

# Guided Reading Activity

## Fiscal Policy

### Lesson 1 *Demand-Side Policies*

#### Review Questions

**Directions:** Read each main idea and complete the statements below. Refer to your textbook as you write the answers.

#### A. Keynesian Economics

**Main Idea:** Fiscal policies are derived from Keynesian economics, an approach designed to lower unemployment by stimulating aggregate demand. John Maynard Keynes put forth these theories in 1936 and dominated the thinking of economists until the 1970s.

1. Keynes wrote his economic theories during the \_\_\_\_\_ of the 1930s. In his model, \_\_\_\_\_ is comprised of consumer spending, business spending, government spending, and the net foreign sector.
2. Due to the \_\_\_\_\_, a change in investment or business spending has a magnified effect on total spending.
3. An \_\_\_\_\_ is a change in investment spending caused by a change in \_\_\_\_\_ spending.

#### B. Impact of Demand-Side Policies

**Main Idea:** Keynes postulated that demand-side policies can have an impact on the economy as a whole and that an increase in spending would fight the combined effects of the multiplier and the accelerator.

1. According to Keynes, the only group big enough to influence overall spending was the \_\_\_\_\_. This spending could offset the decline in \_\_\_\_\_ spending. The government could also encourage spending more indirectly by lowering \_\_\_\_\_.
2. Keynes thought that a \_\_\_\_\_ - \_\_\_\_\_ budget deficit would be necessary to stop further economic decline, but that once the economy recovered, \_\_\_\_\_ would increase and the debt could be paid back.

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3. By the 1960s, many economists talked about \_\_\_\_\_ the \_\_\_\_\_, a term used to suggest that only a \_\_\_\_\_ amount of government spending was needed to initiate a bigger round of overall spending.
4. Programs that automatically trigger benefits if changes in the economy threaten income are called \_\_\_\_\_ . Some examples include the \_\_\_\_\_ tax and \_\_\_\_\_ insurance.
5. \_\_\_\_\_, or broad social programs that provide income supplements, act as a floor on \_\_\_\_\_ when economic times are difficult.

### C. Limitations of Demand-Side Policies

**Main Idea:** Keynes envisioned government spending as a counterbalance to changes in investment spending, and imagined governments could decrease spending as well as increase it. In reality, governments are not that flexible.

1. There is usually not enough \_\_\_\_\_ time for a government to immediately respond and offset an impending recession because of various \_\_\_\_\_.
2. The \_\_\_\_\_ lag occurs because it takes time to see the problem. The \_\_\_\_\_ lag happens because it takes time to agree on a solution. Finally, the \_\_\_\_\_ lag occurs because of the time it takes to actually approve projects and pump money into the economy.
3. Another limitation of Keynesian economics is that people can become more \_\_\_\_\_ on the government rather than their own skills. Also, the reality has been that while the government can \_\_\_\_\_ spending fairly easily, it rarely cuts back later.
4. Eventually, it's likely that a \_\_\_\_\_ will arrive when people decide that the burden of taxes needed to finance government expenditures will outweigh the benefits.

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### Summary and Reflection

**Directions:** Summarize the main ideas of this lesson by answering the question below.

What are some of the pros and cons of Keynesian economics?

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