

ECON 203

CHAPTER 7

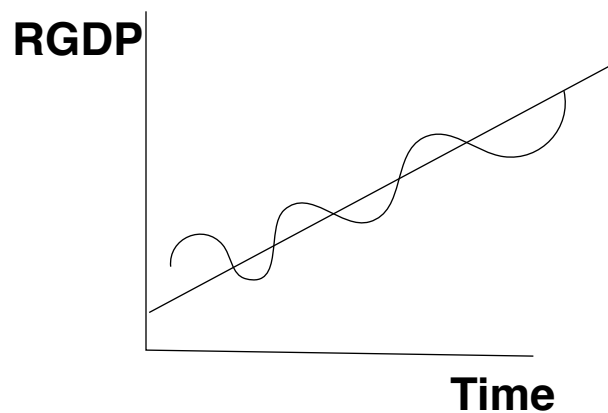
FISCAL POLICY

the use of government spending and taxes to stabilize the business cycle.

4 business cycles:

- Expansion
- Peak
- Contraction
- Trough

The idea of Fiscal policy is to smooth out the business cycle.'



CONTRACTION-AIRY GAP

$$Y_s < Y_p$$

To solve this Prob Increase Gov. Spending and/or Decrease tax. (expansion-airy fiscal policy.

EXPANSION-AIRY GAP

$$Y_{sr} > Y_p$$

To solve this problem; decrease Gov. spending and/or increase Taxes.
(contraction-airy fiscal policy)

Fiscal Policy works with a 3 types of lag.

- recognition-airy lag
- action lag
- effect lag

Deficit, Surplus, Balancing Budgets

BB = Taxes - Gov spending (evaluated at Short run GDP.)

Its appropriate to have a Deficit in an contraction-airy gap.

Its appropriate to to have a surplus in an expiation-airy gap.

At potential GDP, budget should be balanced.

Balance budget amendment

amendment to a state constitution, proposing a law that balances budget annually (bad idea) Makes booms bigger, and recessions worse.

SSB = T_{pgdp} G_{pgdp} (evaluated at long run GDP.5)

If + then structural surplus, If - then structural deficit.

Wednesday, January 29, 2014

Government spending > horizontal line (not part of gap)

GRAPH

Structural Budget balance > based on potential GDP