rapid growth of exports

d. Rising inflation

e. A rise in the natural rate of unemployment

f. A rise in oil prices