

# Fiscal and Monetary Policy

## *How do policymakers use fiscal and monetary policy to stabilize the economy?*

### Speaking of Economics

As you complete the Reading Notes, use these terms in your answers:

|                  |                     |
|------------------|---------------------|
| fiscal policy    | multiplier effect   |
| monetary policy  | easy-money policy   |
| deficit spending | tight-money policy  |
| stagflation      | crowding-out effect |

### PREVIEW

The year is 1974. The U.S. economy is in the middle of a recession. Real gross domestic product (GDP) declined during three of the past four quarters. In just one year, household consumption dropped by more than \$40 billion. There are 2 million more people without jobs, and there is no relief in sight. *Time* magazine reported,

*Jobs are harder and harder to come by. "When something opens up, we all descend like locusts on the company that's hiring," says Bostonian Judy Knight, who lost her job as a staff producer with Atlantic Records last December. "The company ends up getting the pick of the best." When 100 jobs opened recently for firemen in Los Angeles, 1,000 applicants showed up.*

Examine the list of possible actions that policymakers could take to help the failing economy. Predict what you think the effect of each possible action might be. Choose from these effects:

| Effect A              | Effect B                                    | Effect C              |
|-----------------------|---|-----------------------|
| Stimulate the economy | Neither stimulate nor slow down the economy | Slow down the economy |

### Possible Actions Policymakers Could Take

1. Increase spending on government programs, such as Social Security and food stamps.
2. Increase taxes on individuals and corporations.
3. Increase the amount of money banks are required to hold in reserve.
4. Increase the interest rate at which banks can borrow money from the Federal Reserve.
5. Increase the purchasing of government bonds by the Federal Reserve.

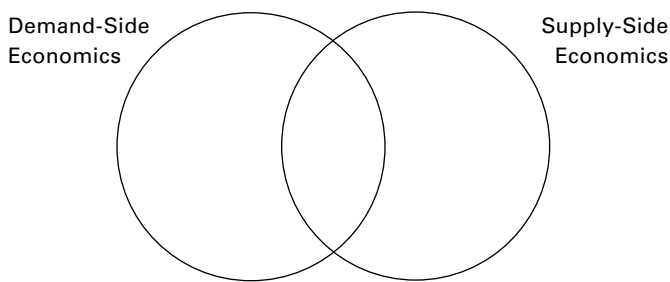
### READING NOTES

#### Section 2

1. Draw a T-chart to compare and contrast the ideas of John Maynard Keynes and Milton Friedman. Title the left side "Keynesian Economics" and the right side "Monetarism." In each column, note the main details of each idea. Include information on beliefs about the causes of recession and the role of the government in the economy. Provide a historical example of when each idea was applied by the government.
2. How do the ideas of John Maynard Keynes and Milton Friedman differ from those of classical economics?

### Section 3

1. A graphic organizer is a diagram for visually organizing and recording information about a particular subject. Design a graphic organizer that explains how the government can use expansionary and contractionary fiscal policy to respond to problems in the economy. On your graphic organizer, describe the two policies, their goals, and their economic impact.
2. Create a Venn diagram like the one below. Record the main ideas of demand-side and supply-side economics. In the overlapping section, identify at least one idea that relates to both schools of thought.



3. Using words, illustrations, or both, explain how \$1,000 spent by the government can have a multiplying effect.
4. What are automatic stabilizers? How do they help counter the ups and downs of the business cycle?

### Section 4

1. Create a graphic organizer that explains how the government can use a tight-money policy and an easy-money policy to respond to problems in the economy. On your graphic organizer, describe the policies, their goals, and their economic impact.
2. Using words, drawings, or both, explain how banks create money from a \$1,000 deposit.
3. Complete a matrix like the one below, answering the questions for each monetary policy tool described in this section.

| Tool | How is this used as part of easy-money policy? | How is this used as part of tight-money policy? | How often does the Fed use this tool? Why? |
|------|--|---|--|
|      |  |   |  |
|      |  |   |  |
|      |  |   |  |

4. What is the federal funds rate, and how is it related to monetary policy? Why does the Federal Reserve focus on targeting the federal funds rate?

### Section 5

1. Design a one-page flyer summarizing the limitations of fiscal and monetary policy in stabilizing the economy. Your flyer should describe each of the three limitations, explain how each of them challenges policymakers, and include an appropriate visual for each.
2. With which of the concerns about the national debt do you most agree and why? Disagree and why? Explain why you think teenagers should or should not be concerned about the national debt.

### PROCESSING

Find and read a news article that describes a recent fiscal or monetary policy action taken to stabilize the economy. Determine whether you think this policy will be effective in achieving its purpose. Express your opinion and your reasoning by doing one of the following or by designing your own option:

- Compose a song.
- Create a short video.
- Design a magazine cover.
- Draw a political cartoon.
- Write an editorial.

In your response, summarize the details and goal(s) of the policy action. Identify the action as either fiscal or monetary, describe its likely outcome, and explain whether you think it will be effective.