

Answer on Question #44873 – Economics – Macroeconomics

Suppose the economy is stagnant or deflationary and government wish to stimulate it through stimulating demand, which fiscal policy tools could be implemented?

Solution

Expansionary fiscal policy involves government spending exceeding tax revenue, and is usually undertaken during recessions. Keynesian economics suggests such policy of increasing government spending and decreasing tax rates as the best ways to stimulate aggregate demand, and decreasing spending and increasing taxes after the economic boom begins. Keynesians argue this method be used in times of recession or low economic activity as an essential tool for building the framework for strong economic growth and working towards full employment. In theory, the resulting deficits would be paid for by an expanded economy during the boom that would follow; this was the reasoning behind the New Deal.