The Demand Dials

Read how spending and taxes can affect the economy.

GE.7.1 "Define and explain fiscal policy and its tools."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline the sentence that defines fiscal policy, and circle its two tools. Draw an arrow from one circled tool to a sentence that explains how it can affect demand.

When Spending Slows Down

1. At a neighborhood hardware store, fewer customers arrive after a wave of layoffs. The owner cuts workers' hours, and those workers buy less from nearby shops. A government can respond with fiscal policy: changes in government spending and taxes meant to influence economic activity. When total spending in the economy falls, officials may try to support demand for goods and services. When spending grows too fast and prices rise broadly, they may try to cool demand instead. Fiscal policy is different from monetary policy, which uses a central bank's tools, such as interest rates.

2. Suppose Congress funds repairs to public school buildings during a downturn. The government pays construction crews and buys materials; those workers and suppliers may then spend some of their income at local businesses. This is an increase in government spending, one fiscal policy tool. Congress could also reduce income taxes, another tool. If households keep more of their pay, some may buy more goods and services. Neither step guarantees a quick recovery: projects take time to start, and households might save their extra money. The federal government often borrows when spending exceeds tax revenue.

3. If demand is rising so rapidly that inflation becomes a concern, lawmakers could cut government purchases or raise taxes. Cutting purchases directly reduces one source of demand; higher taxes leave many households with less money to spend. Either choice can slow economic activity, which may also cost jobs. Some tax and spending changes happen without a new vote: when people lose jobs, tax collections often fall and payments for unemployment insurance often rise. These built-in responses are called automatic stabilizers. They soften swings in household income, but lawmakers still debate how much additional action, if any, to take.

2 ANSWER WITH EVIDENCE

Use the passage

1. What is fiscal policy, and how does it differ from monetary policy?

2. How could funding school repairs during a downturn increase demand beyond the repair project itself?

3. How might an income tax cut support demand during a downturn, and why might its effect be limited?

4. How could lawmakers use fiscal policy to cool demand when inflation is a concern? Explain one possible cost.

3 YOUR TURN

Your own words

A coastal city loses visitors, and hotel workers' hours are cut. In four or five sentences, propose one federal fiscal policy action, name its tool, explain how it could affect demand and jobs, and identify one limitation or cost.

ANSWER KEY

The Demand Dials

PART 1 · READ AND MARK

Underline the sentence that defines fiscal policy, and circle its two tools. Draw an arrow from one circled tool to a sentence that explains how it can affect demand. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	What is fiscal policy, and how does it differ from monetary policy?	**Fiscal policy changes government spending and taxes to influence economic activity. Monetary policy uses a central bank's tools, such as interest rates.**
2	How could funding school repairs during a downturn increase demand beyond the repair project itself?	**The government pays workers and suppliers, who may spend some of that income at local businesses, increasing demand there.**
3	How might an income tax cut support demand during a downturn, and why might its effect be limited?	**Households may spend some of the money they keep, but they might save it instead.**
4	How could lawmakers use fiscal policy to cool demand when inflation is a concern? Explain one possible cost.	**They could cut government purchases or raise taxes. Either action may slow economic activity and cost jobs.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

Congress could fund a coastal cleanup project, using government spending as its fiscal policy tool. The project would hire workers whose hotel hours have been cut. Their earnings could help them spend more at local businesses, supporting demand and jobs. The project might take time to organize, so it may not help workers right away.

Accept other accurate spending or tax proposals that connect the chosen tool to demand and jobs. The limitation or cost should fit the proposed action.