

Fiscal and Monetary Policy Infographic Classroom Activity (Answer Key)

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Key for questions 1–10

1. Fiscal policy is the spending and taxing policies used by Congress and the president to influence and stabilize the economy. Monetary policy is the tools used by the Federal Open Market Committee to influence the availability of credit and the money supply.
2. Congress and the president are responsible for fiscal policy.
3. The Federal Open Market Committee is responsible for monetary policy.
4. Changes in government spending and tax policies such as changes to tax rates and rules are fiscal policy tools.
5. There are four monetary policy tools: open market operations, which is the buying and selling of government bonds; and changes to reserve requirements, the discount rate, and the interest paid on required and excess reserves.
6. During a recession, by lowering taxes or increasing government spending, fiscal policy attempts to increase consumer spending and business investment, which should lead to a decrease in aggregate demand and an increase in real gross domestic product (GDP), the price level, and employment. This is called expansionary fiscal policy.
7. During a recession, by buying government bonds and lowering reserve requirements, the discount rate, and the interest paid on required and excess reserves, monetary policy attempts to increase consumer spending and business investment, which should lead to an increase in aggregate demand and an increase in real GDP, the price level, and employment. This is called expansionary monetary policy.
8. During times of inflation, by raising taxes or decreasing government spending, fiscal policy attempts to decrease consumer spending and business investment, which should lead to a decrease in aggregate demand and a decrease in real GDP, the price level, and employment. This is called contractionary fiscal policy.
9. During times of inflation, by selling government bonds and raising reserve requirements, the discount rate, and the interest paid on required and excess reserves, monetary policy attempts to decrease consumer spending and business investment, which should lead to a decrease in aggregate demand and a decrease in real GDP, the price level, and employment. This is called contractionary monetary policy.
10. Fiscal and monetary policy aim to stabilize the economy by promoting price stability and maximum sustainable employment.

Activity

Real-World Connections: Fiscal and Monetary Policy

This activity connects fiscal and monetary policy actions to the real economy. Students will interpret the following headlines and scan the corresponding articles or op-eds to identify whether the topic relates to fiscal or monetary policy actions, and then will fill in the corresponding tables.

1. Headline: “Fed’s Kaplan Says Monetary Policy Has Reached Limits for Bolstering Growth”
Article: <http://www.marketwatch.com/story/feds-kaplan-says-monetary-policy-has-reached-limits-for-bolstering-growth-2016-07-29>

| What policy? | What is policy goal? | Who conducts policy? | Write a brief description |
|--------------------|--------------------------------|-------------------------------------|--|
| Fiscal or monetary | Expansionary or contractionary | U.S. Congress and president or FOMC | Explain the tools or actions being used |
| Monetary | Expansionary | FOMC | Dallas Fed President Kaplan stated that monetary policy is unable to be any more accommodative to stimulate economic growth. He called for fiscal policy such as investment in infrastructure projects to be used instead. |

2. Headline: “Economy Will Suffer ‘Slowing Pains’ Said Necessary to Future National Prosperity”
Article: <http://cdnc.ucr.edu/cgi-bin/cdnc?a=d&d=DS19700131.2.11>

| What policy? | What is policy goal? | Who conducts policy? | Write a brief description |
|--------------------|--------------------------------|-------------------------------------|---|
| Fiscal or monetary | Expansionary or contractionary | U.S. Congress and president or FOMC | Explain the tools or actions being used |
| Fiscal | Contractionary | U.S. Congress and president | President Nixon announced his administration was working to fight inflation in his annual Economic Report to Congress in 1970. He warned that there would likely be “sluggish business” and an increase in unemployment as a result of this policy. |

Activity continued

- Headline: "PhillyInc.: Philly Fed Chief: Taming Inflation Is Key to Economy"
 Article: http://articles.philly.com/2011-09-30/business/30229221_1_charles-i-plosser-monetary-policy-double-dip-recession

| What policy? | What is policy goal? | Who conducts policy? | Write a brief description |
|--------------------|--------------------------------|-------------------------------------|---|
| Fiscal or monetary | Expansionary or contractionary | U.S. Congress and president or FOMC | Explain the tools or actions being used |
| Monetary | Expansionary | FOMC | Former Philadelphia Fed President Charles Plosser voted against additional rounds of quantitative easing, purchasing long-term government securities, in 2011 because he believed the Fed's actions would not bring more stimulus. He didn't see the signs of a double-dip recession in the data. He was concerned that the Fed be able to hold inflation in check when data show signs of rising inflationary pressures. |

- Headline: "Recessions Hard for Presidents to Remedy"
 Article: <http://www.chron.com/business/article/Recessions-hard-for-presidents-to-remedy-1656654.php>

| What policy? | What is policy goal? | Who conducts policy? | Write a brief description |
|--------------------|--------------------------------|-------------------------------------|--|
| Fiscal or monetary | Expansionary or contractionary | U.S. Congress and president or FOMC | Explain the tools or actions being used |
| Fiscal | Expansionary | U.S. Congress and president | In 2008, taxpayers received government rebate checks as part of a stimulus plan passed by Congress and signed by President George W. Bush. The goal was to boost consumer spending in an attempt to stimulate economic activity. |

Activity continued

5. Headline: “Who Beat Inflation?”

Op-ed: http://www.economist.com/blogs/freeexchange/2010/03/volcker_recession

| What policy? | What is policy goal? | Who conducts policy? | Write a brief description |
|--------------------|--------------------------------|-------------------------------------|---|
| Fiscal or monetary | Expansionary or contractionary | U.S. Congress and president or FOMC | Explain the tools or actions being used |
| Monetary | Contractionary | FOMC | The author acknowledges that Fed Chairman Paul Volcker led the FOMC to raise the federal funds rate in 1980 from around 10 percent to nearly 20 percent in attempt to fight inflation. The author questions whether the deep recession that followed this contractionary policy was the right decision. |

Extension Activity (advanced students)

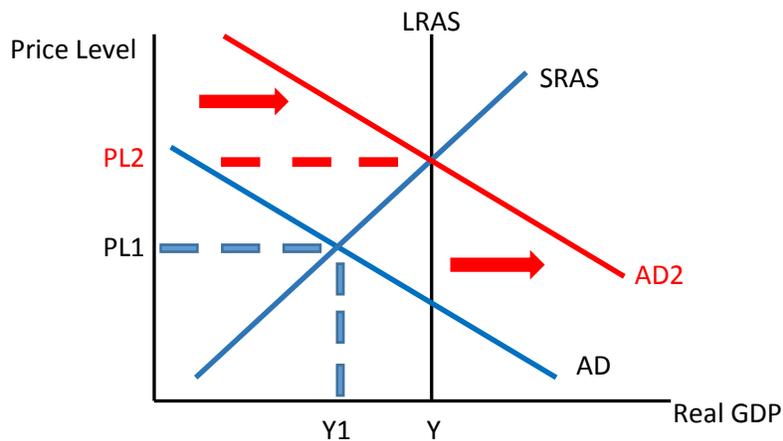
Read the following excerpts. Identify whether the policy action is fiscal or monetary and expansionary or contractionary. Draw and label the change that would occur on the AD/AS graph as a result of the policy action described in each. Identify what will happen as a result of the policy to the price level, employment, and real GDP.

1. *Excerpt from FOMC Statement Released December 16, 2008*

“The Federal Open Market Committee decided today to establish a target range for the federal funds rate of 0 to ¼ percent.

Since the Committee’s last meeting labor market conditions have deteriorated, and the available data indicate that consumer spending, business investment, and industrial production have declined. Financial markets remain quite strained and credit conditions tight. Overall, the outlook for economic activity has weakened further.”

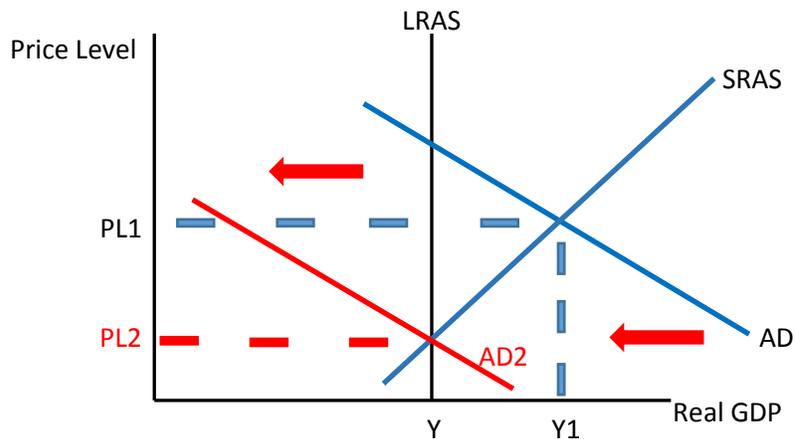
Answer: Expansionary monetary policy shifts AD to the right. This increases the price level, employment, and real GDP.



2. Excerpt from FOMC Meeting Minutes Press Release February 6, 1981

“Shortly after the November 18 meeting, incoming data indicated that the monetary aggregates were growing considerably faster than the rates consistent with the Committee’s objectives for the September-to-December period... These developments were associated with additional upward pressures on the federal funds rate and other short-term interest rates; in the first statement week after the meeting, the funds rate was at about or somewhat above the upper limit of the range of 13 to 17 percent specified by the Committee, compared with an average of 14 ½ percent in mid-November. In a telephone conference on November 26, the Committee raised the upper limit of the intermeeting range for the funds rate to 18 percent.”

Answer: Contractionary monetary policy shifts AD to the left. This decreases the price level, employment, and real GDP.





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3. Excerpt from Public Law 110-85 of the 110th Congress: Signed into law by President George W. Bush February 13, 2008

“To provide economic stimulus through recovery rebates to individuals, incentives for business investment, and an increase in conforming and FHA loan limits. Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

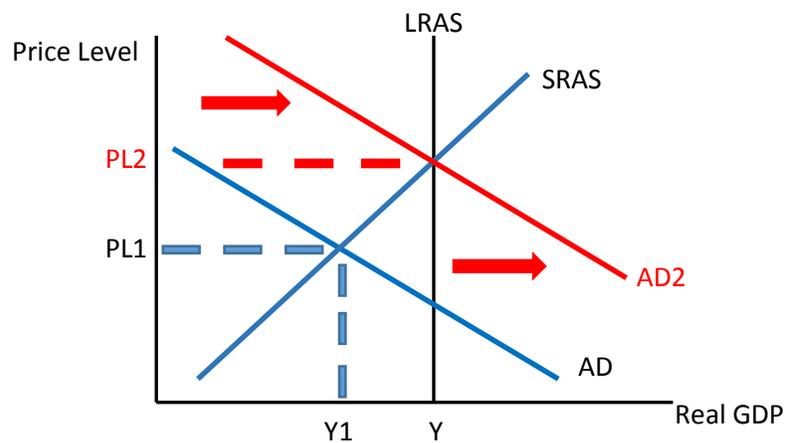
Title I – Recovery Rebates and Incentives for Business Investment

... Sec. 101. 2008 recovery rebates for individuals.

Sec. 102. Temporary increase in limitations on expensing of certain depreciable business assets

Sec. 103. Special allowance for certain property acquired during 2008.”

Answer: Expansionary fiscal policy shifts AD to the right. This increases the price level, employment, and real GDP.





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4. Excerpt from President Jimmy Carter's televised speech delivered October 24, 1978

"Good evening. I want to have a frank talk with you tonight about our most serious domestic problem. That problem is inflation. Inflation can threaten all the economic gains we've made, and it can stand in the way of what we want to achieve in the future.

This has been a long-time threat. For the last 10 years, the annual inflation rate in the United States has averaged 6-1/2 percent. And during the three years before my inauguration, it had increased to an average of 8 percent.

If inflation gets worse, several things will happen. Your purchasing power will continue to decline, and most of the burden will fall on those who can least afford it. Our national prosperity will suffer. The value of our dollar will continue to fall in world trade.

...Inflation is obviously a serious problem. What is the solution?

...I will concentrate my efforts within the government. We know that government is not the only cause of inflation. But it is one of the causes, and government does set an example. Therefore, it must take the lead in fiscal restraint.

...We are going to hold down government spending, reduce the budget deficit, and eliminate government waste.

We will slash federal hiring and cut the federal workforce.

We will eliminate needless regulations.

...And we will oppose any further reduction in federal income taxes until we have convincing prospects that inflation will be controlled."

Answer: Contractionary fiscal policy shifts AD to the left. This decreases the price level, employment, and real GDP.

