



Fiscal Policy

- The use of government spending and revenue collection (taxes) to influence the economy.

Purpose



- Influence economic growth
- Achieve full employment
- Maintain price stability (control inflation)



Fiscal Policy Goals



President



**Secretary of
the Treasury**
*the President's chief
economic advisor*



Congress

Who controls it?



- **Government Spending**



- **Taxes**

Fiscal Policy Tools

Discretionary

- Deliberate Increasing or Decreasing of Government Spending and/or Taxes in order to return the economy to full employment in response to an economic problem


Automatic

- Built in government stabilizers such as unemployment compensation & marginal tax rates that help mitigate the effects of recession and inflation. Takes place without policy makers having to respond to current economic problems

Discretionary vs Automatic Fiscal Policy

Expansionary

Reduce
Taxes 

Increase
Government
Spending 

Contractionary

Increase
Taxes 

Reduce
Government
Spending 

Discretionary Fiscal Policy

- **Difficulty of changing spending levels**
- **Predicting the future**
- **Delayed results**
- **Political pressures**
- **Coordinating fiscal policy**



Limitations

Classical Economics

- Free markets regulate themselves
 - Very limited use of fiscal policy (laissez-faire)
- Problem: How long can we afford to wait for an economy to return to market equilibrium?



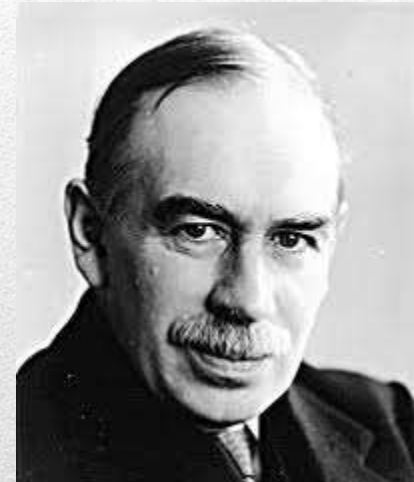
Adam Smith

Fiscal Policy Theories

Keynesian Economics (Demand Side Economics)

- Demand for goods drives the economy
- Use of Government Spending as the main tool boost GDP in times of recession
- Increase taxes (mainly corporate) to control inflation and pay for increased spending
- Increased legislation to protect consumers
- Focuses on *Aggregate Demand*

John Maynard Keynes



Fiscal Policy Theories

Supply-side Economics

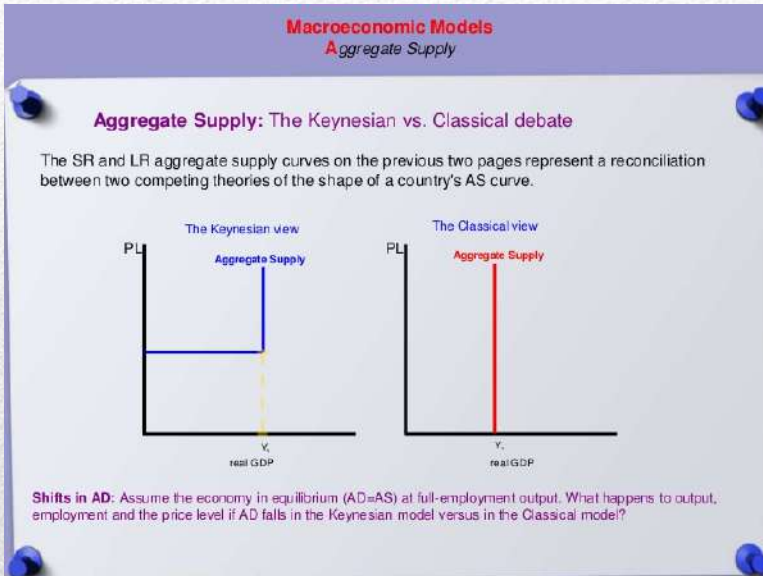
- Supply of goods drives the economy
- Tax cuts increase employment and total output
- Less government intervention in the economy is better
- Focuses on Aggregate Supply

- *Milton Friedman*

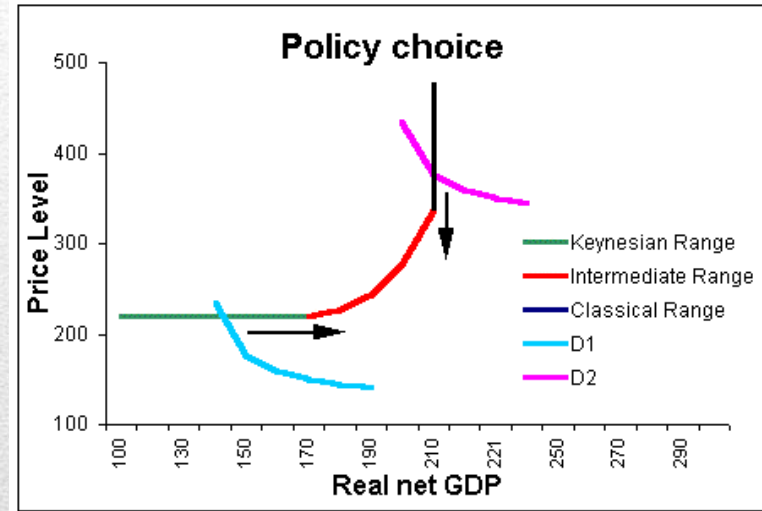


Fiscal Policy Theories

Theories



Compromise



Classical vs Keynesian