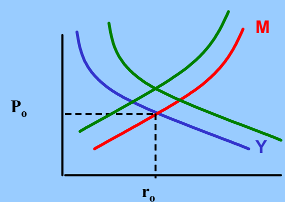
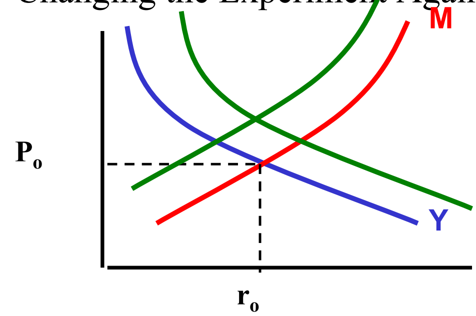
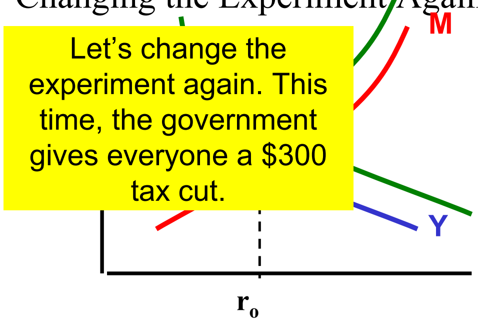
Fiscal Policy-Part 2



Changing the Experiment Again

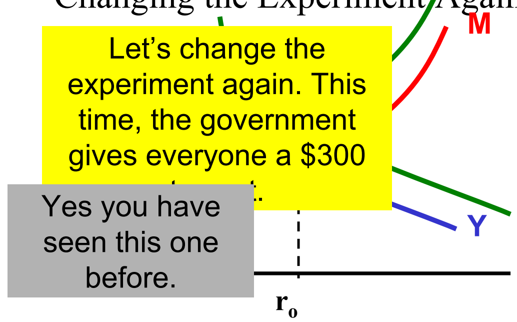


Changing the Experiment Again



Let's change the experiment again. This time, the government gives everyone a $300 tax cut.

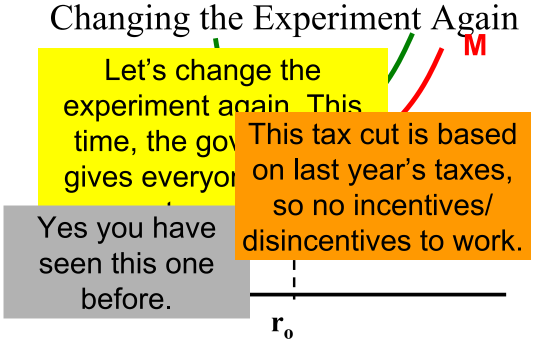
Changing the Experiment Again



Let's change the experiment again. This time, the government gives everyone a $300

Yes you have seen this one before.

Changing the Experiment Again

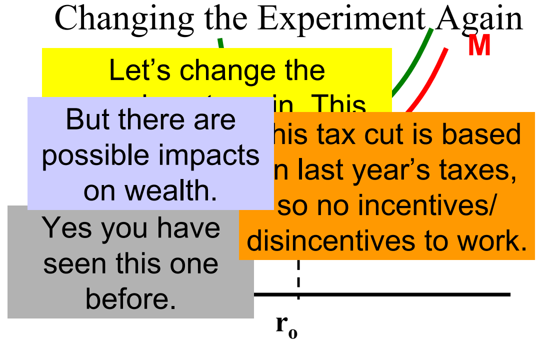


Let's change the experiment again. This time, the gov gives everyo

Yes you have seen this one before.

This tax cut is based on last year's taxes, so no incentives/ disincentives to work.

Changing the Experiment Again



Let's change the

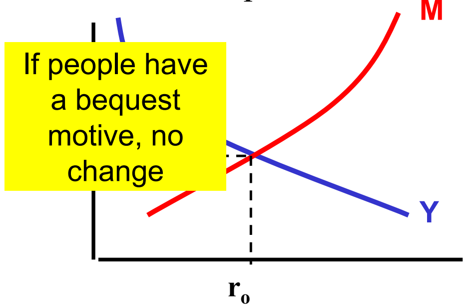
in. This

But there are possible impacts on wealth.

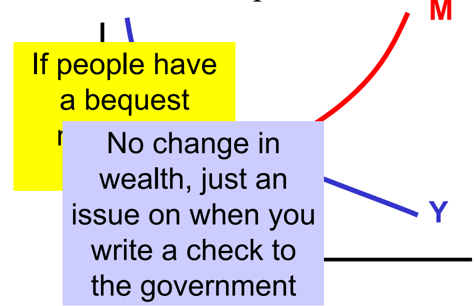
Yes you have seen this one before.

his tax cut is based n last year's taxes, so no incentives/ disincentives to work.

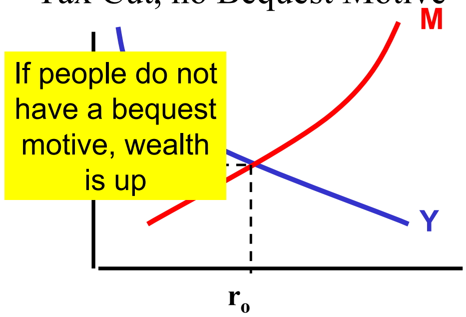
Tax Cut, Bequest Motive



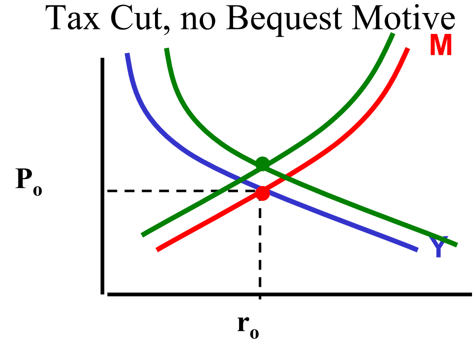
Tax Cut, Bequest Motive



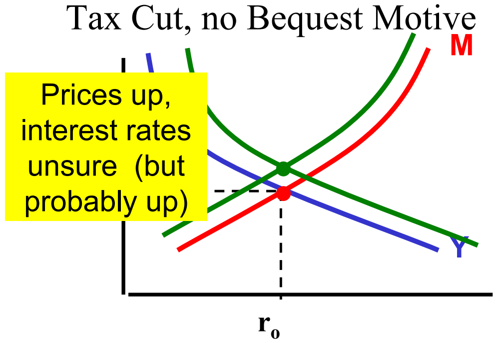
Tax Cut, no Bequest Motive



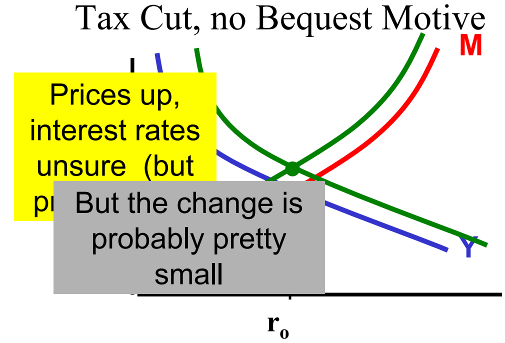
Tax Cut, no Bequest Motive

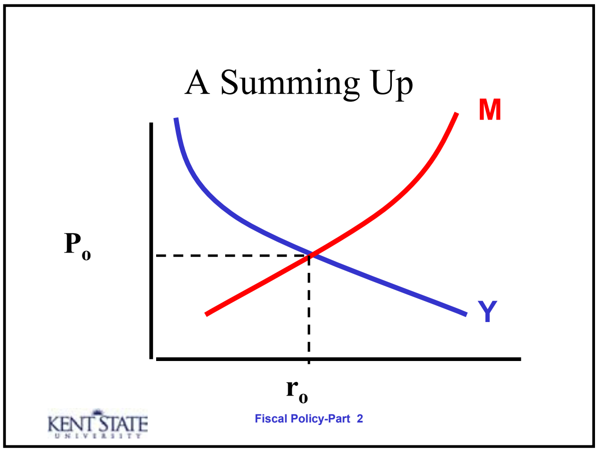


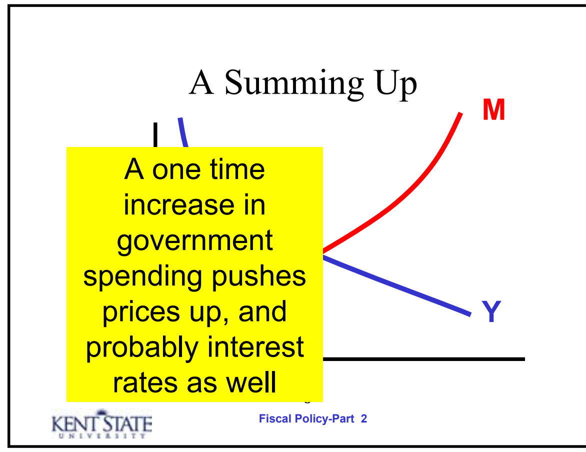
Tax Cut, no Bequest Motive

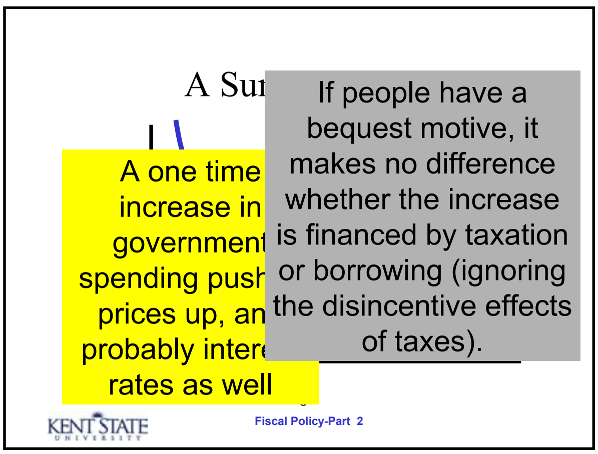


Tax Cut, no Bequest Motive




A Summing Up
M
P₀
Y
r₀
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Summing Up
M
A one time increase in government spending pushes prices up, and probably interest rates as well
Y
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Su
A one time
increase in
government
spending push
prices up, an
probably inter
rates as well
If people have a bequest motive, it makes no difference whether the increase is financed by taxation or borrowing (ignoring the disincentive effects of taxes).
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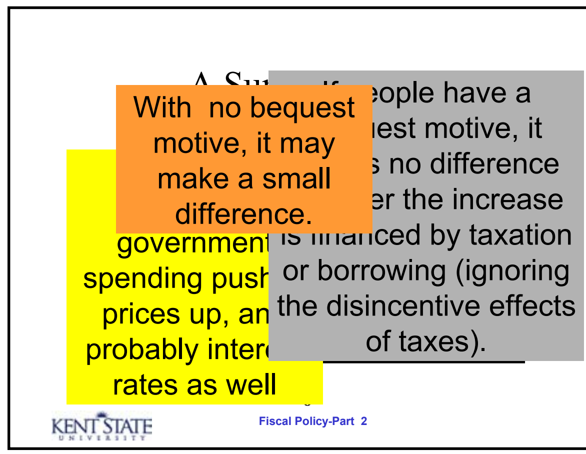
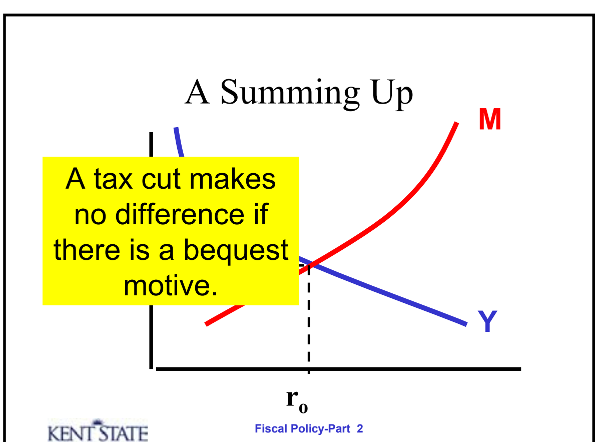
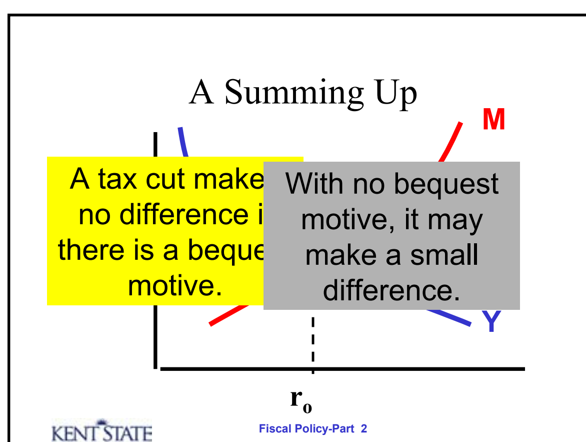
Fiscal Policy-Part 2


With no bequest motive, it may make a small difference.
eople have a
est motive, it
s no difference
er the increase
or borrowing (ignoring
the disincentive effects
of taxes).
government
spending push
prices up, an
probably inter
rates as well
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Summing Up
M
A tax cut makes no difference if there is a bequest motive.
Y
r₀
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Summing Up
M
A tax cut make
no difference i
there is a beque
motive.
With no bequest motive, it may make a small difference.
Y
r₀
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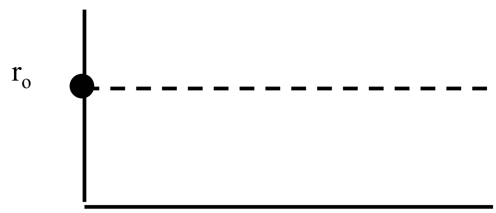
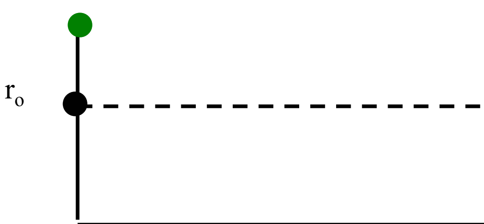
Long Run Effects

- Let's go back to our tax-financed spending increase.
- This is a temporary change.
- Its effects will eventually dissipate.

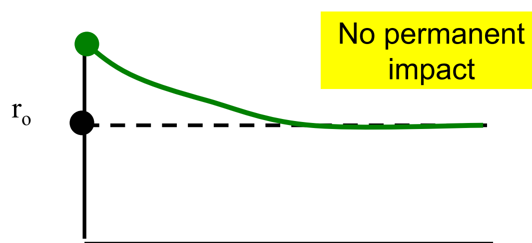
Long Run Effects



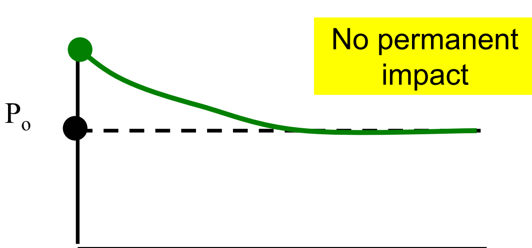
Long Run Effects



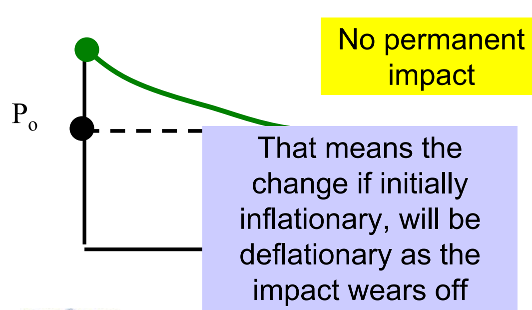
Long Run Effects

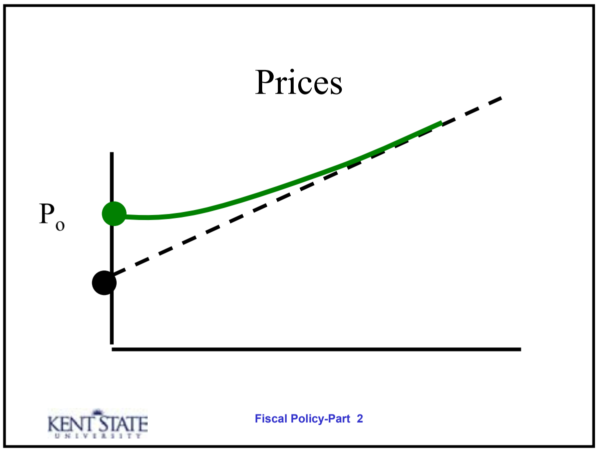


Prices



Prices




Prices
P$_o$
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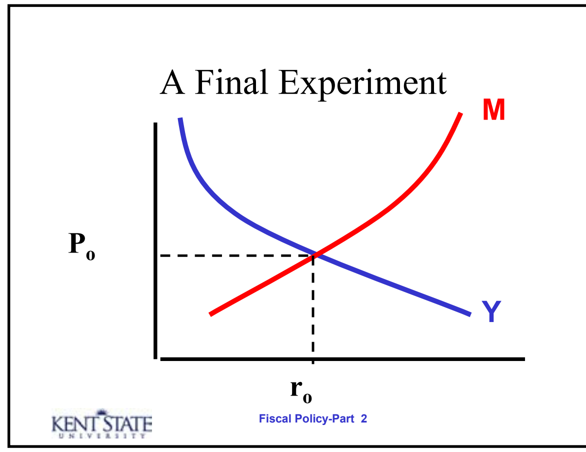
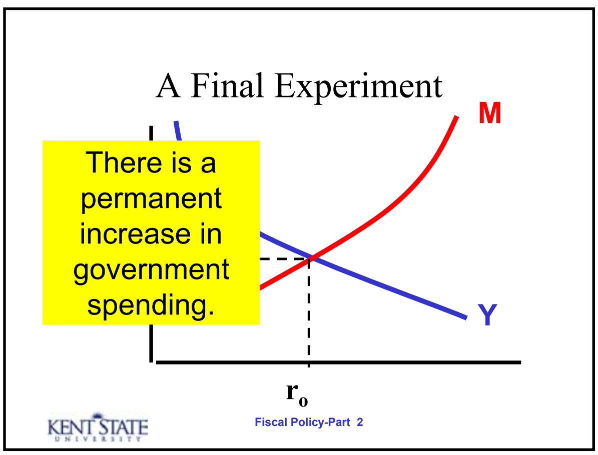
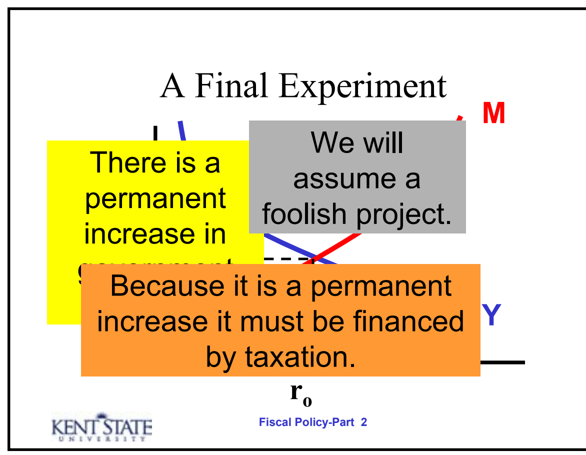
Fiscal Policy-Part 2


A Final Experiment
M
P$_o$
Y
r$_o$
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Final Experiment
M
There is a permanent increase in government spending.
Y
r$_o$
KENT STATE UNIVERSITY
Fiscal Policy-Part 2


A Final Experiment
M
There is a permanent increase in
We will assume a foolish project.
Because it is a permanent increase it must be financed by taxation.
Y
r$_o$
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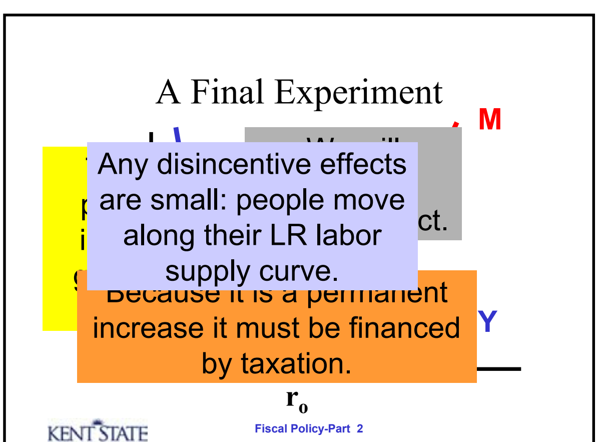
Fiscal Policy-Part 2


A Final Experiment
M
Any disincentive effects are small: people move along their LR labor supply curve.
increase it must be financed by taxation.
Y
r$_o$
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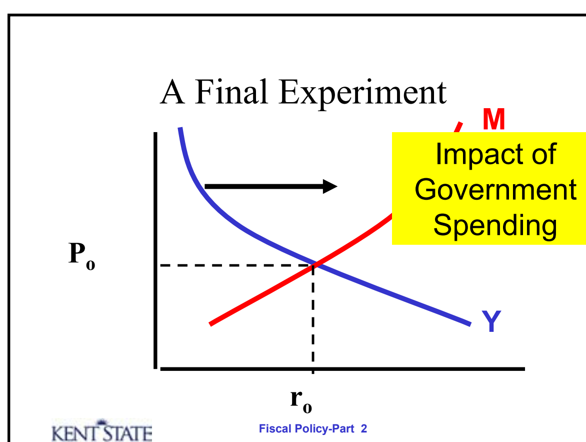
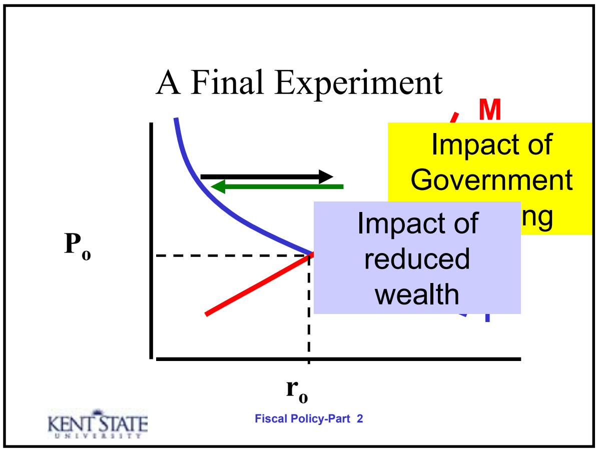
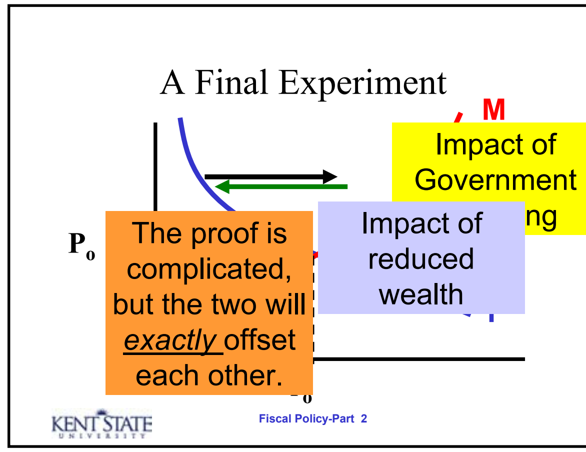
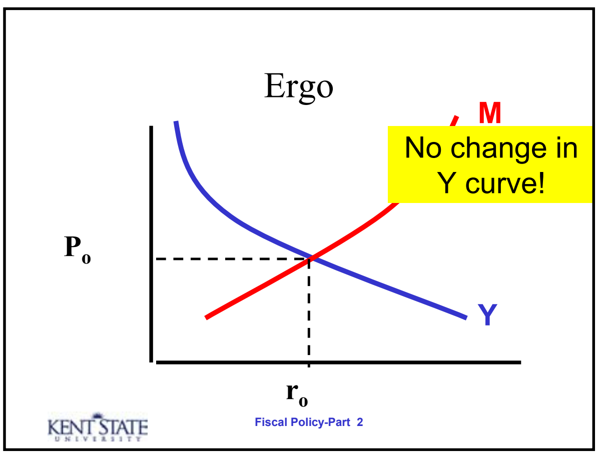
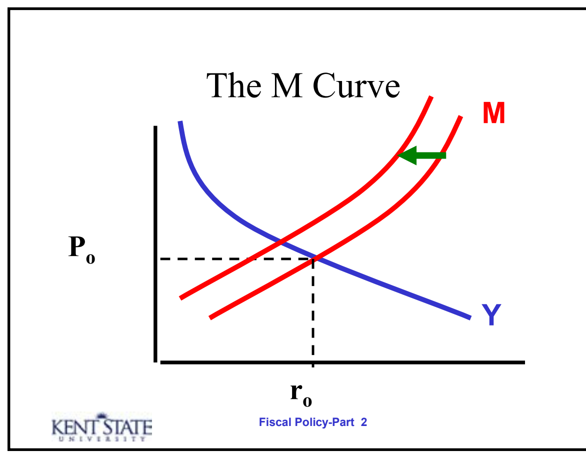
Fiscal Policy-Part 2

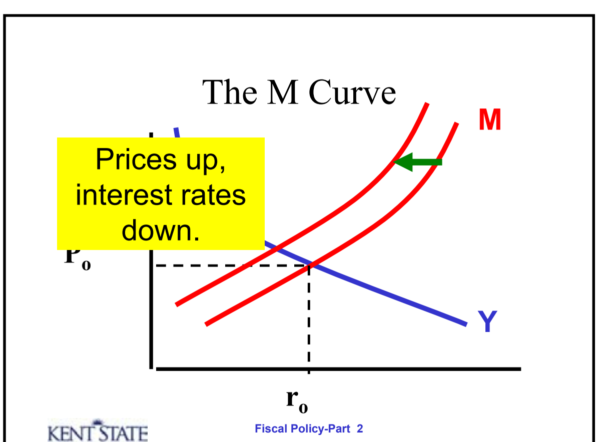

A Final Experiment
M
Impact of Government Spending
P$_o$
Y
r$_o$
KENT STATE UNIVERSITY
Fiscal Policy-Part 2

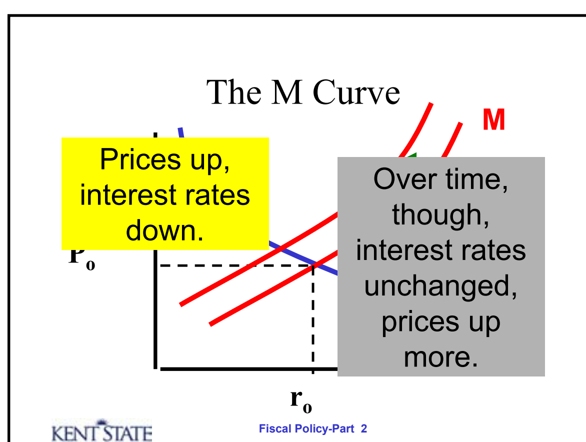

A Final Experiment
M
Impact of
Government
ng
Impact of
reduced
wealth
P$_o$
r$_o$
Fiscal Policy-Part 2


A Final Experiment
M
Impact of
Government
ng
The proof is
complicated,
but the two will
exactly offset
each other.
Impact of
reduced
wealth
P$_o$
Fiscal Policy-Part 2


Ergo
M
No change in
Y curve!
P$_o$
Y
r$_o$
Fiscal Policy-Part 2


The M Curve
M
P$_o$
Y
r$_o$
Fiscal Policy-Part 2


The M Curve
M
Prices up,
interest rates
down.
Y
r$_o$
Fiscal Policy-Part 2


The M Curve
M
Prices up,
interest rates
down.
Over time,
though,
interest rates
unchanged,
prices up
more.
r$_o$
Fiscal Policy-Part 2

End