**CONCEPT:** LONG RUN EFFECTS OF FISCAL POLICY

● The effects of a ***persistent government budget deficit***:

☐ To pay for the deficit, the government needs to borrow funds

> ***Crowding Out*** – Government competing with firms for loanable funds drives up interest rate

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| Budget Deficit → Gov. Borrowing _____ → Interest Rate _____ → Investment Spending _____ →LR Growth _____ |

☐ The debt leads to interest payments putting pressure on future budgets

> Government must increases taxes or cut spending to pay off debt in the future

> Government "should" try to balance extra spending during recessions with surpluses during expansions

- Does this actually happen? _______

● The effects of ***long run tax policy***:

☐ ***Tax Wedge*** – the difference between pre-tax and post-tax income

> Example: You earn $20/hour but are taxed 25%. Post-tax = _______ Tax wedge = _______

☐ *Lower Individual Income Taxes* → More disposable income, leading to more consumption

☐ *Lower Corporate Income Taxes* → Higher returns, leading to more investment

☐ *Lower Taxes on Capital Gains/Dividends* → Increase supply of loanable funds, leading to lower interest rate