CONCEPT: EXPANSIONARY AND CONTRACTIONARY FISCAL POLICY

● The government can change its level of spending or taxes in response to the state of the economy

□ When the economy is ***in recession***, real GDP is below its potential output

> Cyclical unemployment and low investment

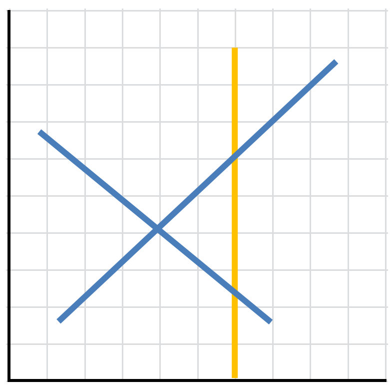
> ***Expansionary fiscal policy*** – Government ______________ spending to stimulate economy

- Expansionary = more GDP

- The government can also _________ taxes (which _____________ consumption)

Expansionary Fiscal Policy

AD-AS Model



□ When the economy is experiencing ***rising inflation***, real GDP is above its potential output

> Overemployment and increasing price levels

> ***Contractionary fiscal policy*** – Government ______________ spending to reduce inflation

- Contractionary = less GDP

- The government can also _________ taxes (which _____________ consumption)

Contractionary Fiscal Policy

AD-AS Model