

Economics Chapter 10 – Fiscal Policy

1. **Federal Budget** – a summary of the federal government's proposals for spending taxes, and the deficit
2. **Budget Deficit** – government expenditures greater than taxes
3. **Budget Surplus** – tax revenues greater than government expenditures
4. **Balanced Budget** – government expenditures equal to tax revenues
5. **Fiscal Policy** – changes in government expenditures and/or taxes to achieve particular economic goals, such as low unemployment, stable prices, and economic growth
6. **Expansionary Fiscal Policy** – increases in government expenditures and/or decreases in taxes to achieve particular economic goals
7. **Contractionary Fiscal Policy** - decreases in government expenditures and/or increases in taxes to achieve particular economic goals
8. **Discretionary Fiscal Policy** – deliberate changes of government expenditures and/or taxes to achieve particular economic goals
9. **Automatic Fiscal Policy** – changes in government expenditures and/or taxes that occur automatically w/o congressional action
10. Transfer payments are assumed to remain unchanged, and only deliberate actions by the government are accounted for when discussing fiscal policy
11. As government purchases and tax rates change, the AD and LRAS curves shift
12. When the economy is in a recessionary gap, changes in fiscal policy can shift the AD curve to the right to restore equilibrium
13. **Crowding Out** – the decrease in private expenditures that occurs as a consequence of increased government spending or the financing needs of a budget deficit
14. **Complete Crowding Out** – the decrease in one or more components of private spending completely offsets the increase in government spending
15. **Incomplete Crowding Out** – the decrease in one or more components of private spending only partially offsets the increase in government spending
16. If there is no crowding out, AD increases, Real GDP increases, and the unemployment rate decreases. If there is crowding out, AD, Real GDP, and unemployment rates will change according to the degree of crowding out
17. As government spending increases and the deficit increases, interest rates may rise due to more government loans, which may decrease investments. It is, in a way, a form of crowding out
18. **Trade Deficit** – the situation where the value of exports is less than the value of imports
19. **The New Classical Economist View:**
 - A. As the government spends more, the people would consume less in order to save more for the higher future taxes
 - B. Deficits will not increase interest rates because people would save more to pay their future higher taxes, increasing the amount of loanable money, and offsetting the increase in borrowing
20. **Lags on the Economy** – for those of you that play games on the Internet, you all know what lag is:
 - A. **Data Lag** – policy makers are not aware of changes in the economy as soon as they happen
 - B. **Wait-And-See Lag** – after policymakers are aware of a downturn in the economy, they usually wait to see if the problem resolves itself quickly
 - C. **Legislative/Recognition Lag** – Congress and the President have to propose a new plan and get it passed, taking time
 - D. **Transmission Lag/Implementation** - New measures take time to implement
 - E. **Effectiveness Lag/Impact** – actually a measure is implemented, it takes time before it to actually take effect
21. Keynesians view fiscal policy as effective methods of moving the economy out of a recessionary gap
Monetarists and new classical economists do NOT
22. Tax cuts also raise consumption and help pull the economy out of a recession gap, but not as effectively as raising government spending. When government spending goes up, every dollar counts towards total consumption. However, when taxes are cut, the people are left with more money, but some of it gets saved.
23. **Marginal Tax Rate** – the change in a person's tax payment divided by the change in the person's taxable income.
$$\text{Marginal Tax Rate} = \frac{\text{change in Tax payment}}{\text{change in Taxable Income}}$$
24. Lower marginal tax rates usually lead to more incentive to work and make more money
25. **Laffer Curve** – shows the relationship between tax rates and tax revenues. According to the Laffer curve, as tax rates rise from zero, tax revenues rise, reach a maximum at some point, and then fall with further increases in tax rates.
26. If the tax rate is too high, people would be discouraged to work
27. **Tax Base** – the total amount of taxable income
$$\text{Tax Revenue} = \text{Tax base} * \text{Tax Rate}$$
28. As the tax rate drops, the tax base normally increases, and as the tax rate rises, the base decreases. However, the amount of decrease and increase are not linear, especially at the extremes

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1. The budget proposal and what actually gets spent is not nearly the same
 - a. Congress plays w/ the President's budget, adding and deleting items, before the President signs it
 - b. Unexpected events such as wars and natural disaster call for reallocating funds
 - c. **Supplementals** – change in a spending program or tax law that affects the current fiscal year
2. **Budget Cycle** – from the proposal early in a year to the enactment in October of the year till Oct of the next year
 - a. Sometimes, 3 budgets can be considered at once
 - b. Say, it's Sept 2000. The 2000 budget is coming to a close, but people are still talking about it. The 2001 budget is still being deliberated in Congress, so people are talking about that. The 2002 budget is being hammered out by the President's staff for presentation in early 2001, so people are talking about that too
 - c. Many times Congress and President don't agree on a fiscal policy till after the fiscal year starts
3. **Taxes** – Personal, corporate profits, payroll (social security, Medicare, disability, etc), and sales taxes
4. **Government spending** – only purchases of goods and services counted, such as defense
5. **Transfer payments** – social security, Medicare, disability, do not count in GDP
6. **Interest payments** – payment for interest on the deficit
7. **Debt to GDP ratio** – the deficit divided by the nominal GDP
8. Federal government expenditures are larger than state expenditures, but the states make more purchases of goods and services than the Federal government
9. Fiscal policy generally acts on a “do no harm” basis
10. If the GDP is below potential, and the government increases spending, then the curve shifts to the right, and if they spend the right amount, GDP will be back at potential GDP almost instantaneously, w/o the recession
11. Unfortunately, this quick fix doesn't lower the interest rates as the economy would have had it recovered on its own, so you don't get the increased potential GDP growth rate afterwards
12. If taxes drop, people have more money to spend, and the AD curve shifts right, which could lift the economy
13. **Countercyclical Fiscal Policy** – policy designed to offset the fluctuation in the business cycle
 - a. Sometimes they mess up and lower taxes too much in a recession, causing a boom, which raises inflation
 - b. Usually, these policies are not made quickly enough, so they don't prevent anything, only speed recovery
14. **Discretionary fiscal policy** – changes in tax or spending policy requiring action by the President or Congress
15. **Automatic stabilizers/Fiscal policy**– automatic tax and spending changes that occur over the course of the business cycle and tend to stabilize the fluctuations in real GDP. Taxes are a proportion of income, so when income rises, taxes also rise. Also, the rich are taxed more, so as the number of rich rise, the government gets more revenue
16. Spending also changes according to the economy – the gov pays more unemployment benefits in a recession
17. During the '91 recession, taxes went down by 116bil, not by choice, while spending went up by 91bil, by choice
18. This made the recession less severe, but raised the deficit
19. **Structural surplus** – the level of the budget surplus where real GDP is equal to potential GDP and unemployment is full (meaning only natural unemployment)
20. When GDP falls, the deficit rises because taxes fall but the government spends more since unemployment benefits are higher