

Fiscal Policy

1 Instruments

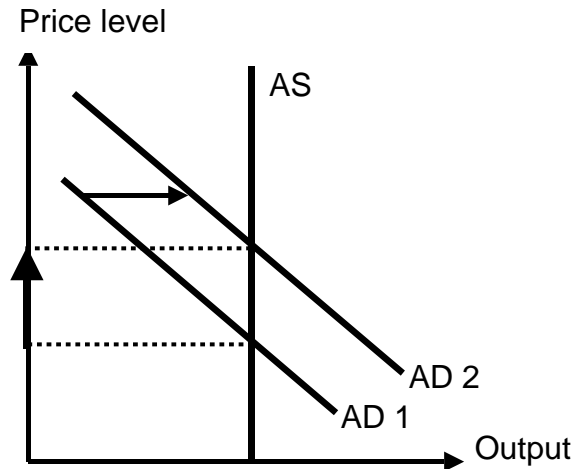
- Government spending (G)
- Taxes (T)

Using these instruments aggregate demand (AD) is changed.

2 Impact on the price level and on output

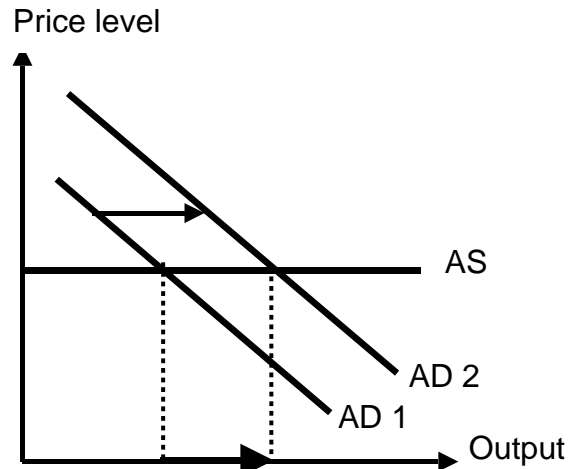
The impact depends on aggregate supply (AS). In the cases 21 to 23 we assume fiscal policy during a recession.

21 AS is vertical (prices flexible)



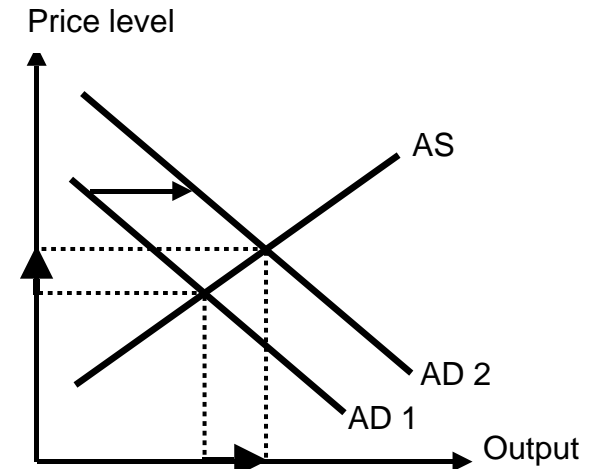
Result
Fiscal policy is totally ineffective. Only the price level is increased.
(View by classical economists / long term)

22 AS is horizontal (prices sticky)



Result
Fiscal policy is totally effective. Output is increased without a higher price level.
(View by Keynesian economists)

23 AS is upward sloping



Result
Fiscal policy is partially effective. Output and price level are increased.