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* Impact of Fiscal policy

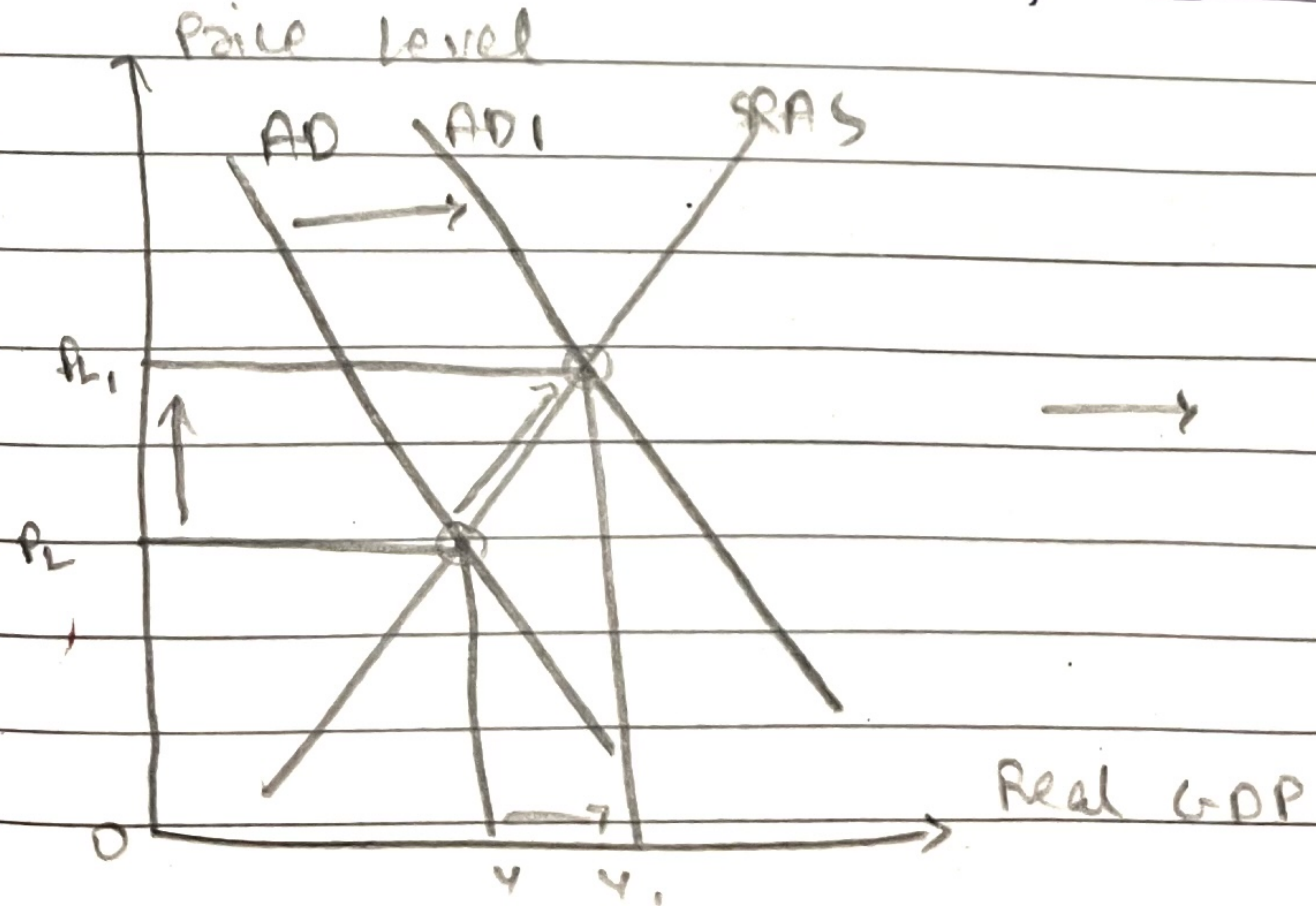
- Expansionary policy ↑ in G → Government purchases, TP.
Government purchases ↑ → AD ↑
Transfer payments ↑ → C↑, I↑, → AD ↑
Tax ↓ → C↑, I↑, → AD ↑

- Contractionary
G↓ → AD ↓
TP ↓ → C↓, I↓, → AD ↓
Tax ↑ → C↓, I↓ → AD ↓

→ An increase in indirect taxes (i.e. contractionary) will lead to a decrease in the purchasing power of households and eventually to a decrease in their consumption and therefore AD. And vice versa if indirect taxes are decreased.

→ A multiplier effect refers to a small change in ~~into~~ spending which leads to a much larger change in the income.

* Consequences of Fiscal Policy - Short Run



→ Expansionary

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* Fiscal Policy *

- Government spending and taxation is influenced.

* Fiscal policy

→ Fiscal policy refers to the use by the government of taxes and spending in order to influence the economy.

→ Fiscal policy is a demand-side policy. That is it will influence the economy by making AD shift.

→ A fiscal policy that leads to an increase in AD is known as expansionary. A fiscal policy that leads to a decrease in AD is known as contractionary.

→ In expansionary fiscal policy, the government spending increases and the taxes decreases in order to increase AD in the economy.

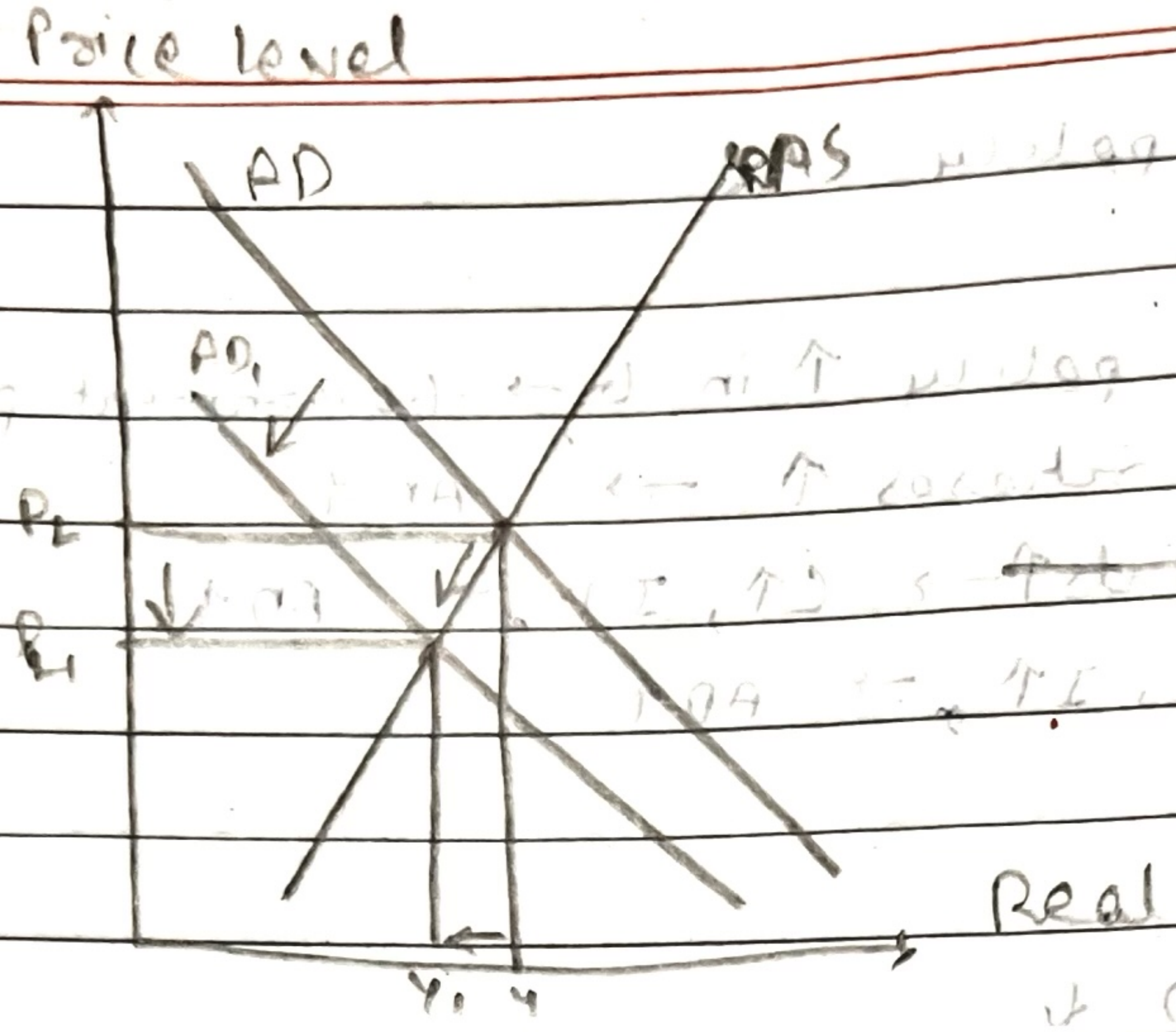
→ In contractionary fiscal policy, the government spending decreases and the taxes increase in order to decrease AD in the economy.

→ Fiscal policy can be discretionary or non-discretionary.

→ A discretionary fiscal policy is a deliberate change in taxes or government spending.

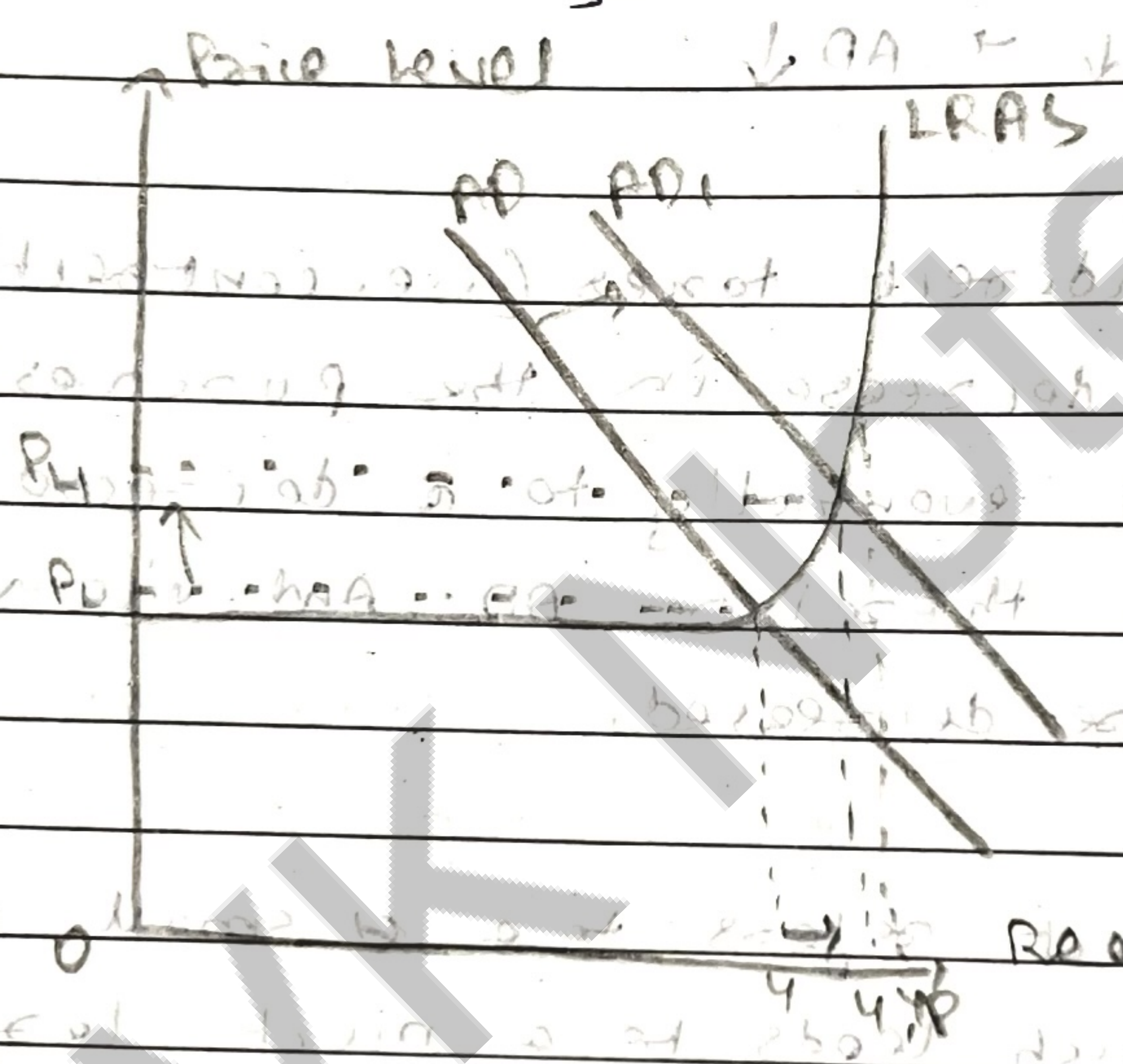
→ A non-discretionary fiscal policy is a change in taxes or government spending that results from the automatic-stabilizers.

→ Fiscal policy will be used in the time of recession and inflation.



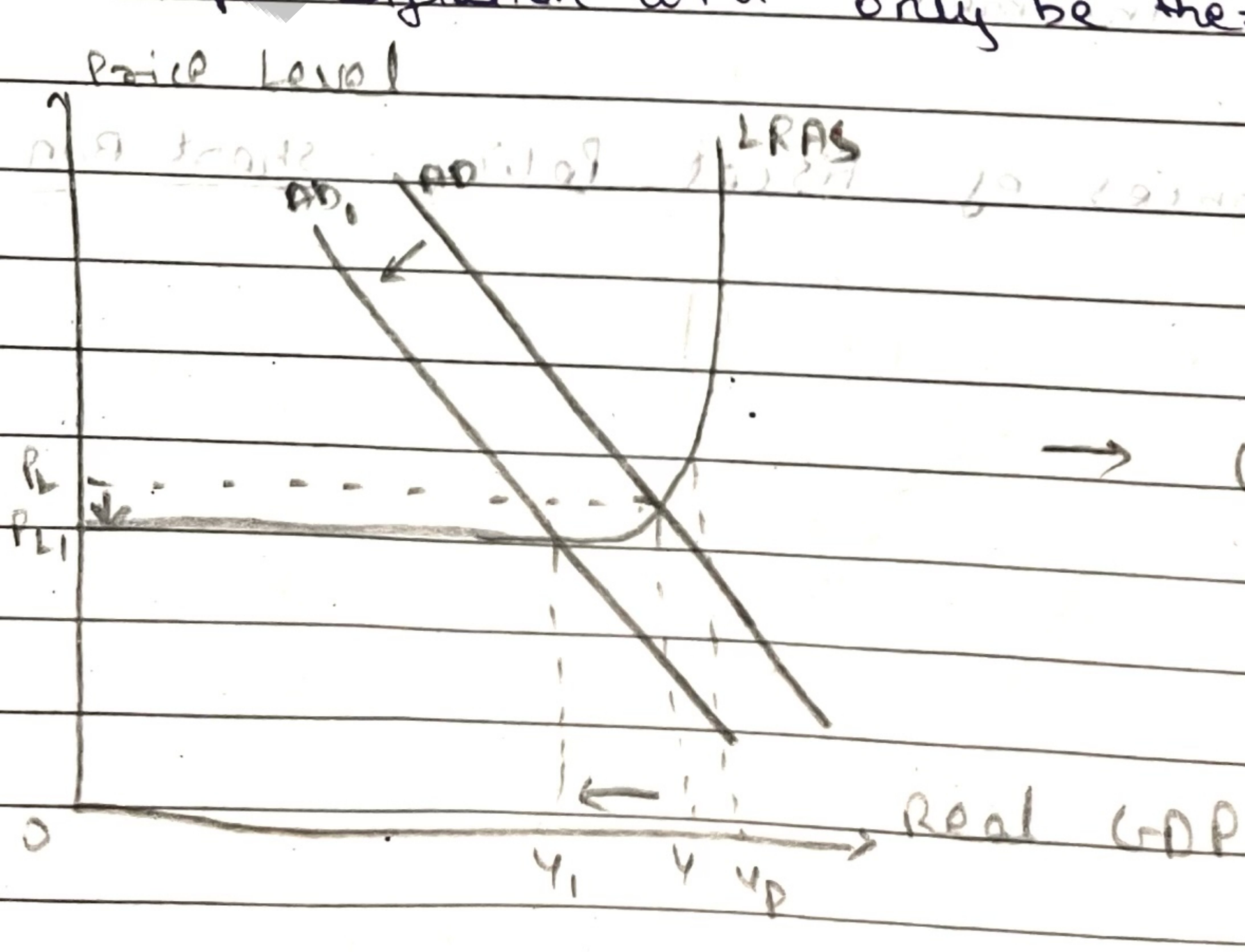
→ Contractionary

* Consequencies - Long Run



Expansionary

~~Expo~~ Inflation will only be there in section
and 3.



→ Contractionary

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* Automatic Stabalizers

→ These are the factors that automatically, without any action by government, work towards stabalizing the economy by reducing the short-term fluctuation of the business cycle.

Types of Automatic Stabalisers :-

1] Progressive Taxation - During Boom
2] Transfer Payments - During Recession.

* Evaluation of Fiscal Policy

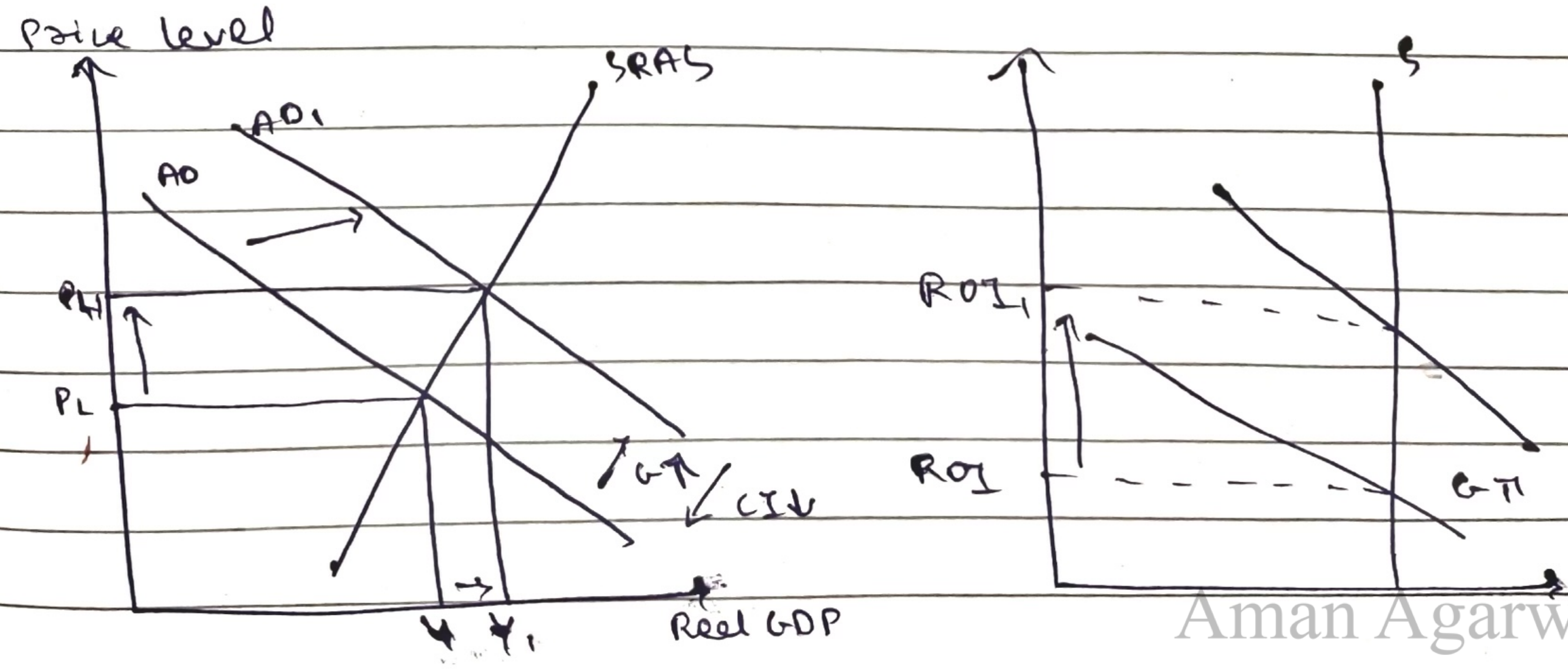
→ Positives

- Pulling an economy out of deep recession.
- Ability to deal with escalating inflation.
- Ability to target sectors of the economy.
- Ability to affect supply in the long run. [LRAS]

→ Negatives = - In a recession, tax ~~cut~~ cuts may not be effective

- Time lag
- Political constrains
- Crowding out.
- Inability to deal with supply-side causes of instability

* Crowding out



→ EFP

→ Because of increase in government spending the AD increases. For government to increase its spending it may borrow more from the central bank, hence more money will be supplied. This will lead to an increase in the rate of interest, which makes borrowing expensive in the economy. This leads to decrease in the investment and or consumption in the economy, leading to decrease in the AD, nullifying the effect of the expansionary fiscal policy.

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* Monetary Policy *

→ Monetary policy refers to the use of changes in the money supply in order to influence the economy.

→ Monetary policy is controlled by the central bank.
→ It is a demand-side policy.
→ It will influence the economy by making AD shift.

→ An expansionary monetary policy is a monetary policy in which the central bank increases the money supply in order to increase AD. It will bring the interest rates down.

→ ~~An~~ A contractionary monetary policy aims to decrease the money supply in order to decrease AD. It will ~~bring~~ push the interest rates up.

* The Transmission Mechanism

1] Expansionary

Increase in the money supply → Decrease in the interest rate → Increase in the C, I and NX → Increase in AD

2] Contractionary

Decrease in the money supply → Increase in the interest rate → Decrease in the C, I and NX → Decrease in AD

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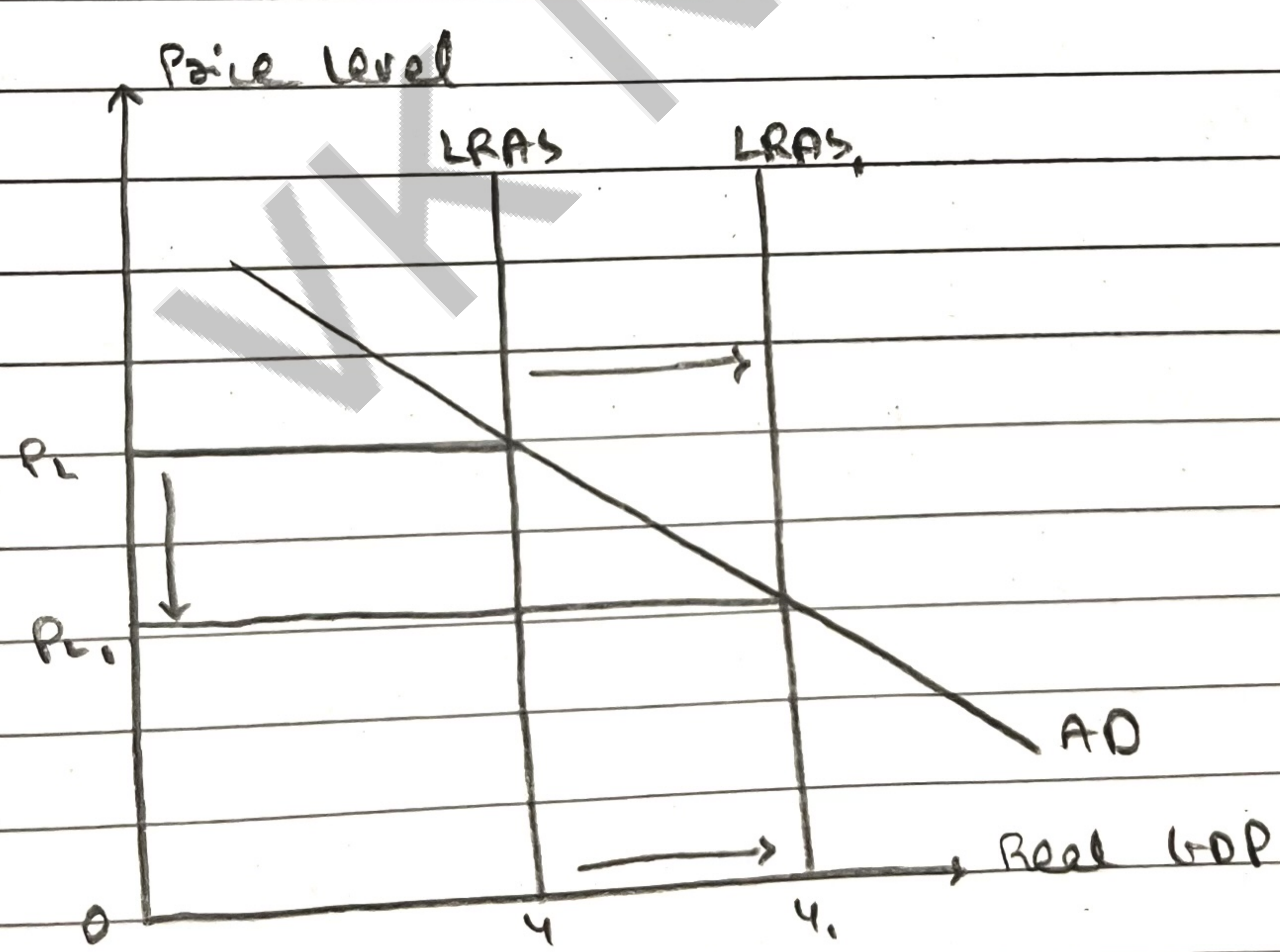
* Supply-side policies *

→ Supply-side policies aim to increase production and supply by shifting the LRAS curve to the right hence increasing the economy's potential output and long-run economic growth.

* Methods and tools of supply side policies

- Investment in human capital - training, education and Healthcare.
- Investment in Technology
- Privatisation
- Deregulation
- Labour market reforms - Decrease minimum wages, decrease trade unions power



* Objectives and Diagrams are same as fiscal policy.

* Evaluation of monetary policy
- **Advantages**

- Relatively quick implementation
- Central bank independence
- No crowding out.

- **Negatives**

- Time lag.
- Possible ineffectiveness during recession.

* **Inflation targeting**
+ It is public announcement of numerical target of inflation by the central bank.

* Evaluation of supply-side policies

- Positives
  - Increases potential output
  - Decreases inflationary pressure.

- Negatives
  - time lag
  - Is of no use in the short run
  - could cause a budget deficit