FISCAL POLICY TERMS

Fiscal Policy: changes in federal-government spending or taxes designed to promote full employment, price stability and reasonable rates of economic growth

Expansionary Fiscal Policy: an increase in government spending and/or a decrease in taxes designed to increase aggregate demand in the economy. The intent is to increase gross domestic product and reduce unemployment.

Contractionary Fiscal Policy: a decrease in government spending and/or an increase in taxes designed to decrease aggregate demand in the economy. The intent is to control inflation.

Multiplier Effects: in economics, the idea that increased spending by consumers, businesses or government becomes income for someone else. When this person spends the income, it becomes income for someone else and so on, leading to increased production in an economy. Multiplier effects can also work in reverse when spending decreases.

Supply-Side Fiscal Policy: the idea that fiscal policy may directly affect aggregate supply and not just aggregate demand. For example, a tax cut may give businesses incentives to expand or invest in capital goods, since they have more after-tax income to spend as they choose.

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DEBATES ABOUT FISCAL POLICY

1. **How large are the multiplier effects?**
It is important to know this to decide how large the initial change in taxes and government spending must be to effectively fight recession or inflation. Too large a change could cause more problems, and too small a change would not solve anything. However, economists do not know precisely how large multiplier effects are.

2. **How fast does fiscal policy work?**
Time lags frequently occur with fiscal policy because of the time it takes
   A. to realize there is a problem in the economy
   B. to get a change in taxes or spending policy passed by Congress
   C. for the fiscal policy to affect the recession or inflation
Economists cannot predict how long these lags will be and therefore cannot predict how long it will take fiscal policy to help the economy.

3. **How is fiscal policy affected by international events?**
The U.S. is part of the world economy and is greatly affected by world events it does not control. Actions in other countries may affect how or if U.S. fiscal policy achieves its goals. For example, the U.S. government may try to fight a recession by increasing aggregate demand. But people in other countries may offset this if they decide to buy fewer U.S. exports, decreasing aggregate demand for U.S. goods and services.

4. **How does fiscal policy affect the national debt and interest rates?**
Since expansionary fiscal policy means government spending goes up or tax revenue goes down, this will most likely boost a current national deficit or cut a current surplus. This may lead to increased interest rates in the economy. When interest rates rise, private businesses may borrow less and slow their investment in capital goods. This *crowding out* of private investment may offset the expansionary effects of fiscal policy.

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