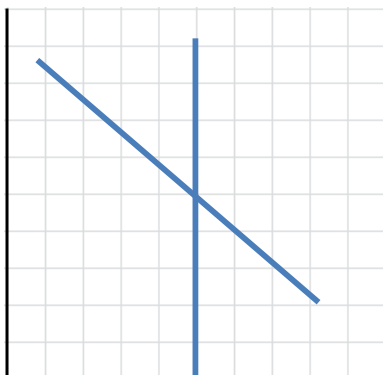


CONCEPT: CRITICISM OF FISCAL POLICY

- The government's fiscal policy can be ineffective because of a _____:
 - *Recognition Lag*: Time between the beginning of a recession (or inflation) and awareness of its existence
 - > The economy is usually 4-6 months into a recession (or inflation) before it is clearly known
 - *Operational Lag*: Time between approval of fiscal policy and its impact on the economy
 - > Tax policy can be put in effect relatively quickly
 - > Government spending on public projects can take (6-12 months)
 - Example: Building highways, dams, and other infrastructure projects
- The government's fiscal policy can be ineffective because of the _____ environment:
 - *Re-election*: Politicians can support inappropriate fiscal policy to help them get re-elected
 - > A strong economy during the election period will help them get re-elected
 - > Example: Tax cuts or increased spending for subsidies, health care reform, or education
 - *Future Policy Reversals*: Changes that are viewed as temporary will not have long-term effects
 - > Example: Temporary tax cut may not increase consumption (increase savings, maintain consumption)
- The government's fiscal policy can be ineffective because of the actions of _____ governments:
 - *Pro-cyclical fiscal policy*: S&L government generally make policy decisions that worsen recession and inflation
 - > Act similar to households, S&L government reduce spending during recession
 - Generally because they have legal requirements to keep a balanced budget
- The government's fiscal policy can be ineffective because of the **crowding out effect**:
 - Increased government spending → Money demand _____ → Interest Rate _____ → Investment spending _____

Money Market



Aggregate Demand

