2.4 FISCAL POLICY

TERMS

1. current expenditures
2. capital expenditures
3. transfer payments
4. government budget
5. balanced budget
6. budget deficit
7. budget surplus
8. public/government debt
9. fiscal policy
10. expansionary fiscal policy
11. contractionary fiscal policy
12. automatic stabilisers
13. crowding out

OBJECTIVES

1. Explain that the government earns revenue primarily from taxes (direct and indirect), as well as from the sale of goods and services and the sale of state-owned (government-owned) enterprises.

2. Explain that government spending can be classified into current expenditures, capital expenditures and transfer payments, providing examples of each.

3. Distinguish between a budget deficit, a budget surplus and a balanced budget.

4. Explain the relationship between budget deficits/ surpluses and the public (government) debt.

5. Explain how changes in the level of government expenditure and/or taxes can influence the level of aggregate demand in an economy.

6. Explain the mechanism through which expansionary fiscal policy can help an economy close a deflationary (recessionary) gap.

7. Construct a diagram to show the potential effects of expansionary fiscal policy, outlining the importance of the shape of the aggregate supply curve.

8. Explain the mechanism through which contractionary fiscal policy can help an economy close an inflationary gap.

9. Construct a diagram to show the potential effects of contractionary fiscal policy, outlining the importance of the shape of the aggregate supply curve.

10. Explain how factors including the progressive tax system and unemployment benefits, which are influenced by the level of economic activity and national income, automatically help stabilize short-term fluctuations.

11. Evaluate the view that fiscal policy can be used to promote long-term economic growth (increases in potential output) indirectly by creating an economic environment that is favourable to private investment, and directly through government spending on physical capital goods and human capital formation, as well as provision of incentives for firms to invest.

12. Evaluate the effectiveness of fiscal policy through consideration of factors including the ability to target sectors of the economy, the direct impact on aggregate demand, the effectiveness of promoting economic activity in a recession, time lags, political constraints, crowding out, and the inability to deal with supply- side causes of instability.