Fiscal Policy and Problem with Budget Deficits

Fiscal policy is when the government manipulates its spending and taxation in order to manage the level of aggregate demand and therefore the level of economic growth.

Aggregate demand is made up of different components, Consumption, Investment, Government Spending and net Exports.

Hence the formula AD = C + I + GS (Or just simply G) + (X-M)

Anyway, to put it simply, there may be two problems in the economy.

(1): the economy may be overheating (Which means that there may be quick growth, which you may think it good but..) which leads to inflation or even worse hyper-inflation.

(2): the economy may be weak due to not enough demand.

The solutions?

(1) The solution to this is **loosening** the fiscal policy

To do this the government would have to **increase** its spending (Governement Spending) or **cut** its tax

This would lead to and increase in Aggregate Demand and a rightward shift in AD (On the AD diagram) which would mean more jobs.

Further evaluation?

With more spending made by the government they can help build all sorts of things and eventually help the long term growth of the country and economy. This can be such as schools or roads, these can help the long time needs of the country such as students who in the long term are going to be assets to help the growth of the country.

Cutting tax will lead to people in the country having extra disposable income and therefore the people will (hopefully) spend their money in the country and help boost the country's economy.

The problem with this is that some countries take it too far and therefore cause problems with the country's debt. They aren't raking in as much tax as before and therefore their debt is increasing which obviosuly hurts the country.

(2) The solution to this is **tightening** the fiscal policy