

Review Problems: Fiscal Policy

Prof. Lutz Hendricks. October 15, 2009

Jones, Macroeconomics, problems 13.4-13.6.

1 Questions

1. In words, what does the government's intertemporal budget constraint say? Does it imply that the government must eventually repay its debt?
2. Why do large government debts tend to lead to inflation?
3. What is crowding out?
4. Which country characteristics likely affect the amount it can borrow?
5. Why are deficits poor measures of government liabilities? Give examples.
6. What are the sources of saving that finance domestic investment?
7. Why is the outlook for the federal budget bleak?

2 Answers

1. Present value of revenues equals present value of expenditures + value of initial debt. The government does not have to repay its debts, ever.
2. The government needs additional revenue; it prints more money. It inflates away the value of the debt.
3. Government spending reduces private spending.
4. See slides.
5. See slides.
6. Private and government saving plus foreign saving (the trade deficit).
7. Entitlement programs are growing, especially health care.