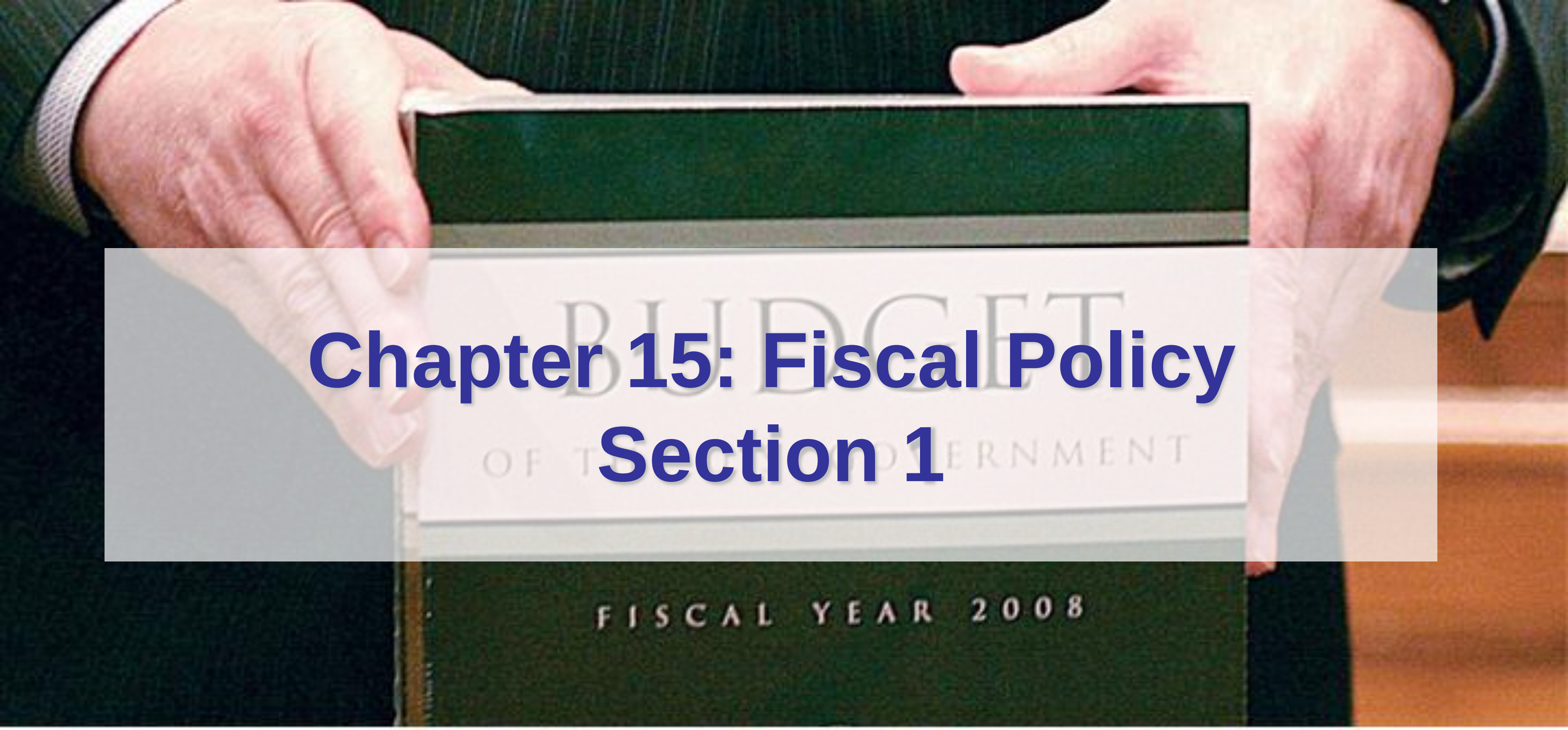
Chapter 15: Fiscal Policy
Section 1



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ECONOMICS

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Objectives

1. **Describe** how the federal budget is created.
2. **Analyze** the impact of expansionary and contractionary fiscal policy on the economy.
3. **Identify** the limits of fiscal policy.

Key Terms

- **fiscal policy:** the use of government spending and revenue collection to influence the economy
- **federal budget**: a written document estimating the federal government's revenue and authorizing its spending for the coming year
- **fiscal year**: any 12-month period used for budgeting purposes

Key Terms, cont.

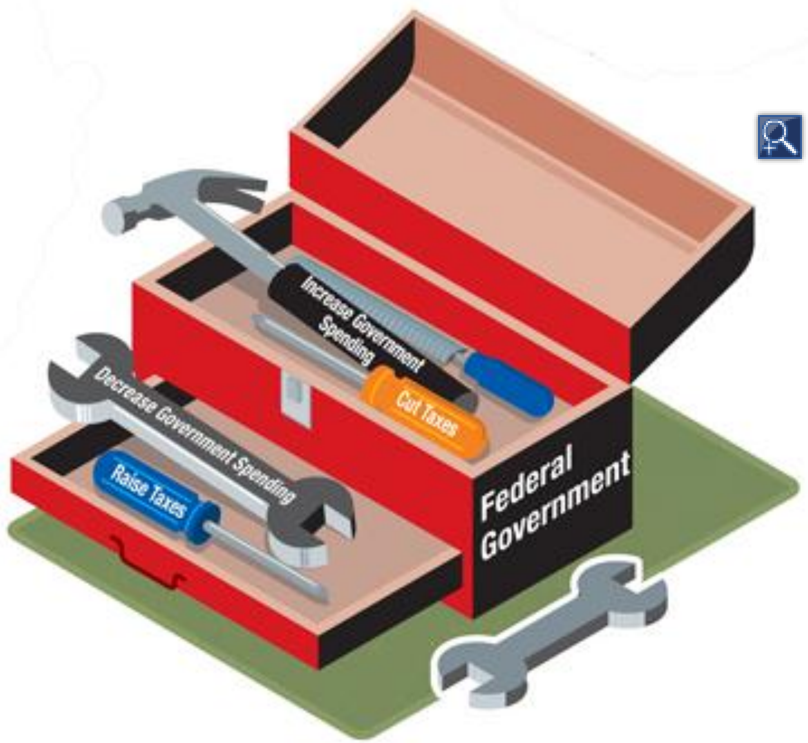
- **appropriations bills**: a bill that authorizes a specific amount of spending by the government
- **expansionary policy**: a fiscal policy used to encourage economic growth, often through increased spending or tax cuts
- **contractionary policy**: a fiscal policy used to reduce economic growth, often through decreased spending or higher taxes

Introduction

- What are the goals and limits of fiscal policy?
  - The goals of fiscal policy include:
    - Expand or slow economic growth
    - Achieve full employment
    - Maintain price stability
  - Fiscal policy is limited because it is difficult to know which way the economy is heading and therefore, which type of fiscal policy will be the most helpful.

What is Fiscal Policy?

- The government's taxing and spending decisions are shaped by both budgetary needs and fiscal policy.
  - Fiscal policy is a tool used to expand or slow economic growth, achieve full employment, and maintain price stability.



Creating the Federal Budget

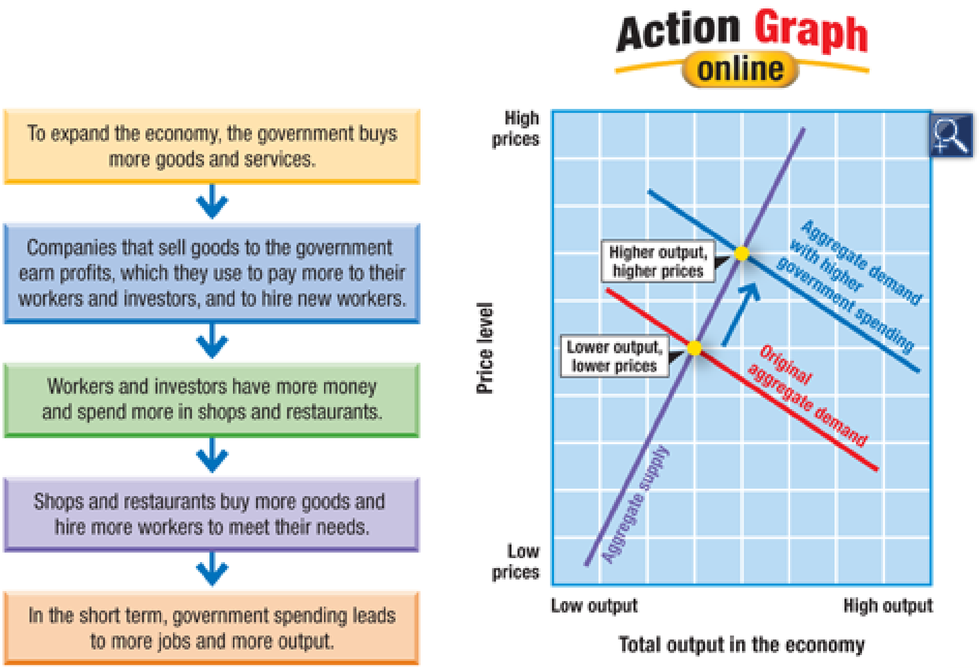
- The federal government makes key fiscal policy decisions each year when it establishes the federal budget.
  - The federal government prepares a new budget for every fiscal year, which goes from October 1 to September 30.
  - Who takes the first step in the budget process?

Creating the Federal Budget, cont.

- Government officials who take part in the budget process debate how much should be spent on specific programs such as defense, education, and scientific research.
  - Total government spending can be raised or lowered to help increase or decrease the output of the economy.
  - Similarly, taxes can be raised or lowered to help reduce or boost the output of the economy.

Expansionary Fiscal policy

- Governments use expansionary fiscal policy to encourage growth, either to prevent a recession or to move the economy out of a recession.
- Expansionary fiscal policy involves either increasing government spending or cutting taxes, or both.



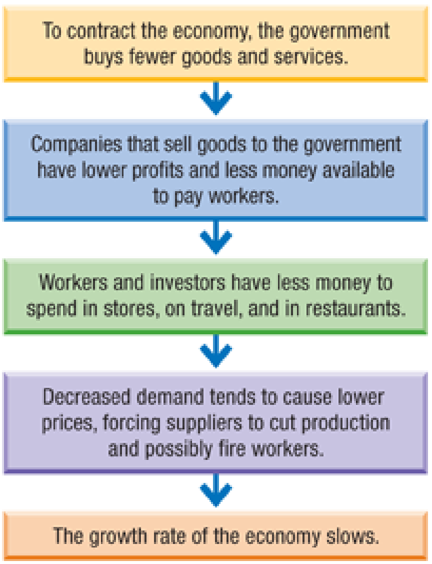
Contractionary Fiscal Policy

- Contractionary fiscal policy tries to decrease aggregate demand, and in doing so, reduce the growth of economic output.

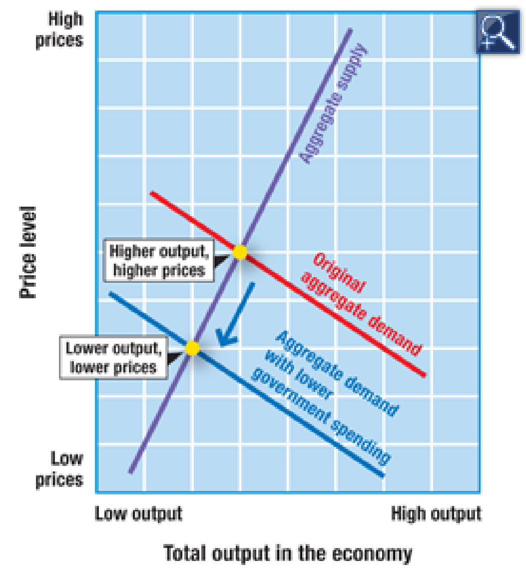
- Why would the government deliberately slow down economic output?
  - Because fast growing demand can exceed supply.
  - If producers cannot expand production to keep up with increasing demand, they will raise prices, which causes inflation.

Contractionary Fiscal Policy, cont.

- Fiscal policy aimed at slowing the growth of total output generally involves decreasing government spending or raising taxes or both.
  - How does lower government spending affect equilibrium?



Action Graph online



Limits of Fiscal Policy

- Fiscal policy can be clumsy and difficult to practice.
  - Increasing or decreasing the amount of federal spending is not an easy task. Since much of the budget goes to pay for entitlement programs only a small amount is available to make significant changes to.
  - Fiscal policy is made difficult by not knowing what the future of the economy holds.

Limits of Fiscal Policy, cont.

- Changes in fiscal policy need time to take effect. By the time the effects are felt, the economy might be moving in a different direction.
- Government officials must enact policies that please voters in order to get reelected. Officials often struggle to keep voters happy while doing what is best for the economy.

Coordinating Fiscal Policy

- For fiscal policy to be effective, various branches and levels of government must plan and work together, which is very difficult to do.
  - State and local governments don't always agree with the fiscal policy decisions of the federal government.
  - Business people, politicians, and economists often disagree about economic performance and the goals of fiscal policy.
  - Fiscal policy must also be coordinated with monetary policy.

Coordinating Fiscal Policy, cont.

- Short-term effects can differ greatly from long-term effects.
  - For example, a tax cut or an increase in government spending will give a temporary boost to economic production and to employment.
  - However, as the economy returns to full employment, high levels of government spending will lead to increased inflation as the economy overheats.

Review

- Now that you have learned about the goals and limits of fiscal policy, go back and answer the Chapter Essential Question.
  - How effective is fiscal policy as an economic tool?