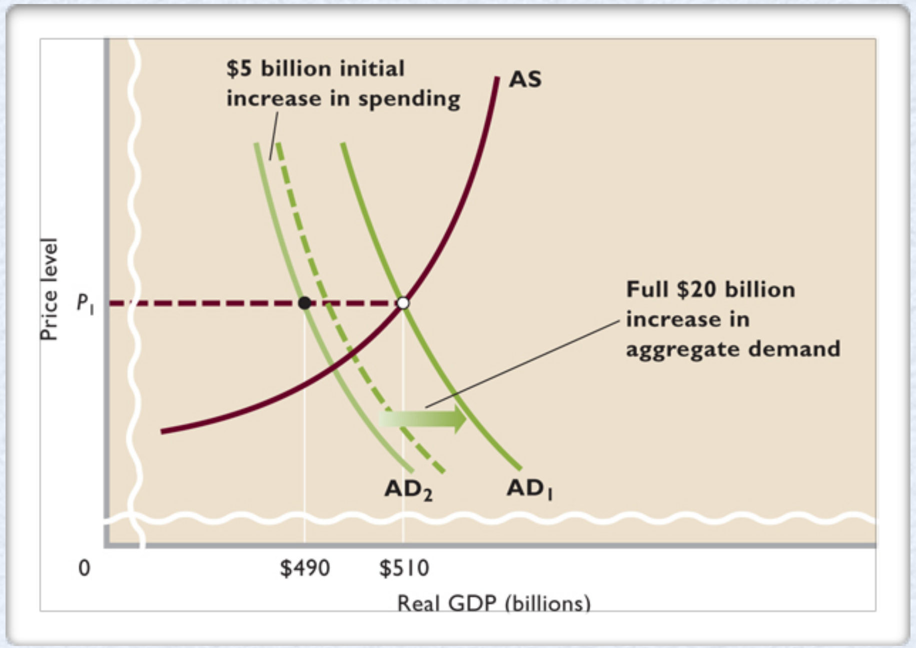
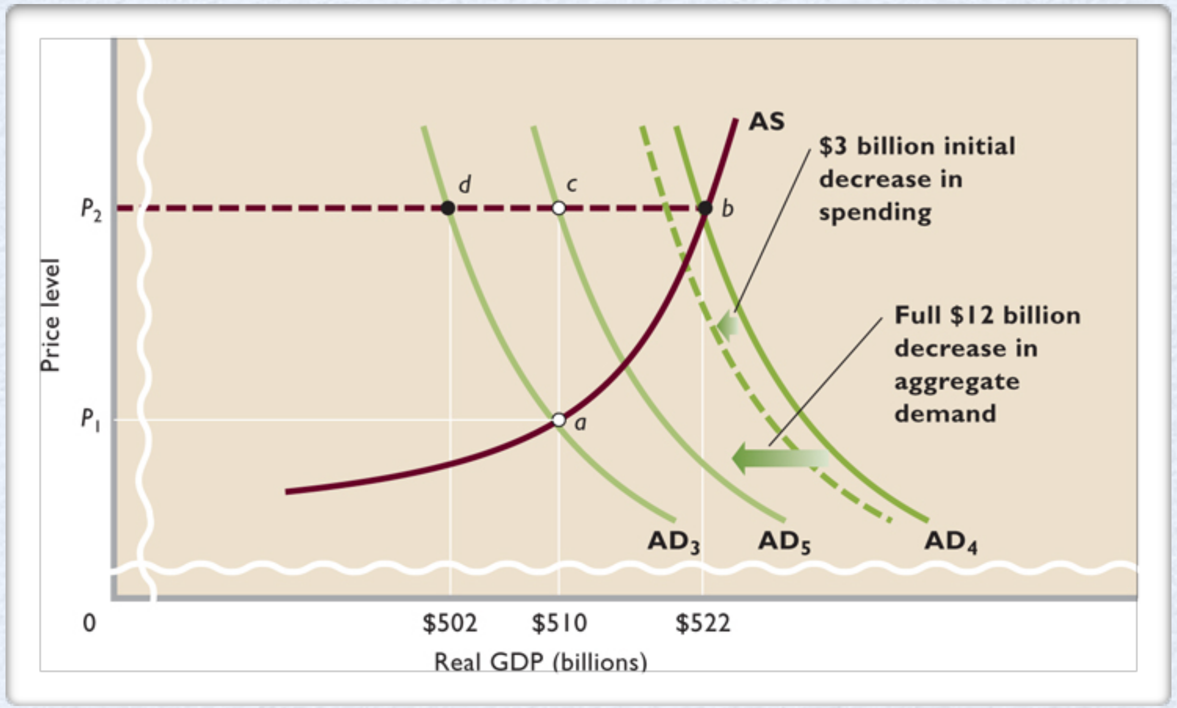
CHAPTER 31

Expansionary Fiscal Policy

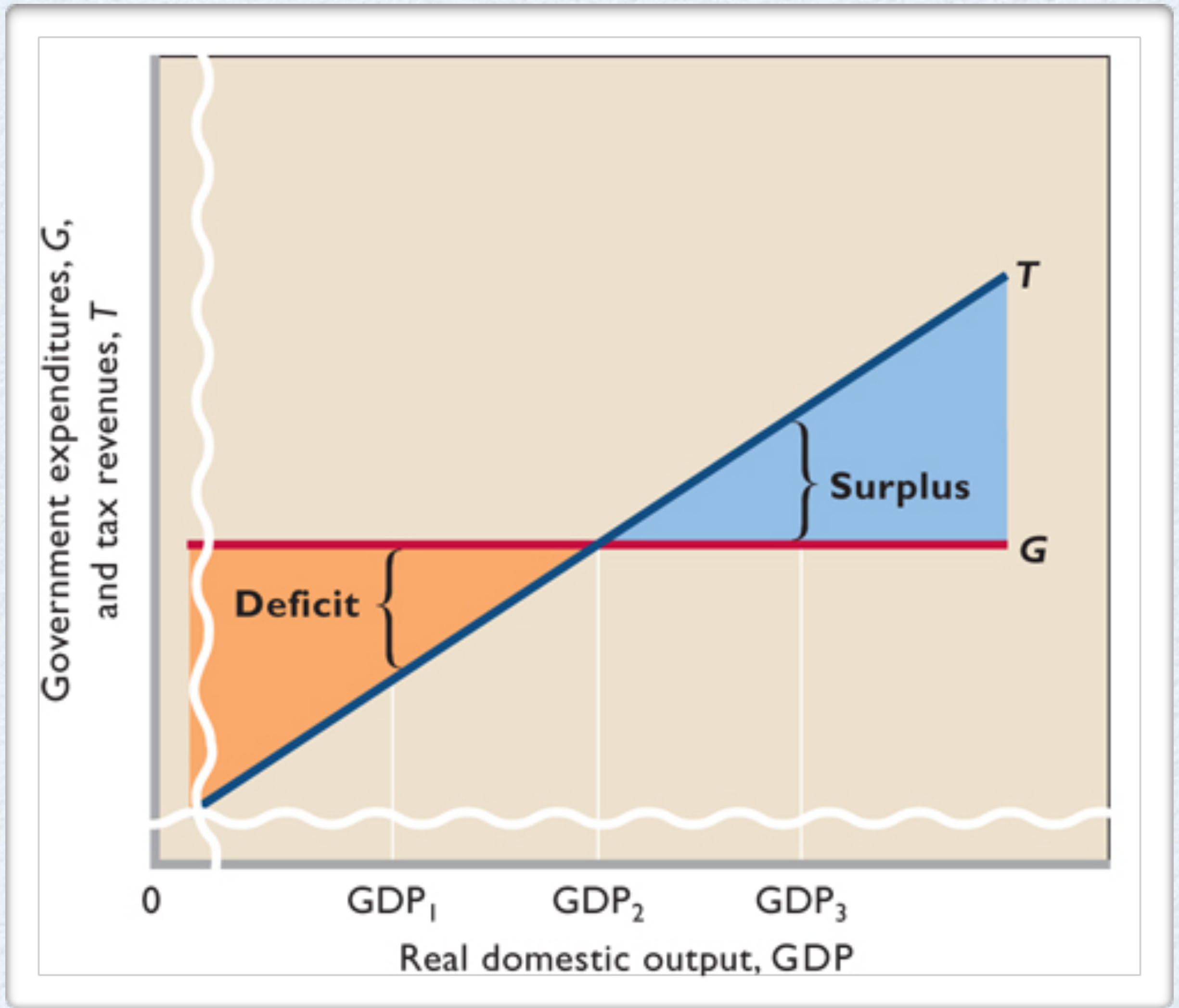
- Expansionary fiscal policy
  1. Increased government spending
  2. Decreased taxes
  3. Combined government spending increases and tax reductions
- Contractionary fiscal policy
  4. Decreased government spending
  5. Increased taxes
  6. Combined government spending decreases and increased taxes





Built-In Stability

- Automatic or built-in stabilizers - tax revenue varies directly with GDP
- G is assumed to be independent of GDP



Problems, Criticisms, and Complications

- **Problems of timing**

  1. **Recognition lag** - the time between the beginning of recession or inflation and the certain awareness that it is actually happening

  2. **Administrative lag** - the time the need for fiscal action is recognized and the time action is taken

  3. **Operational lag** - the time fiscal action is taken and the time that action affects output, employment, or the price level

- **Crowding-out effect** - an expansionary fiscal policy may increase the interest rate and reduce investment spending, thereby weakening or canceling the stimulus of the expansionary policy

The Public Debt

- **Public debt** - the total accumulation of the deficits (minus the surpluses) the Federal government has incurred through time
- The total public debt of $9.01 trillion represents the total amount of money owed by the Federal government to the holders of US securities: financial instruments issued by the Federal government to borrow money to finance expenditures that exceed tax revenues

1. Treasury bills (short-term)
2. Treasury notes (medium-term)
3. Treasury bonds (long-term)
4. US saving bonds (long-term, nonmarketable bonds)