Chapter 10, Fiscal Policy

I. Fiscal Policy
   A. Budget: Expenditures and Revenues
   B. Defined

II. Demand Side Fiscal Policy
   A. Changes in Government Purchases and Taxes: Effects on Aggregate Demand
   B. Crowding Out
      1. Impacts
         a. On Consumption: Direct
         b. On Investment: Indirect, through the increase in the rate of interest
         c. On Net Exports: Indirect, through the increase interest rates and exchange rates
      2. Degree of completeness (to what extent does crowding out occur)..., p. 236, Ex. 2
         a. Zero (none): there is no crowding out
         b. Incomplete (partial): there is some crowding out
         c. Complete: Government spending completely crowds out the sum of C, I, NX
      3. New Classical view: there is no change in the interest rate, because consumers increase their savings in anticipation of later taxation increases to pay for G.
   C. Lags and the Effectiveness of Fiscal Policy
      1. Data lag: Getting the latest numbers
      2. Wait and see lag: Is it a transitory problem or is there a “fix” needed?
      3. Legislative lag: Getting it through Congress...
      4. Transmission lag: Implementing the legislation (bids and contracts...)
      5. Effectiveness lag: Waiting for results
   D. Theoretical impacts
      1. For an increase in government spending: $\Delta RGDP = \Delta G \times m$ (the multiplier)
      2. For a decrease in taxation: $\Delta RGDP = \Delta T \times MPC \times m$ (MPC times the multiplier)

II. Supply Side Fiscal Policy
   A. Marginal Tax Rates: Does a tax decrease lead to less work (more disposable income) or more work (higher cost of leisure, greater opportunity costs)
   B. Tax Rates and Revenues (the Laffer Curve)
      1. Tax revenues will be zero with zero taxes or 100% taxes (no one works)
      2. Presumably tax revenues will increase and then decrease with positive tax rates
      3. Two questions
         a. What is the shape of the curve (heavy to the left or the right)?
         b. Where are we on the curve?
      4. Supply side theory (as fiscal policy) suggests that we’re on the down side of the curve, that if we reduce taxes we will increase tax revenues.