Evaluating Fiscal Policy

Strengths of Fiscal Policy

- Is accredited with pulling the economy out of the Great Depression.
- Can deal with rapid and escalating inflation
- Ability to target sectors of the economy
    - Examples: education, health care, infrastructure, public goods
- Direct impact of government spending on AD
- Ability to affect potential output

Weaknesses of Fiscal Policy

- There is a lag until the problem is recognized by the government, appropriate policy is decided upon, and the policy takes effect in the economy.
- Political restraints: tax increases are politically unpopular and may be avoided even if necessary
- Crowding out (higher interest rates can lead to lower investment spending by private firms)
- **Inability to deal with supply-side causes of instability**
- In a recession, tax cuts may not be effective in increasing AD
- Fiscal policy can lead the economy in a general direction, but cannot fine tune the economy.