Chapter 16: Fiscal Policy.

1. What percentage of GDP went to federal government revenues? expenditures?

2. In 1998, what fraction of Federal government spending was on transfers? defense? interest on debt?

3. What fraction of Federal government revenues come from the personal income tax? social security taxes? corporate income taxes?

4. As a percentage of GDP, has federal government spending been rising or falling over the past 30 years?

5. As a fraction of the federal budget, what two areas have received the largest growth in the past 30 years? which one received the largest decline?

6. Distinguish between the minority and majority view of an increase in government spending financed by deficit spending in terms of (i) how much investment decreases; (ii) how much interest rates are affected; (iii) how much consumption is affected; and (iv) how much AD is affected.

7a. Explain how, according to the majority view, an increase in the federal budget deficit reduces (“crowds out”) private investment.
   b. Explain why “crowding out” doesn’t occur in the “minority view”.

8a. Supply side economists argue that decreases in marginal tax rates may increase long run aggregate supply. Explain why.
   b. Deregulation was an important objective of supply side economists. Explain how deregulation might increase aggregate supply.

9. When government spending increases, either consumption or investment must decrease if the level of full employment output is fixed. However, changes in government spending could affect the rate of growth in the economy. Explain how the effect of increased government spending differs if:
   a. the spending is on "infrastructure" (e.g. roads, airports, etc.) as opposed to transfers (unemployment insurance, welfare, etc.)
   b. the additional spending is financed by a tax increase on consumption (e.g. a sales tax) as opposed to an income tax increase.
   c. the additional spending is financed by increased government borrowing (i.e. a larger deficit) financing as opposed to a tax increase on consumption.

10. According to the Laffer curve, it is possible to cut tax rates and increase tax revenue.
a. Draw a Laffer curve and be sure to label the axes.
b. Explain how each of the following are affected by lower tax rates in order to explain how lower tax rates could lead to greater tax revenue: (i) labor supply; (ii) the underground economy and tax cheating; (iii) investments in tax shelters.

10. Deficits are highly sensitive to economic conditions. If the economy goes into a recession, the budget deficit is likely to grow. Explain why.

11. Distinguish between the government deficit and the government (national) debt.

12. What is an “automatic stabilizer”? Give some examples and explain how they help stabilize the economy.

13. Explain why discretionary fiscal policy is not a very useful tool for reacting to the business cycle.