Earlier this year Congress passed a major fiscal package, which includes personal tax cuts and increases in transfer payments, incentives for business investment, federal grants for state and local governments to reduce their need to cut services or cancel building projects, and increases in federal purchases. Estimates are that this package will push the federal budget deficit to about $1.8 trillion this fiscal year.

A) What is the argument for adopting this stimulus package and greatly increasing what was already a large federal budget deficit?

Regarding this deficit Ben Bernanke remarked in recent congressional testimony, “With such large near-term deficits, it may seem too early to be contemplating the necessary return to fiscal sustainability. To the contrary, maintaining the confidence of the financial markets requires that we begin planning now for the restoration of fiscal balance .”

B) Why is it important at this time to maintain”the confidence of the financial markets” in our ultimate commitment to restoration of fiscal balance despite the large near term increases in the federal budget deficit. (What are the potential consequences of a loss in confidence among financial market investors in the US’s commitment to fiscal sustainability and how would the task of the Fed be complicated in such an event?) Explain in detail.