

Macroeconomic Stabilization Policy

Government's attempt to change AD demand and thus the level of real GDP, unemployment and price level.

1. Discretionary
action must be taken

2. Automatic stabilizer
NO action needed

Fiscal Policy

Monetary Policy

Done by: president and congress.

Done by: the fed, reserve

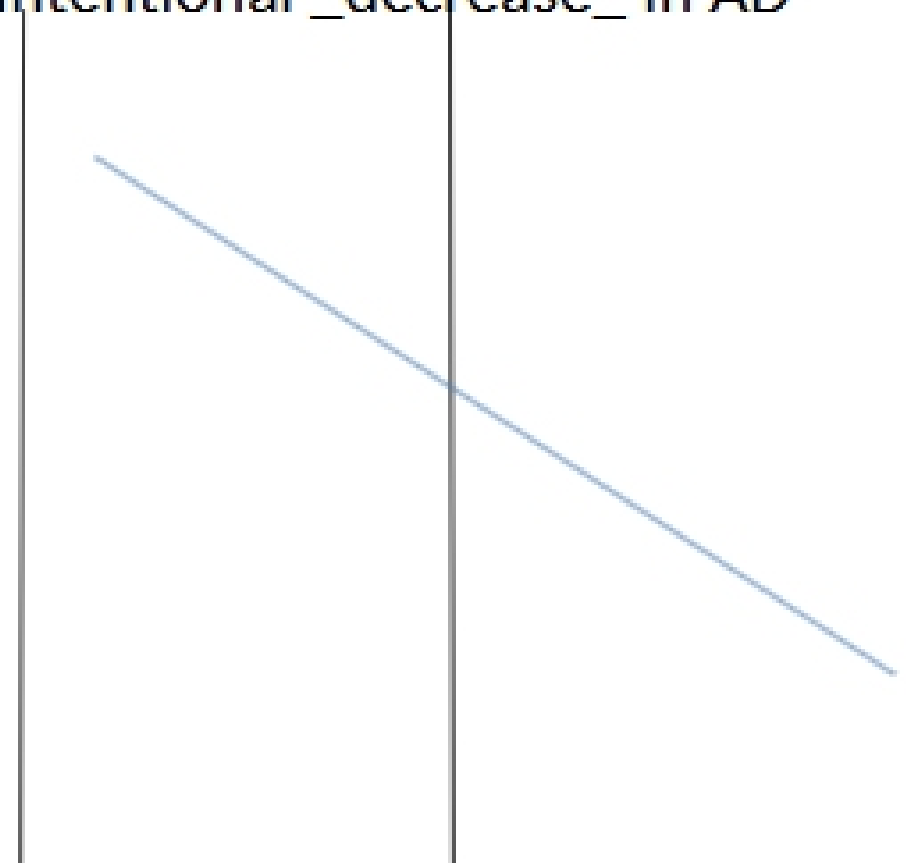
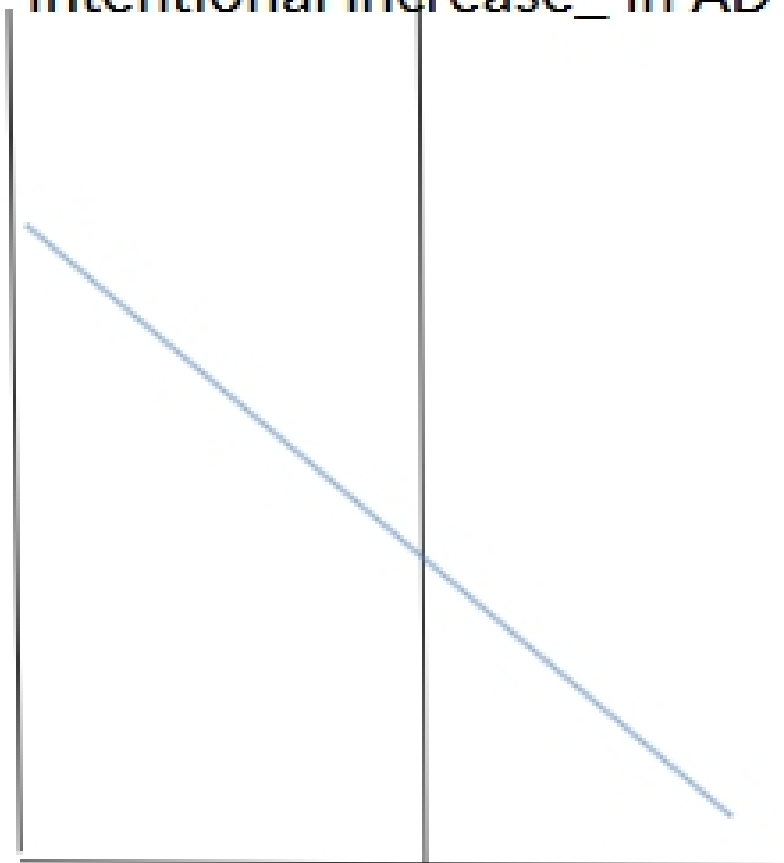
- Goals:
1. Steady, sustainable growth (long run)
 2. Low unemployment, 4%-6%
 3. Low inflation 2%

Expansionary Policy

Contractionary

Intentional increase in AD

Intentional decrease in AD



Should be done if:

should be done if:

Y Less than Y_N

Y _____ Y_N

U _____ U_N

U _____ U_N

Inflation is _____

Inflation is _____

Policy is much more complicated when we have _____.

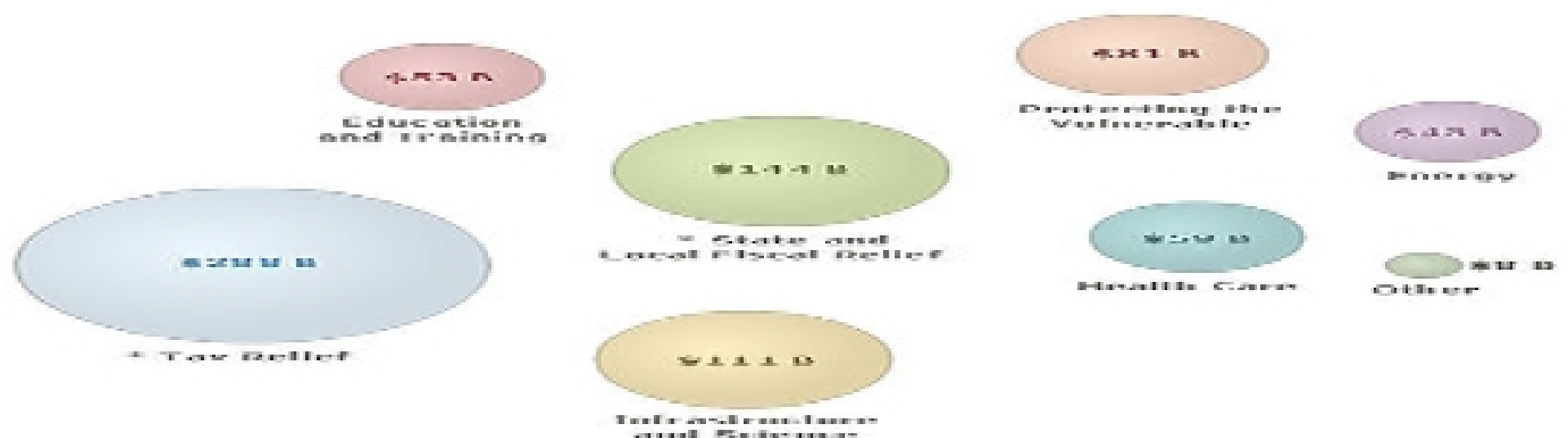
3 Discretionary Fiscal Policy Tools.

1. Changes in Govt. spending such as spending on infrastructure, defense, edu., Health care will Directly affect AD.
2. Changes in taxes will affect disposable income, which will in turn affect consumption and thus AD.
3. Changes in transfer payments will also affect income and affect consumption and AD.
For example: voting to extend unemployment.
Compensation beyond 6 months...

Expansionary Fiscal - An increase in G and/or TP or a decrease in taxes. Will Shift AD out.

Contractionary Fiscal - An decrease in G and/or TP or a increase in Taxes: will shift AD inward.

Obama's Fiscal Policy: 2010 - 737 Billion Recovery Act



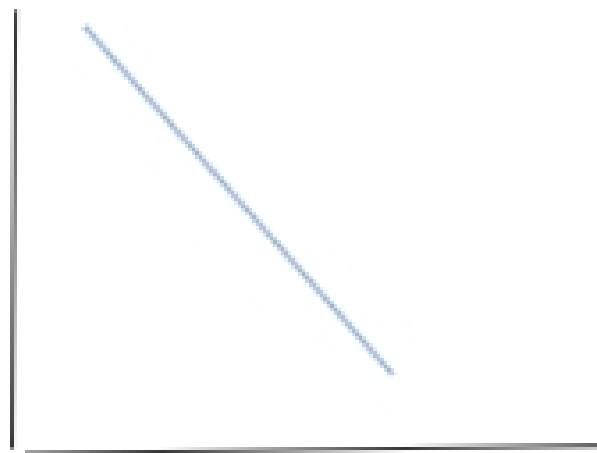
↳ Fiscal policy has three affects.

I. **Direct Expenditure effect** –

- If Government spending changes AD changes as much as the change in G.
- If Taxes or Transfer Payments change, AD changes less since people don't spend all of the extra income.

II. **Multiplier Effect** – Increases in Government spending (or other types of spending) will lead to increases in RGDP that are greater than the initial Change in Spending. Due to additional increases in income and thus consumption.

- If the government spend \$100 B on planes from Boeing, Boeing revenue increases by \$ \$100 B.
- This is distributed to Boeing's workers (as wages) and owners (as profits or stock dividends).
- This extra consumption causes increases in AD.



Increase in G by \$100 shifts the AD curve out by .1 T to AD_1 .
However, the increase in Income causes C to increase which