

DISCUSSION QUESTION

Name:

Instructor:

Course:

Politicians often compare government budgets to household budgets. For example, in 2013, House Speaker, John Boehner said “Every family in America has to balance their budget. Washington should too.” Source: <http://www.npr.org/sections/itsallpolitics/2013/03/19/174762184/how-the-federal-budget-is-just-like-your-family-budget-or-not>

- a) How accurate is this analogy? What are some important differences between household budgets and the federal government's budget?
- b) Why might it be more acceptable for the federal government to continue to run a budget deficit compared to a household?

PEER GROUP PROBLEM SOLVING

Name:

Instructor:

Course:

Categorize each of the following scenarios into one of the following four groups:

- A. Expansionary fiscal policy
 - B. Contractionary fiscal policy
 - C. Automatic stabilizer
 - D. Not related to fiscal policy
-
- 1. A decrease in government expenditures on education
 - 2. A decrease in the age at which citizens are eligible to receive Social Security benefits
 - 3. An increase in the highest marginal income tax rate
 - 4. An increase in the number of people who receive unemployment benefits
 - 5. An increase in interest rates
 - 6. An increase in infrastructure spending
 - 7. A decrease in the number of people collecting food stamps
 - 8. An increase in environmental standards for energy producers
 - 9. A decrease in the corporate tax rate
 - 10. An increase in the number of patents awarded to corporations

IN-CLASS EXPERIMENT / ACTIVE EXERCISE

Have students form groups of four or five and consider the following:

Your group is in charge of fiscal policy for an economy. You have four options:

1. Do nothing
2. Employ contractionary fiscal policy: increase taxes and/or decrease government spending
3. Employ expansionary fiscal policy: decrease taxes and/or increase government spending
4. Uncertain.

Suppose the economy faces the following economic conditions. Your group must determine what the appropriate fiscal policy is for each scenario. Explain why you chose each option.

- a) Unemployment is 8% and inflation is 1%
- b) Unemployment is 3% and inflation is 8%
- c) Unemployment is 4% and inflation is 2%
- d) Unemployment is 10% and inflation is 10%

SOLUTIONS AND INSTRUCTOR NOTES

Discussion Question

Politicians often equate government budgets with household budgets. For example, in 2013, House Speaker John Boehner said “Every family in America has to balance their budget. Washington should too.” Source: <http://www.npr.org/sections/itsallpolitics/2013/03/19/174762184/how-the-federal-budget-is-just-like-your-family-budget-or-not>

- a) How accurate is this analogy? What are some important differences between household budgets and the federal government’s budget?

The analogy is not accurate. Most American families do not actually balance their budget. In addition, the government has the ability to increase taxes or print money – individuals and families do not

- b) Why might it be more acceptable for the federal government to continue to run a budget deficit compared to a typical household?

There are several reasons. For one, the federal government’s deficit is easier to continually finance through the selling of bonds. Also, since the federal government has the power to print money, even in cases of extreme financial stress, they can avoid defaulting on debts through monetization. The federal government also faces lower interest rates than a typical family. Furthermore, in times of recession, federal government deficit spending can be an important method of reducing the severity of the economic downturn.

Peer Group Problem Solving

Categorize each of the following into one of the following four groups:

- A. Expansionary fiscal policy
 - B. Contractionary fiscal policy
 - C. Automatic stabilizer
 - D. Not related to fiscal policy
1. A decrease in government expenditures on education: *B*
 2. A decrease in the age at which citizens are eligible to receive Social Security benefits: *A*
 3. An increase in the highest marginal income tax rate: *B*
 4. An increase in the number of people who receive unemployment benefits: *C*
 5. An increase in interest rates: *D*
 6. An increase in infrastructure spending: *A*
 7. A decrease in the number of people collecting food stamps: *C*
 8. An increase in environmental standards for energy producers: *D*
 9. A decrease in the corporate tax rate: *A*
 10. An increase in the number of patents awarded to corporations: *D*

In-Class Experiment / Active Exercise



Have students form groups of four or five and consider the following:

Your group is in charge of fiscal policy for an economy. You have four options:

1. Do nothing
2. Employ contractionary fiscal policy: increase taxes and/or decrease government spending
3. Employ expansionary fiscal policy: decrease taxes and/or increase government spending
4. Uncertain.

Suppose the economy faces the following economic conditions. Your group must determine what the appropriate fiscal policy is for each scenario. Explain why you chose each option.

The purpose of this activity is to get students to match macroeconomic conditions with the appropriate fiscal policy response. After students have had approximately five minutes to consider and discuss the questions ask for volunteers to present their answers to the class. As an additional activity, after students have explained their choices ask students to consider what other factors should be considered when determining fiscal policy. This can be used to introduce crowding out and timing lags. Here are some things to consider for each question:

- a) Unemployment is 8% and inflation is 1%

Unemployment is the larger problem here. If any policy is chosen, the appropriate response would be expansionary fiscal policy. This would increase AD, which should increase output and decrease unemployment, with the trade-off of higher inflation.

- b) Unemployment is 3% and inflation is 8%

Inflation is the larger problem here. If any policy is chosen, the appropriate response would be contractionary fiscal policy. This would decrease AD, which should decrease output and decrease inflation, with the trade-off of increased unemployment.

- c) Unemployment is 4% and inflation is 2%

Do nothing. There is no problem! Inflation and unemployment are both low.

- d) Unemployment is 10% and inflation is 10%

Uncertain. This situation depends on which you believe to be the bigger problem: unemployment or inflation. Policymakers must be particularly careful when faced with high unemployment and high inflation – any policy response to address one is likely to result in a short-run exacerbation of the other. In this scenario, doing nothing may be the best response.

For more in-class experiment and active learning ideas, visit www.econedactive.com.