Exercise walk-through

Fiscal Policy ▪ 3.8

eXercise

You must be able to

- define **fiscal policy 财政政策** as government spending and taxes
- distinguish **expansionary 扩张性** from **contractionary 紧缩性** fiscal policy
- apply the **spending** and **tax multipliers** to estimate the change in output
- relate a fiscal choice to closing a recessionary or inflationary gap

Method — Fiscal policy

The government's use of **spending** and **taxes** to influence aggregate demand.

Method — Expansionary vs contractionary

- **Expansionary** (more spending or lower taxes) $\rightarrow$ AD **right**; used to close a **recessionary** gap.
- **Contractionary** (less spending or higher taxes) $\rightarrow$ AD **left**; used to close an **inflationary** gap.

Method — Sizing the policy

Use the spending multiplier: the spending change needed $= \dfrac{\text{output gap}}{\text{multiplier}}$.

Practice 2.1 ▪ 1 mark

Define fiscal policy.

Solution 2.1

Method: Fiscal policy

Worked steps

the government's use of spending and taxes to influence the economy **B1**.

Practice 2.2 ▪ 1 mark

State the type of fiscal policy used to close a recessionary gap.

Solution 2.2

Method: Expansionary vs contractionary

Worked steps

expansionary fiscal policy **B1**.

Practice 2.3 ▪ 1 mark

State the effect of expansionary fiscal policy on AD.

Solution 2.3

Method: Fiscal policy

Worked steps

it increases (shifts right) AD B1.

Exam-style 3.1 ▪ 1 mark

Expansionary fiscal policy involves

A cutting government spending

B raising taxes

C increasing government spending

D raising interest rates

Solution 3.1

Method: Fiscal policy

A cutting government spending

B raising taxes

C increasing government spending ✓

D raising interest rates

Worked steps

C.

Exam-style 3.2 ▪ 1 mark

To fight high inflation, the government should use ________ fiscal policy.

A expansionary

B contractionary

C monetary

D no

Solution 3.2

Method: Fiscal policy

A expansionary

B contractionary ✓

C monetary

D no

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

An economy is in a recessionary gap of $\$100$ billion, with $MPC = 0.8$.
(a) Name a fiscal tool that could close it.
(b) State the effect on AD.
(c) Find the rise in government spending needed.

Solution 3.3

Worked steps

(a) increase government spending (or cut taxes) **B1**. (b) AD shifts right **B1**. (c) multiplier $= \dfrac{1}{1-0.8} = 5$, so spending $= \dfrac{100}{5} = \$20$ billion **B1**.