Chapter 7: Policy Effectiveness

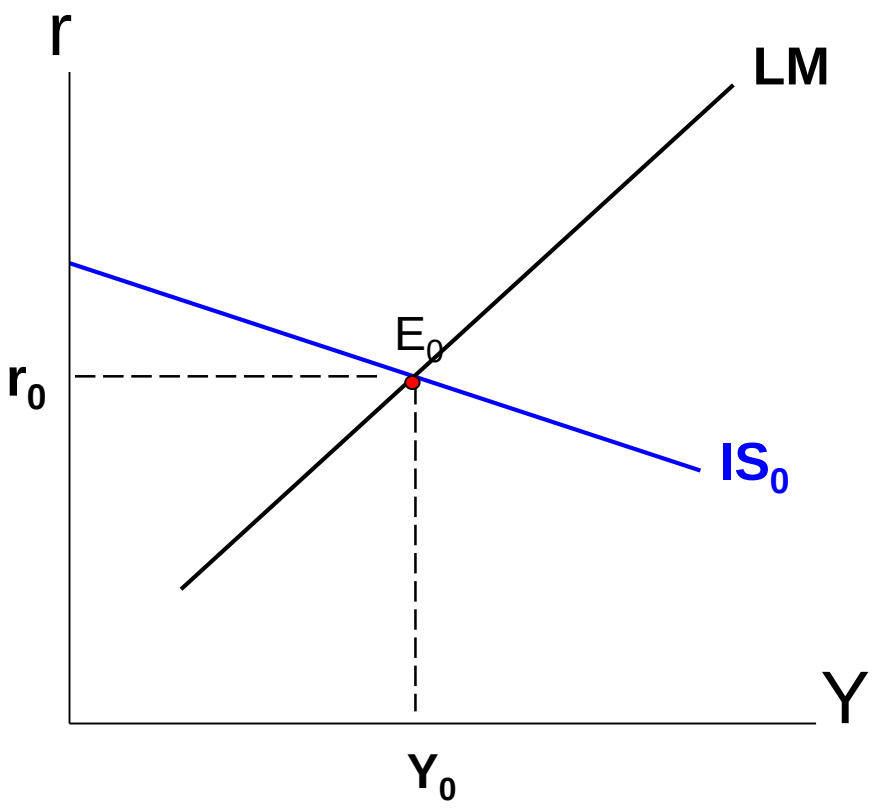
7.1 Fiscal Policy Effectiveness

7.1.1 Fiscal policy effectiveness and slope of IS curve

7.1.2 Fiscal policy effectiveness and slope of LM curve

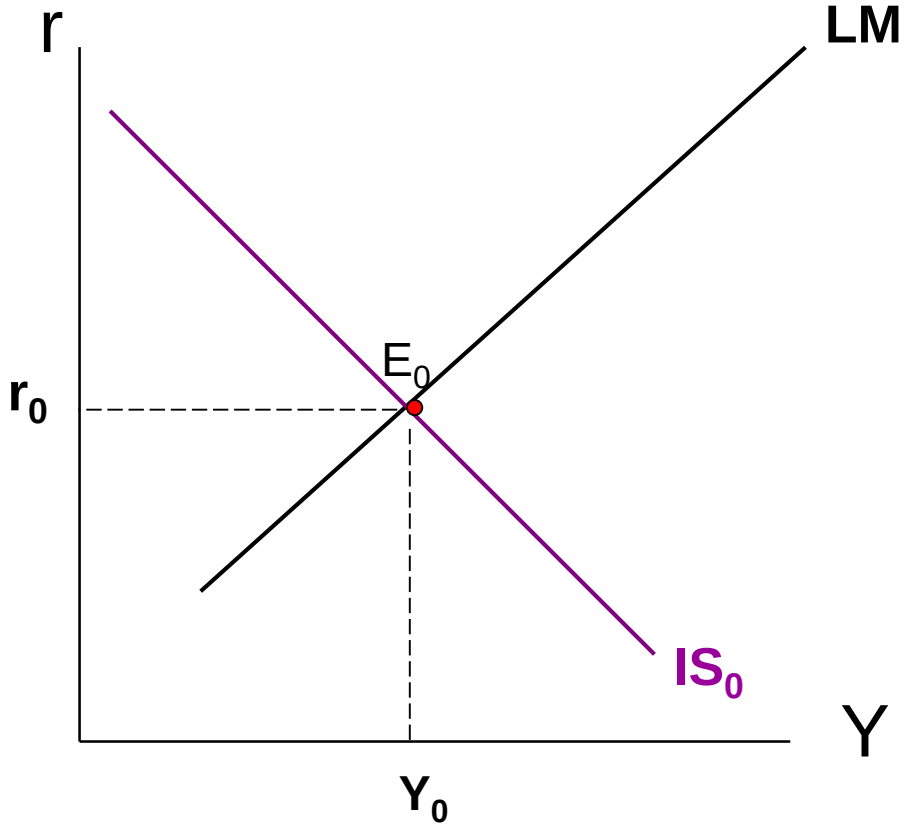
7.1.1 Fiscal policy effectiveness and slope of IS curve

(a) IS curve is quite flat



Y ↑

(b) IS curve is quite steep



Y ↑

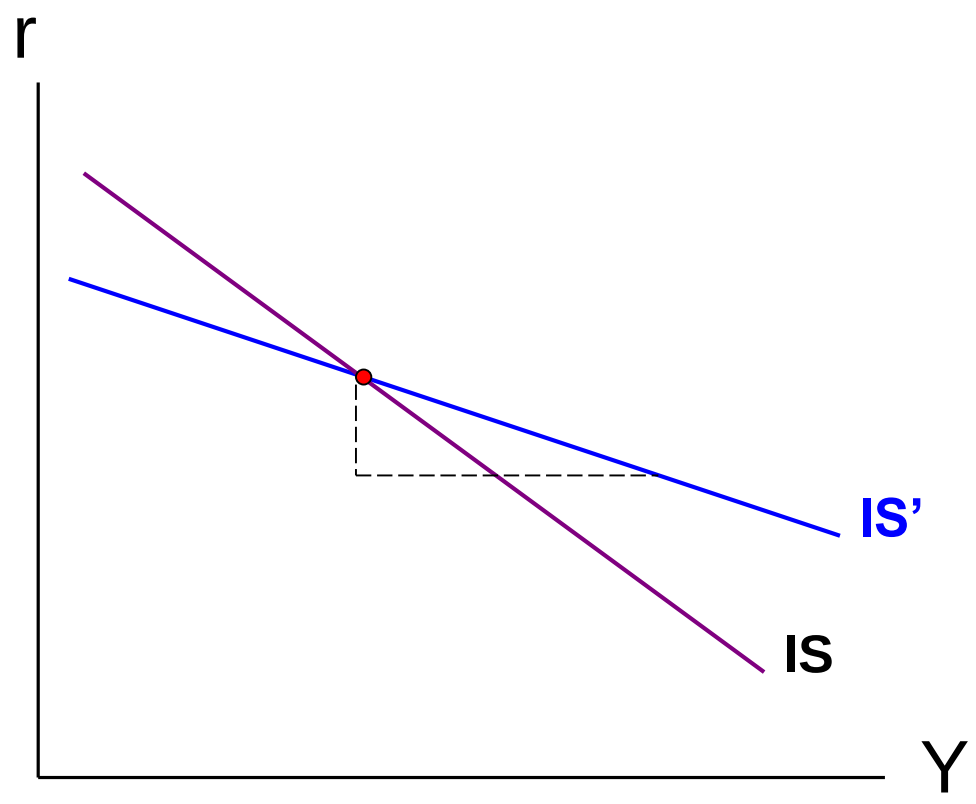
7.1.1 Fiscal policy effectiveness and slope of IS curve

(a) IS curve is quite flat: suppose due to high $\varepsilon_{I,r} = \frac{\Delta I}{\Delta r} \times \frac{r}{I}$

- G↑ ⇨ DAE ↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**

(b) IS curve is quite steep: suppose due to low $\varepsilon_{I,r} = \frac{\Delta I}{\Delta r} \times \frac{r}{I}$

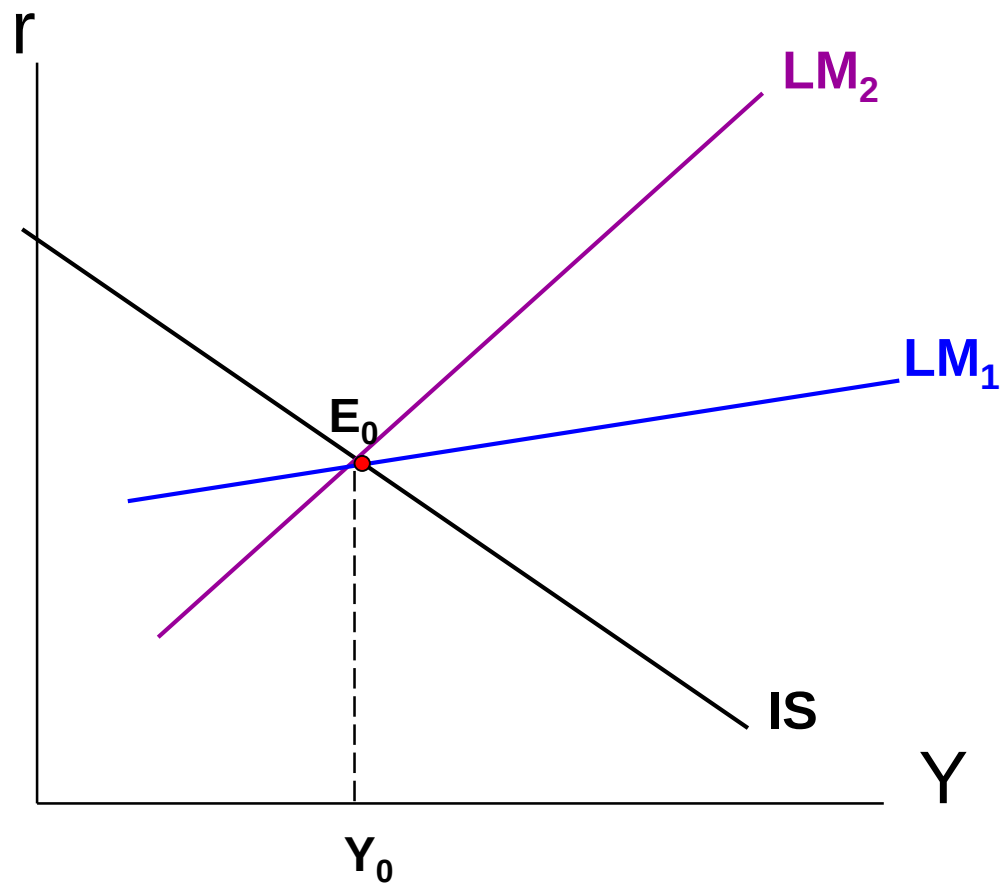
- G↑ ⇨ DAE↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨ Y
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**


r
IS'
IS
Y

7.1.2 Fiscal policy effectiveness and slope of LM curve

(a) LM is quite flat

(b) LM is quite steep



7.1.2 Fiscal policy effectiveness and slope of LM curve

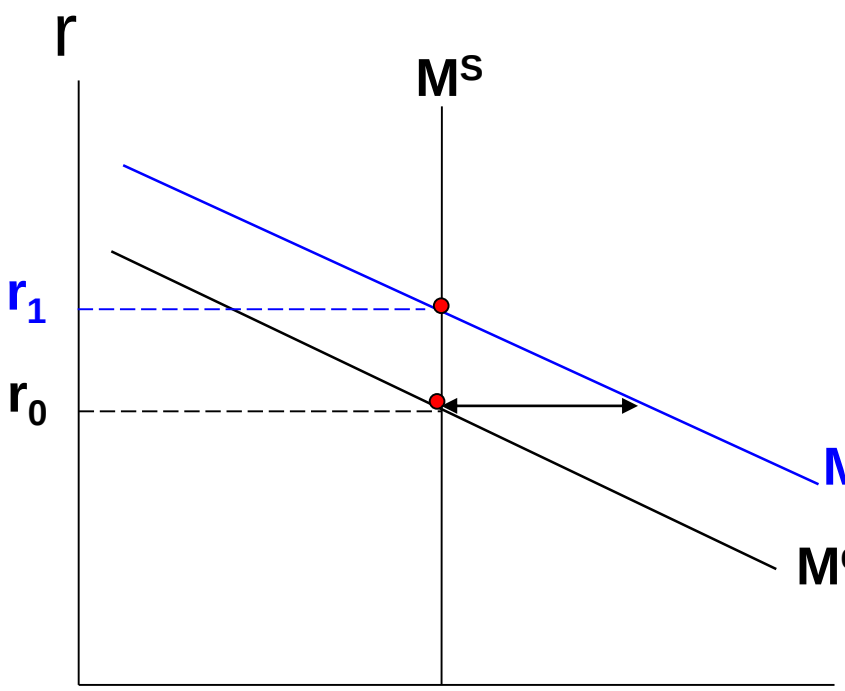
(a) LM curve is quite flat: suppose due to high $\varepsilon_{M^d,r} = \frac{\Delta M^d}{\Delta r} \times \frac{r}{M^d}$

- G↑ ⇨ DAE ↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**

(b) LM curve is quite steep: suppose due to low $\varepsilon_{M^d,r} = \frac{\Delta M^d}{\Delta r} \times \frac{r}{M^d}$

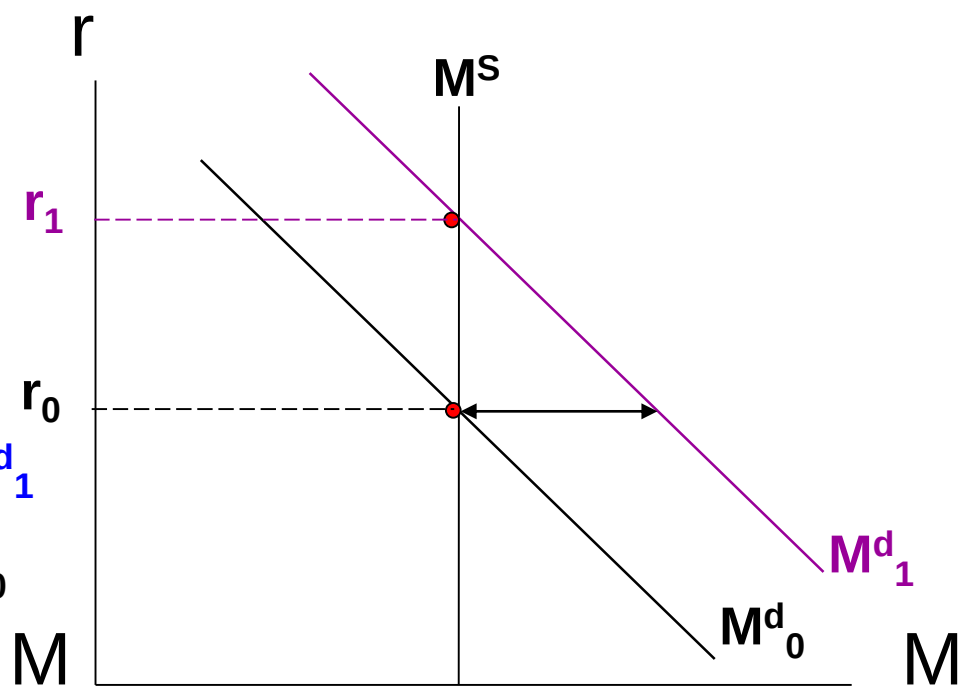
- G↑ ⇨ DAE↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨ Y
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**

$\varepsilon_{Md,r}$ high

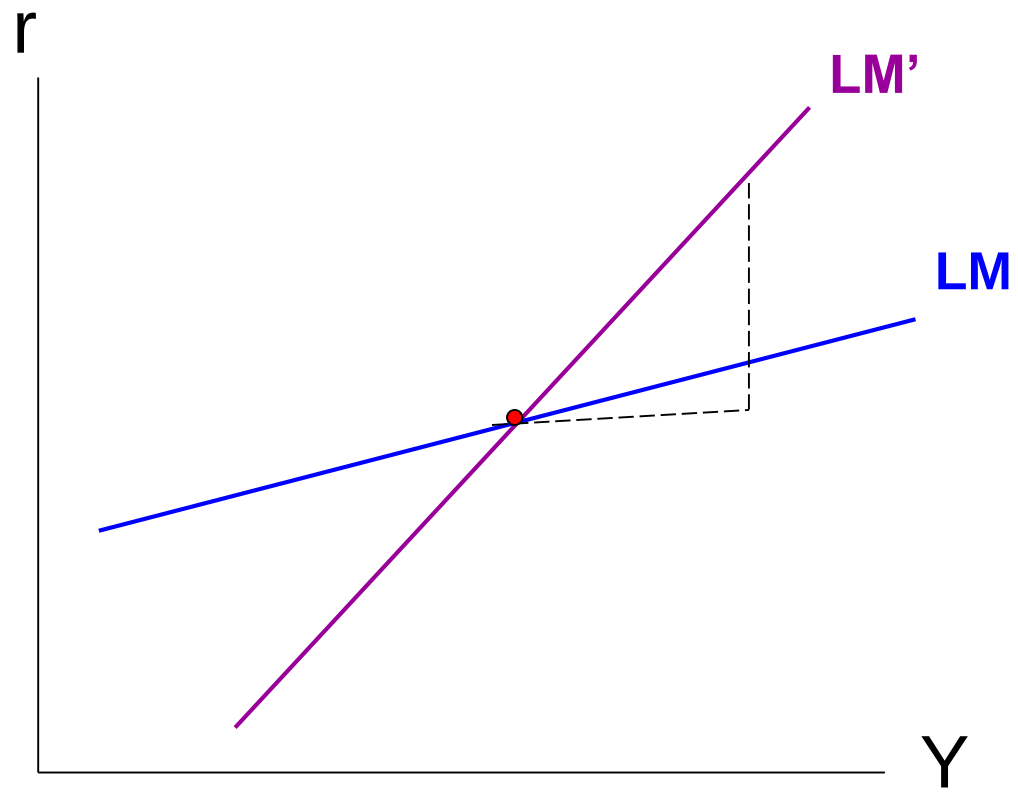


LM is quite flat

$\varepsilon_{Md,r}$ low



LM is quite steep


r
LM'
LM
Y

7.1.2 Fiscal policy effectiveness and slope of LM curve

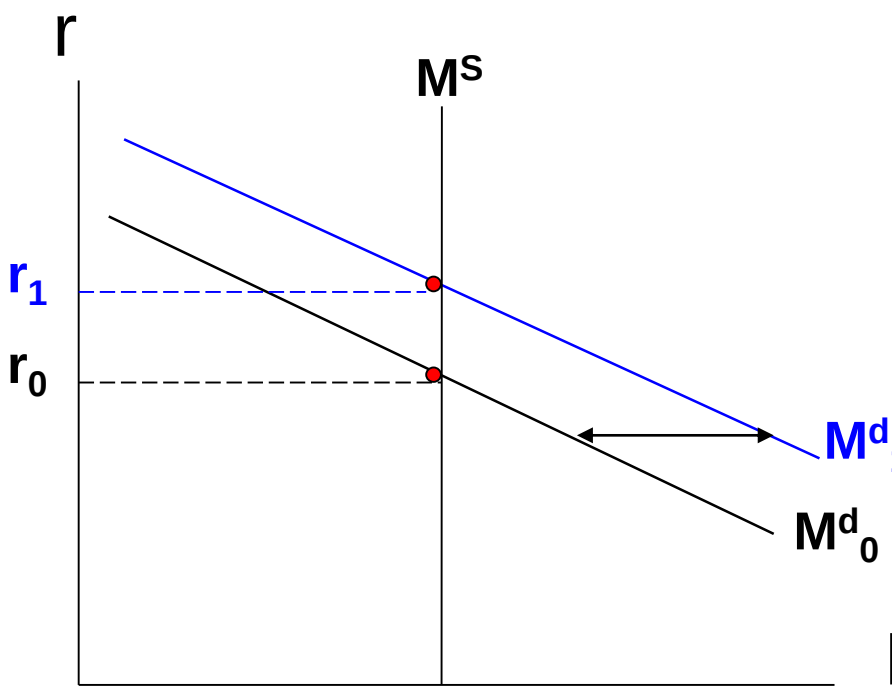
(a) LM curve is quite flat: suppose due to low $\varepsilon_{M^d,Y} = \frac{\Delta M^d}{\Delta Y} \times \frac{Y}{M^d}$

- G↑ ⇨ DAE ↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**

(b) LM curve is quite steep: suppose due to high $\varepsilon_{M^d,Y} = \frac{\Delta M^d}{\Delta Y} \times \frac{Y}{M^d}$

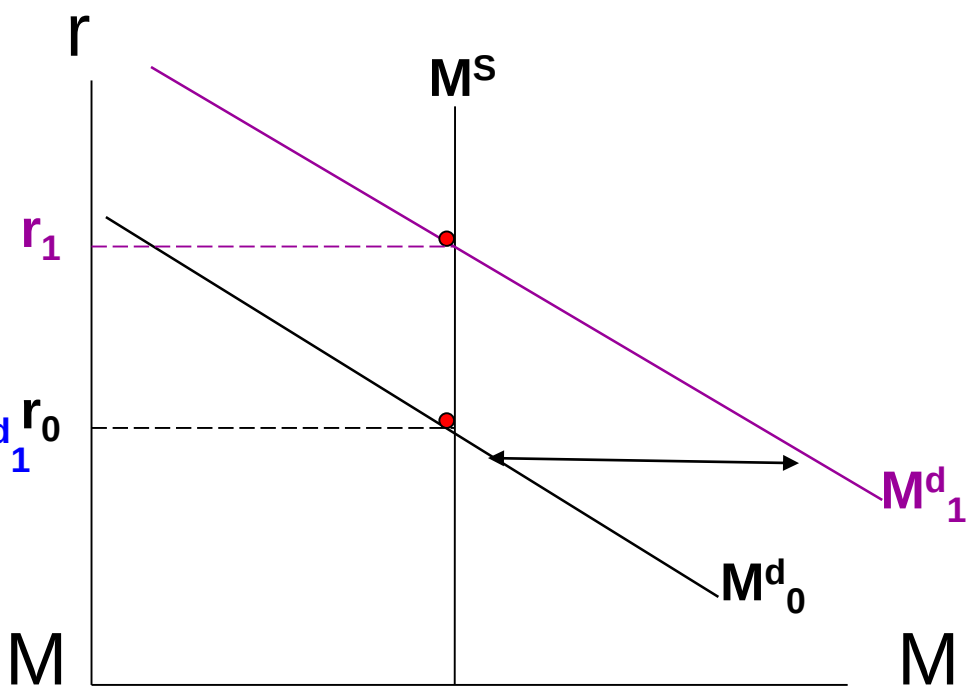
- G↑ ⇨ DAE↑ ⇨ Y ↑↑ , ΔY = multiplier × ΔG
- Y↑↑ ⇨ ⇨ ⇨ ⇨
- crowding-out effect ⇨ Net change in Y, ⇨ **Fiscal policy is**

$\varepsilon_{M^d,Y}$ low



M^d shifts a little

$\varepsilon_{M^d,Y}$ high



M^d shifts a lot