MACROECONOMICS AT WORK EXERCISE

FISCAL POLICY AND THE MULTIPLIER

REFERENCE: 'The smart fiscal policy that's needed now' (by Margaret Popper), *BusinessWeek*, 2 September 2002, pp. 32–3.

CHAPTERS RELEVANT TO THIS EXERCISE: Chapters 12, 15.

OVERVIEW

This article, written in the context of the US economy, notes that fiscal policy has not been used extensively in recent years, partly because of the delays and lags associated with implementing policies and partly because *monetary* policy has been seen as an effective alternative way of regulating the aggregate level of economic activity and inflation (see also pp. 352–3). It is argued, however, that present circumstances — the 'economic malaise' of 2002 — may be such that appropriate fiscal policy is called for. 'Smart' fiscal policy is defined in terms of sharply increased government spending (G), directed to areas where there is a high multiplier effect, in conjunction with tax cuts of the sort likely to have a substantial positive effect on private consumption and investment spending (C and I).

QUESTIONS

1. Analyse the statement in the article that 'for the past 25 years Americans have relied on the Federal Reserve to set the economy right'?

2. Why is it argued that monetary policy may not be the 'right way to deal with the economic malaise of 2002'?

3. What are the main elements in the fiscal policy suggested in the article? What is implied in the suggestion that 'it's not the time to worry about the deficit'?

4. What types of *government expenditure* are considered most effective in increasing GDP? Explain the (somewhat unscholarly) concept of expenditure that gives the 'most bang for the buck'.

5. What types of *tax cuts* are argued to be the most effective in stimulating the economy?

6. How relevant is the analysis to the Australian situation?