

Section 1: Guided Reading and Review

Understanding Fiscal Policy



A. As You Read

As you read Section 1, fill in two supporting facts or details under each main idea by answering each question.

Main Idea: The president and Congress work through a budget process to draw up a spending plan for the following fiscal year.

1. Which part of the executive branch is responsible for preparing the president's budget proposal? _____
2. Which congressional committees submit the final bills that authorize specific spending? _____

Main Idea: The federal government may use fiscal policy to try to make the economy run more smoothly.

3. Under what conditions might the government use expansionary fiscal policies? _____
4. Under what conditions might the government use contractionary fiscal policies? _____

Main Idea: The federal government has specific policies that it uses to influence the economy.

5. What are its two main expansionary policies? _____
6. What are its two main contractionary policies? _____

Main Idea: Although fiscal policies may appear to be powerful economic tools, they can be difficult to put into practice.

7. What kinds of entitlement programs make it difficult to change spending levels? _____
8. Why does it take so long to put fiscal changes into effect? _____

© Prentice-Hall, Inc.

B. Reviewing Key Terms

Answer each of the following questions.

9. What is the federal budget? _____
10. What is the main function of the Congressional Budget Office? _____
11. What is the overall goal of expansionary policies? _____
12. What is the overall goal of contractionary policies? _____



Section 3: Guided Reading and Review

Monetary Policy Tools

CHAPTER 16

A. As You Read

As you read Section 3, answer the following questions.

1. If you deposit \$1,000 of borrowed money in a bank checking account, by how much do you increase the money supply? _____
2. Why does the Federal Reserve establish a required reserve ratio? _____

3. What three tools could the Federal Reserve use to adjust the money supply? _____

4. What two effects, leading to an increased money supply, could a reduced RRR have? _____

5. Why does the Fed seldom, if ever, change bank reserve requirements? _____

6. How do banks respond to a lowered discount rate? _____

7. How does a raised discount rate affect bank loans and the money supply? _____

8. What effect does the Fed's purchase of government bonds have on the money supply? _____

9. How does the Fed's sale of bonds reduce the money supply? _____

10. Which of its monetary policy tools does the Federal Reserve use most often? _____

B. Reviewing Key Terms

Rewrite each statement below as needed to make it correct.

11. *Money creation* is the process by which money is manufactured. _____

12. The *required reserve ratio* is the ratio of reserves to loans required of banks by the Federal Reserve. _____

13. The size of loans created with each demand deposit is measured by the *money multiplier formula*. _____

14. *Open market operations* refers to the buying and selling of banks by the Federal Reserve. _____



Monetary Policy and Macroeconomic Stabilization

A. Key Terms

Briefly define or identify each of the following.

1. tight money policy _____

2. easy money policy _____

3. inside lag _____

4. outside lag _____

5. monetarism _____

B. Main Ideas

Write the letter of the correct answer in the blank provided.

- ___ 6. What does monetary policy do?
 - a. It alters the supply of money.
 - b. It changes the way that taxes are collected.
 - c. It charters new banks.
 - d. It mints new coins and prints bills.
- ___ 7. What effect do low interest rates have on business investment?
 - a. They generally stop it completely.
 - b. They slow it down.
 - c. They encourage it.
 - d. They do not have much effect on essential investment.
- ___ 8. What does fiscal policy include?
 - a. changes in interest rates and loan policies
 - b. changes in government spending and taxation
 - c. changes in banking regulations and policies
 - d. changes in monetary policy
- ___ 9. Why does monetary policy usually involve a streamlined inside lag?
 - a. Congress and the president act quickly on monetary policy.
 - b. Monetary policy is determined by independent leaders of industry.
 - c. The Federal Open Market Committee can act almost immediately.
 - d. Predicting economic trends is simple and reliable today.
- ___ 10. What is likely to be the best approach to a recession that is expected to turn into an expansion in a short time?
 - a. Use monetary policy to lower interest.
 - b. Use monetary policy to raise interest.
 - c. Use fiscal policy to lower interest.
 - d. Do nothing and let the economy fix itself.

14. ECONOMIC STABILITY

Name _____ Date _____

ECONOMIC SKILLS LAB FISCAL AND MONETARY POLICIES-APPLYING ECONOMIC PRINCIPLES

Complete the following chart by circling the fiscal and monetary policies commonly used to stabilize the economy based on the economic conditions described in the left-hand column.

Economic Conditions	Recommended action to be taken by				
	The President & Congress		The Federal Reserve Board		
	Taxes	Spending	Open Mkt. Conditions	Discount Rate	Reserve Ratio
1. Full employment and rising inflation	Increase Decrease	Increase Decrease	Buy securities Sell securities	Raise Lower	Raise Lower
2. Unemployment and declining production	Increase Decrease	Increase Decrease	Buy securities Sell securities	Raise Lower	Raise Lower

A Historical Case Study: The U.S. Economy in 1984

In 1984 the U.S. economy was showing signs of recovering from a period of recession. Unemployment rates were going down. Automobile sales and new home construction were increasing. Yet there were causes for concern. The federal debt was still very high, with indications that it might go higher. Interest rates were rising, and stock prices were unsteady. Volatile political situations in the Persian Gulf, Lebanon, and Central America were cited by President Reagan as reasons to increase defense spending. It was also suggested that the economy was already "overheated" and that inflationary pressures were on the increase.

Questions for Understanding

Use the chart above to develop a plan for solving the problems facing the U.S. economy in 1984. Remember, using all the fiscal and monetary tools at one time can have a greater effect than you might want. Suggest a program that would serve to "cool" the economy without creating a recession, while providing for defense needs and human services programs.

- Should taxes be increased or decreased? Would your tax proposals be designed to influence consumption, investment, or both?

- Should government spending be increased or decreased? Explain which spending programs you would increase, or decrease, and why?

- What policies would you recommend that the Federal Reserve Board adopt in this situation?

