Aggregate demand, aggregate supply and fiscal policy

Rush

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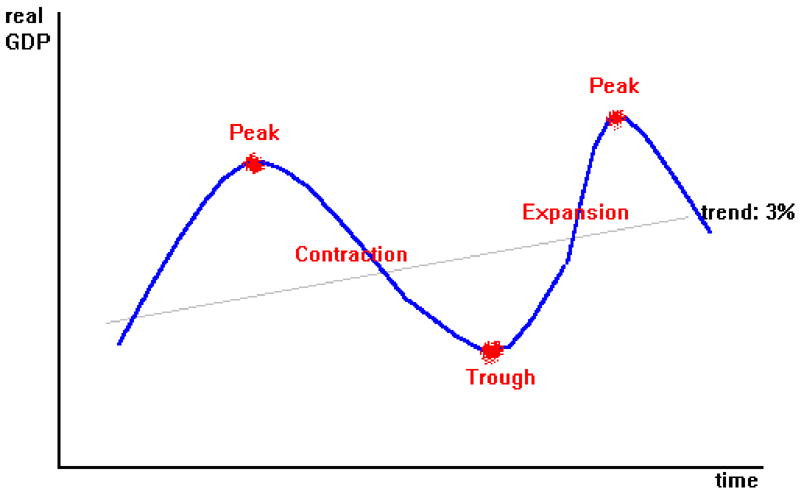
Fiscal policy quick start

- In your notes (not to turn in), answer:



- What is fiscal policy?
- What might be the goals of EXPANSIONARY fiscal policy?
- What might be the goals of CONTRACTIONARY fiscal policy?

Today's goals

- I will learn what fiscal policy is, and how the government uses it to speed up or slow down the economy.

New vids! WeTheEconomy.com

- Debt and the deficit
- https://www.youtube.com/watch?v=n7N-0q4WgB4&list=PLHJwMKzESQAKqNC4sVOAmZfwPfy4mwxO
- Your tax dollars at work
- https://www.youtube.com/watch?v=909lIBU89yY&index=3&list=PLHJwMKzESQAKqNC4sVOAmZfwPfy4mwxOl
- Recession
- https://www.youtube.com/watch?v=QQ3JTPu9gIY&list=PLHJwMKzESQAJkbqYBEJGl8nsKGRqbtsHQ

What is fiscal policy?

- Changes in federal TAXES and federal government SPENDING designed to affect the level of aggregate demand.

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What is aggregate demand?

- Aggregate demand (AD) is
  the total amount of spending
  on goods and services in the economy
  during a stated period of time.
- What’s that formula again?

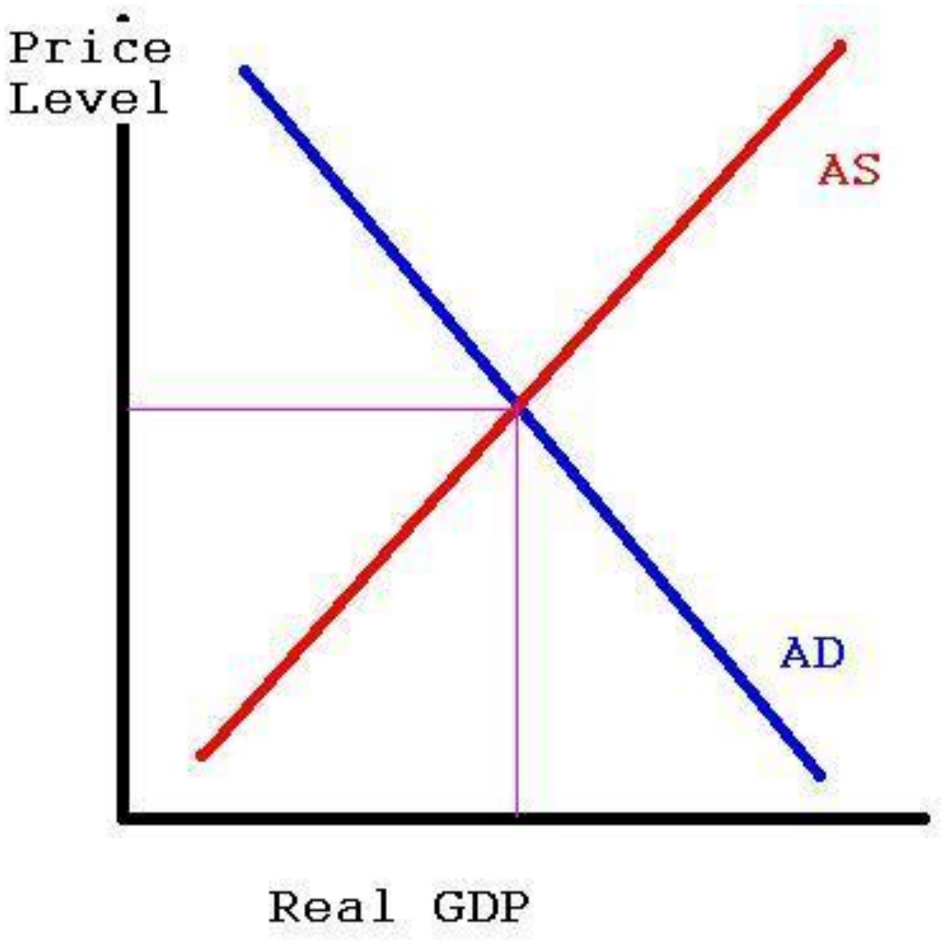
What is aggregate demand?

- $GDP = C + I + G + (X – M)$
- Not just consumer demand. It includes:
  - the demand of consumers (C)
  - the demand of business firms (I)
  - the demand of governments (G)
  - the demand of foreigners for exports (X) minus the demand for imports (M) (X – M, or net exports)

Aggregate demand curve?

- The AD curve shows the relationship between the total output buyers want to buy, or real GDP demanded, and the economy’s price level.

Aggregate demand curve?



Macro AD vs. micro demand

- In micro, consumers
  are buying a single product.
- In macro AD, all possible buyers
  are buying the economy’s
  total output, or total real GDP.

Shifts in the AD curve

- The AD curve can shift left or right.
  It is important to distinguish between movements on the curve,
  caused by changes in the price level,
  and shifts of the AD curve,
  caused by the determinants of AD.

Shifts in the AD curve

- A rightward shift means that AD increases: For any price level, more real GDP is demanded.
- A leftward shift means that AD decreases: For any price level, less real GDP is demanded.

Shifts in the AD curve

- Because AD is composed of C, I, G and (X – M), changes in AD and shifts in the AD curve can be caused by any factor that produces a change in one of these four components.

Causes of changes in consumer spending (C)

- Changes in consumer confidence.
- Changes in interest rates.
- Changes in wealth.
- Changes in personal income taxes.
- Changes in the level of household indebtedness.

Causes of changes in investment spending (I)

- Changes in business confidence.
- Changes in interest rates.
- Changes (improvements) in technology.
- Changes in business taxes.
- The level of corporate indebtedness.
- Legal/institutional changes.

Causes of changes in government spending (G)

- Changes in political priorities.
- Changes in economic priorities: Deliberate efforts to influence aggregate demand.

Causes of changes in net exports (X - M)

- Changes in national income abroad.
- Changes in exchange rates.
- Changes in the level of trade protection.

Expansionary fiscal policy

- During a recession, AD is too low to bring about full employment of resources. Government can increase AD by spending more, cutting taxes, or doing both. Such an EXPANSIONARY policy should increase employment, price level,or both.

Contractionary fiscal policy

- If AD is too high, creating inflationary pressure, government can reduce its spending, increase taxes, or both. Such a CONTRACTIONARY policy should lower the level of AD, and the economy will experience less employment, lower prices, or both.

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