Name: ________________________________ Date: _____________

1. The amount by which government spending exceeds government revenues is called the ______, and the accumulation of past government borrowing is called the ______.
   A) deficit; debt
   B) debt; deficit
   C) devaluation; deflation
   D) deflation; devaluation

2. Historically, the primary cause of increases in government debt is:
   A) printing too much money.
   B) cutting taxes.
   C) increasing interest rates.
   D) financing wars.

3. Relative to the size of GDP, the U.S. federal government debt was at its maximum:
   A) at the end of the Revolutionary War.
   B) at the end of the Civil War.
   C) at the end of World War II.
   D) following the 9/11 terrorist attacks in 2001.

4. The factors most responsible for forecasts of the U.S. government debt spiraling out of control in the next half century are the projected:
   A) slowdowns in the rates of technological change and human capital growth.
   B) decrease in high-skilled domestic workers and the increase in immigration of low-skilled workers into the United States.
   C) aging of the U.S. population and rising health care costs.
   D) increase in international competition and the outsourcing of U.S. jobs.

5. An increase in the elderly population of a country affects fiscal policy most directly because:
   A) the elderly generally are not required to pay taxes.
   B) governments provide pensions and health care for the elderly.
   C) the elderly favor high interest rates on their savings.
   D) governments spend more on education as the proportion of the elderly increases.

6. If the government debt, *D*, equals $5 trillion, the nominal interest rate is 7 percent, and the real interest rate is 3 percent, then nominal budget deficit overstates the real deficit by $ ___ trillion.
   A) 0.35
   B) 0.20
   C) 0.15
   D) 0.07

7. Under capital budgeting, *all* of the following transactions would affect the federal budget deficit *except* the federal government's:
   A) sending a check to a welfare recipient.
   B) sending a check to the state of Massachusetts.
   C) selling a highway to the state of New York and using the proceeds to retire federal debt.
   D) selling an office building.

8. Assume that a government has a balanced budget when the economy is at full employment. If the economy then enters a recession, with no change in tax or spending laws, then the budget of the government is most likely to:
   A) remain balanced.
   B) be in deficit.
   C) be in surplus.
   D) be in either deficit or surplus, depending on the severity of the recession.

9. According to the traditional view of government debt, if taxes are cut without cutting government spending, then the short-run effects will be:
   A) higher output and lower unemployment.
   B) higher output and higher unemployment.
   C) no change in output or unemployment.
   D) no change in output and higher unemployment.

10. According to the traditional view of government debt, if taxes are cut without cutting government spending, then the international effect initially will be a capital ______ and a trade ______.
    A) inflow; deficit
    B) inflow; surplus
    C) outflow; deficit
    D) outflow; surplus

11. The international impacts of a debt-financed tax cut, according to the traditional view of government debt, are a(n) ______ in net exports and a domestic currency _____.
    A) increase; appreciation
    B) increase; depreciation
    C) decrease; depreciation
    D) decrease; appreciation

12. According to the traditional view of government debt (as in the *IS–LM* model), if taxes are cut without cutting government spending, then in the short run interest rates will ______ and investment will ______.
    A) increase; increase
    B) increase; decrease
    C) decrease; decrease
    D) decrease; increase

13. According to the traditional view of government debt (as in the Mundell–Fleming model), if taxes are cut without cutting government spending, then the short-run effects are a(n) ______ of the dollar and a(n) ______ in net exports.
    A) appreciation; increase
    B) appreciation; decrease
    C) depreciation; increase
    D) depreciation; decrease

14. Ricardian equivalence refers to the same impact of financing government:
    A) whether by printing money or raising taxes.
    B) in the long run as in the short run.
    C) whether by debt or taxes.
    D) in an open economy as in a closed economy.

15. The logic of Ricardian equivalence implies that:
    A) tax cuts do not influence consumer spending but changes in government spending do.
    B) neither tax cuts nor changes in government spending affect consumer spending.
    C) tax cuts combined with future decreases in government spending will decrease consumer spending.
    D) if the government cuts taxes and increases current government spending, consumer spending will increase.

16. According to the theory of Ricardian equivalence, tax cuts combined with no plans to reduce government spending ______ public saving and ______ private saving.
    A) reduce; reduce
    B) reduce; increase
    C) increase; increase
    D) increase; reduce

17. Suppose a household considers only current income in making consumption decisions. This is an example of:
    A) Ricardian equivalence.
    B) the permanent-income hypothesis.
    C) myopia.
    D) the life-cycle model.

18. Monetary policy is linked to fiscal policy when government spending is financed by:
    A) taxes.
    B) borrowing from banks.
    C) borrowing from foreigners.
    D) printing money.

19. Hyperinflations typically occur when governments:
    A) attempt to keep the unemployment rate below the natural rate.
    B) finance spending with the inflation tax.
    C) set inflation targets too high.
    D) use discretionary monetary policy to stabilize output.

20. High levels of government debt that raise investors' fear of a government default on debt will result in capital ______ and a(n) ______ of the country's exchange rate.
    A) outflows; depreciation
    B) outflows; appreciation
    C) inflows; depreciation
    D) inflows; appreciation