Fiscal Policy & Monetary Policy: What’s the difference?

Lesson Author
Kevin Woodcox, Federal Reserve Bank of Richmond

Standards and Benchmarks

Voluntary National Content Standards in Economics
Standard 20: Fiscal and Monetary Policy
Federal government budgetary policy and the Federal Reserve System’s monetary policy influence the overall levels of employment, output, and prices.

• Benchmark 1, Grade 12: Fiscal policies are decisions to change spending and taxation levels by the federal government. As fiscal policies, these decisions are adopted to influence national levels of output, employment, and prices.

• Benchmark 2, Grade 12: In the short run, increasing federal spending and/or reducing taxes can promote more employment and output, but these policies also put upward pressure on the price level and interest rates. Decreased federal spending and/or increased taxes tend to lower price levels and interest rates, but they reduce employment and output levels in the short run.

• Benchmark 7, Grade 12: Monetary policies are decisions by the Federal Reserve System that lead to changes in the supply of money, short term interest rates, and the availability of credit. Changes in the growth rate of the money supply can influence overall levels of spending, employment, and prices in the economy by inducing changes in the levels of personal and business investment spending.

• Benchmark 8, Grade 12: The Federal Reserve System’s major monetary policy tool is open market purchases or sales of government securities, which affects the money supply and short-term interest rates. Other policy tools used by the Federal Reserve System include making loans to banks (and charging a rate of interest called the discount rate). In emergency situations, the Federal Reserve may make loans to other institutions. The Federal Reserve can also influence monetary conditions by changing depository institution’s’ reserve requirements.

Lesson Description

Fiscal Policy & Monetary Policy: What’s the difference? Provides middle and high school students with the chance to examine quotes from the news to distinguish the differences between monetary and fiscal policy. This full lesson is based in part upon The Monetary and Fiscal Policy Two Step activity originally featured in the Spring/Summer 2013 issue of 5E Educator.

Grade Level

9–12

Concepts

Dual Mandate
Fiscal policy
Monetary policy
Fiscal Policy & Monetary Policy: What’s the difference?

Objectives

Students will be able to:

- Define monetary policy, fiscal policy, price stability, maximum employment, economic growth, federal funds rate, inflation, and taxes.
- Identify the differences between monetary and fiscal policy.
- Examine a series of quotes from news sources.
- Classify the series of quotes based on whether they discuss monetary policy, fiscal policy, or both.

Essential Question

How do you distinguish between fiscal policy and monetary policy?

Time Required

45 minutes

Materials

- Slide 1: Fiscal Policy & Monetary Policy: What’s the difference?
- Slide 2: Sample Quote A
- Slide 3: Sample Quote B
- Slide 4: Classroom Venn Diagram
- Handouts 1–10: 10 News Quotes (1 printed copy of each quote)
- Handout 11: Student Notes (1 copy per student)
- Handout 12: Group Venn Diagram Worksheet (1 copy per student group)
- Handout 13: Student Assessment (1 copy per student)
- An adhesive such as tape, sticky tack, mounting putty or push pins
- Optional Monetary and Fiscal Policy Video: What is the difference between monetary policy and fiscal policy? from the Board of Governors of the Federal Reserve System. ([http://www.federalreserve.gov/faqs/money_12855.htm](http://www.federalreserve.gov/faqs/money_12855.htm)) 1:24 minutes (requires - AV projector, TV or other video device connected to a PC with an internet connection).

Preparation

Before the lesson, create 5 stations by affixing pairs of Handouts 1–10: 10 News Quotes to the walls in the following order:
- Station A: Handouts 1 and 2
- Station B: Handouts 3 and 4
- Station C: Handouts 5 and 6
- Station D: Handouts 7 and 8
- Station E: Handouts 9 and 10
Fiscal Policy & Monetary Policy: What’s the difference?

Procedure

1. Share with the students that they are going to learn to identify and distinguish between Monetary Policy and Fiscal Policy. Explain that they will start by reviewing an infographic.
2. Distribute a copy of Handout 11: Student Notes to each student.
3. Display Slide 1: Fiscal Policy & Monetary Policy: What’s the difference? Describe the infographic to the students by identifying the differences between Fiscal Policy and Monetary Policy. (When necessary, use the provided glossary to assist students with terms they may not be familiar with.)
   - The infographic is divided into two columns and four rows:
     i. The first column is on Fiscal Policy
     ii. The second column is on Monetary Policy
     iii. The first row contains the definitions of the two policies
     iv. The second row lists the goals of the two policies
     v. The third row identifies who’s responsible for determining and executing each policy
     vi. The fourth row identifies what tools are used to achieve each policy’s goals
4. Give students time to complete Handout 11 independently. Remind the students to pay particular attention to the differences between monetary and fiscal policy.
5. After the students have completed Handout 11, reiterate that Monetary Policy is the actions taken by the Federal Reserve to influence interest rates and the availability of credit, while Fiscal Policy is the federal government’s overall approach to spending, borrowing and taxation.
6. Optional: Show video What is the difference between monetary policy and fiscal policy? from the Board of Governors of the Federal Reserve System (1:24 minutes).
7. Ask the students the following questions:
   - Which of the two policies focuses on influencing interest rates? (Monetary Policy)
   - Which policy is the responsibility of the President of the United States and the Congress? (Fiscal Policy)
   - What are the goals of Monetary Policy? (promote price stability and maximum sustainable employment)
   - Paying interest on bank reserves, buying and selling securities, and lending money to banks are the tools of which policy? (Monetary Policy)
   - Which policy impacts how much you pay in taxes? (Fiscal Policy)
8. Divide the students into small groups. Inform the students that they will be using what they have learned about monetary and fiscal policy to examine quotes from news sources and determine whether the quotes are about fiscal policy, monetary policy or both policies.
9. Distribute a copy of Handout 12: Group Venn Diagram Worksheet to each group.
10. Inform them that each group will need to select a Record Keeper that will enter the group’s information on the top of the worksheet and be responsible for recording the group’s responses.
11. On a whiteboard, screen or electronic board display Slide 2: Sample Quote A and read the text of the quote to the class.
   - “The new phase for the Fed could present new challenges, including when to start shrinking its large portfolio of securities, something Ms. Yellen said was discussed at the meeting. The Fed boosted its portfolio, or balance sheet, after the 2008 financial crisis with several rounds of asset purchases aimed at stimulating the economy by lowering long-term rates.”
12. Ask each group to think about the information they learned about Monetary and Fiscal Policy for a moment. Each group should then quickly and quietly confer and reach a consensus decision if the quote is about Fiscal Policy, Monetary Policy or both polices. After giving the groups a minute to make their choice, poll the groups.

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13. To take the poll, each group’s Record Keeper will vote by putting their thumb up if the quote is about Monetary Policy, thumb down if it is about Fiscal Policy and a fist if the quote deals with both policies. Wait for students to respond and gauge the class’s vote.

14. Using Slide 2, reread the quote to the class and then display Slide 1 and explain to the class using the infographic that the quote deals with Monetary Policy. *(Monetary Policy — The Fed refers to the Federal Reserve System, the Central Bank of the United States. The buying or selling of securities is a tool used by the Federal Reserve to influence interest rates in order to promote price stability and maximum employment.)*

15. Display Slide 4: Classroom Venn Diagram, then write or type the term “Sample Quote A” in the Monetary Policy section of the diagram. Each group’s Record Keeper should also write “Sample Quote A” in the Monetary Policy section of the Venn Diagram Worksheet.

16. Explain that as groups they will rotate around the classroom reading, discussing and categorizing the quotes found in the 5 stations like they just did as a whole class. The groups will have about four minutes to read both quotes at each station and as a group decide which section of the Venn diagram to place each of the News Quotes. The group Record Keeper will write the number (1–10) associated with each News Quote in the appropriate section of the group’s Venn Diagram Worksheet.

17. Ask the students if they have any questions about the instructions.

18. Assign a starting station for each group and have the class proceed to their first station. When all groups are at their assigned stations they may begin.

19. Allow the students to spend 3–4 minutes at each station. When time is up, instruct students to proceed to the next station rotating clockwise. Repeat this process four times. When time is up have the groups remain at their final station.

20. Tell the class that a student volunteer at each station will read one of the two quotes found at the station aloud and that after this all of the Record Keepers will be polled. Remind the Record Keepers that they will be voting by hand by putting their thumb up if the quote is about Monetary Policy, thumb down if it is about Fiscal Policy and make a fist if the quote deals with both policies.

21. Starting at Station A, have a student read quote 1 (“[According to one economist], the Fed’s newfound confidence appears to be fueled by a surge in consumer and business sentiment, rooted largely in President Trump’s plan to cut taxes and regulations and boost federal spending, and a rise in inflation close to the Fed’s annual 2% target.”).

22. Ask the Record Keepers to share their group’s responses by voting by hand. Ask one or more students why their group(s) categorized the quote as they did? *(Answers will vary based on the students/groups.)*

23. Display Slide 1, then explain to the class why the quote deals with both policies *(Both Monetary and Fiscal Policy — The quote refers to both monetary and fiscal policies because potential fiscal policy changes like lower taxes and changes in government spending may have an effect on inflation and monetary policy.)* Then display Slide 4 and place the number 1 in the both sections of the Venn diagram.

24. Repeat steps 22–24 with the remaining quotes.

<table>
<thead>
<tr>
<th>Quote:</th>
<th>Answers:</th>
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<tr>
<td>“[According to one economist], the Fed’s newfound confidence appears to be fueled by a surge in consumer and business sentiment, rooted largely in President Trump’s plan to cut taxes and regulations and boost federal spending, and a rise in inflation close to the Fed’s annual 2% target.”</td>
<td>Both Monetary and Fiscal Policy — The quote refers to both monetary and fiscal policies because potential Fiscal Policy changes like lower taxes and changes in government spending may have an effect on inflation and Monetary Policy.</td>
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<td><strong>2.</strong></td>
<td>“The Fed anticipates hiking rates three times in total in 2018, part of an ongoing move away from the extraordinary measures it took to stimulate the economy during and after the Great Recession. But the central bank opened the door to potentially doing four hikes. Higher rates are likely to be welcomed by savers but not by borrowers, who will face more expensive loan terms.”</td>
<td>Monetary Policy — This quote refers to Monetary Policy because it discusses actions by the Federal Reserve to influence interest rates, which factor into people’s saving and spending decisions.</td>
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<td><strong>3.</strong></td>
<td>“The national debt, which has exceeded $21 trillion, will soar to more than $33 trillion in 2028, according to the budget office. By then, debt held by the public will almost match the size of the nation’s economy, reaching 96 percent of gross domestic product, a higher level than any point since just after World War II and well past the level that economists say could court a crisis.”</td>
<td>Fiscal Policy — This quote outlines the total national debt of the U.S. government due to its spending and borrowing decisions. Spending, borrowing and taxation are aspects of Fiscal Policy.</td>
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<td><strong>4.</strong></td>
<td>“U.S. banks are set to push up borrowing costs on credit cards and other types of loans while keeping interest rates on saving products largely unchanged. Within minutes of the Fed’s quarter point increase, lenders ... said they would lift their ‘prime rates,’ which are used to determine borrowing costs.”</td>
<td>Monetary Policy — The quote shows the effect of a change in the Federal Funds Rate on other interest rates in the economy. Actions taken by the Fed to influences interest rates fall under monetary policy.</td>
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<td><strong>5.</strong></td>
<td>“President Donald Trump called for deep reductions in business tax rates and major changes to the individual tax system ... which include a 15% tax rate for all businesses, lower individual rates ... to benefit middle-income households.”</td>
<td>Fiscal Policy — This quote refers to a proposed change to the tax code for both businesses and individuals. The government’s taxation decisions fall under Fiscal Policy.</td>
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<td><strong>6.</strong></td>
<td>“The fulcrum of Powell’s policy is straight out of modern economic theory — keeping inflation expectations low and stable. Measures of what the public expects longer-run inflation to be can be somewhat hazy, but most gauges show them at low and stable rates. If they ever broke free, the Fed would act aggressively. ‘I am confident that the FOMC would resolutely “do whatever it takes” should inflation expectations drift materially up or down or should crisis again threaten,’ Powell said.”</td>
<td>Monetary Policy — The quote discusses Federal Reserve Board Chairman Powell’s views on inflation and how the Fed will conduct Monetary Policy if inflation does not match expectations.</td>
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<td><strong>7.</strong></td>
<td>“With the unemployment rate at a 17-year low of 4.1%, President Donald Trump ... enacted tax cuts of at least $1.5 trillion over 10 years and spending increases worth $300 billion over two years that will swell federal budget deficits. These measures could boost household and business spending and push up inflation. Mr. Powell’s testimony acknowledged how the tailwind from fiscal stimulus could shift the Fed’s focus.”</td>
<td>Both Monetary and Fiscal Policy — The quote refers to both policies because Fiscal Policy changes in taxing and government spending may lead to higher inflation, which could create a scenario where the Federal Reserve would need to adjust Monetary Policy.</td>
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8. “The budget deal that President Trump signed into law Friday morning has plenty of critics. But it would do one unarguably good thing: avert a debt ceiling crisis for the next year. And yet the bipartisan deal accomplishes that in a back-door way — by suspending the legal cap on U.S. borrowing for a year. The debt limit is currently set at $20.456 trillion. ... A suspension lets the U.S. Treasury borrow as needed to satisfy the country's legal obligations in full and on time.”

Fiscal Policy – Suspending the debt ceiling is a Fiscal Policy action because the national debt is composed of years of deficit spending where the government spent more than the funds collected in taxes. Taxes, spending, and borrowing fall under Fiscal Policy.

9. “We at the Federal Reserve must remain squarely focused on our congressionally mandated goals. The economy has essentially met the employment portion of our mandate and inflation is moving closer to our 2 percent objective. This outcome suggests that our goal-focused, outlook-dependent approach to scaling back accommodation over the past couple of years has served the U.S. economy well.”

Monetary Policy – The quote is discussing the Federal Reserve’s dual mandate for monetary policy – maximum employment and “price stability.”

10. “House and Senate negotiators reached a deal to avoid a government shutdown Thursday that would spare them a nasty fight before November's midterm elections. The deal includes both a long-term funding package for the departments of Defense, and Labor, Health and Human Services and Education for fiscal 2019 along with a short-term measure that would keep remaining agencies funded through Dec. 7 while negotiations continue.”

Fiscal Policy - The quote talks about a deal reached by the Congress to fund government operations, so this makes the quote about Fiscal Policy. Since government spending and taxing decisions are Fiscal Policy, actions the funding of government programs and services is clearly Fiscal Policy.

25. When all of the quotes have been reviewed, have a single member from each group turn in their groups Venn Diagram worksheet. Then all students should return to their original seats.

Closure

25. On a whiteboard, screen or electronic board, display Slide 3: Sample Quote B and read the text of the quote to the class.
   - “Upside risks to the economy are that growth will continue and perhaps even defy the skeptics who say the rapid 2018 pace is the result only of temporary fiscal stimulus that won't last. That upside carries with it the possibility of inflation, both in price pressures and market valuations that could force the Fed into hiking even more aggressively than the market thinks.”

26. Ask the students to think about what they have learned about Fiscal and Monetary Policy and prepare them to be polled as a whole class on this final quote. Remind the class that they will voting by hand by putting their thumbs up if the quote is about Monetary Policy, thumbs down if it is about Fiscal Policy and making a fist if the quote deals with both policies.
Fiscal Policy & Monetary Policy: What’s the difference?

27. After the students have had a moment to review the quote, call for them to vote by a show of hands. Ask one or more students what was their rationale for making the selection they did when casting their vote.

28. Discuss the students’ responses to the quote and finally inform the whole class that the quote dealt with both Monetary and Fiscal Policy. (Monetary and Fiscal Policy – The quote mentions Fiscal Policy when discussing the 2018 fiscal stimulus and Monetary Policy when looking at the Fed. The quote argues that the economic growth in 2018 is caused in part by Fiscal Policy decisions and that the effects of this policy could force the Fed to adjust the path of Monetary Policy.)

29. Distribute Handout 13: Student Assessment, and review the assessment instructions with the class. Then have the students complete the assessment.
   - Student Assessment Answer Key

Write the letter next to the term that best matches the definitions below.

1. d. Maximum Employment a) Financial charges imposed by governments to fund public services.
2. c. Price Stability b) Actions by the Fed to influence interest rates and the money supply.
3. e. Fiscal Policy c) Low, stable inflation over an extended period of time.
4. g. Dual Mandate d) Job markets performing at their best possible sustainable levels.
5. a. Taxes e) Spending, taxing and borrowing decisions of the federal government.
6. b. Monetary Policy f) A rise over time in a nation's production of goods and services.
7. f. Economic Growth g) The Fed's task to promote maximum employment and stable prices.

Answer the questions below in complete sentences.

8. What are the main goals of Fiscal Policy?
   A complete answer should include: fund government operations and services, manage economic growth, and that other goals vary with each administration.

9. The buying and selling of securities and paying interest on bank reserves are both examples of what?
   Answers may vary but should include: Both the buying and selling of securities and the paying of interest on bank reserves are tools of Monetary Policy used by the Fed.

10. Read the following quote and explain in complete sentences whether it discusses fiscal policy, monetary policy or both.

    “Taking substantial action at this point, though, would send what could be a negative message to the market — that the balance sheet runoff, which former Chair Janet Yellen said would be ‘like watching paint dry,’ is running into snags and requires corrective action. However, the Fed would have no choice if there are indications that it can't control the market movements, particularly considering the record level of Treasury debt the government has issued this year.”

    A complete answer will include: The quote deals with Monetary Policy. While the quote discusses both the Fed (Federal Reserve System) and the Treasury as a part of the U.S. government, the quote is focused on the balance sheet runoff or the selling of securities, which is a tool of Monetary Policy. The discussion about the Treasury is in reference to possible future actions the Fed may have to take based on many factors, including the government’s selling of Treasury bonds.
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Glossary

- Balance sheet – A financial report that lists the Federal Reserve assets (securities it owns) and liabilities (bank reserves and the value of currency in circulation).
- Budget deficit – Government expenditures in excess of government revenues.
- Debt ceiling – The upper limit set on the amount of money the government may borrow to meet its existing legal obligations.
- Dual mandate – The Federal Reserve’s responsibility to use monetary policy to promote maximum employment and price stability.
- Economic growth – A sustained rise over time in a nation’s production of goods and services.
- Fed – short for the Federal Reserve System
- Federal funds rate - The interest rate at which a depository institution lends funds that are immediately available to another depository institution overnight.
- Fiscal policy – The federal government’s overall approach to spending, borrowing, and taxation.
- Inflation – A general, sustained upward movement of prices for goods and services in an economy.
- Gross Domestic Product (GDP) – The total market value, expressed in dollars, of all final goods and services produced in an economy in a given year.
- Maximum employment – Job markets performing at their best possible sustainable levels over the long-term.
- Monetary policy – Managing the money supply to influence interest rates and the availability of credit.
- National debt – The accumulation of budget deficits. Also known as government debt.
- Portfolio – A list or collection of financial assets that an individual, organization, or company owns.
- Price stability – A low and stable rate of inflation maintained over an extended period of time.
- Protectionism – Government actions or policies that shield domestic industries from foreign competition.
- Recession – A period of declining real income and rising unemployment; significant decline in general economic activity extending over a period of time.
- Reserves – The sum of cash that banks hold in their vaults and the deposits they maintain with Federal Reserve banks.
- Security – A financial asset that can be bought or sold, such as stocks and bonds.
- Tariff – A tax on imported or exported goods.
- Taxes – Financial charges imposed by governments on business and individual income, activities, property, or products to fund public services and government operations.
- Unemployment rate – The percentage of the labor force that is willing and able to work, does not currently have a job, and is actively looking for employment.
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Slide 1: Fiscal Policy & Monetary Policy: What’s the difference?
A. “The new phase for the Fed could present new challenges, including when to start shrinking its large portfolio of securities, something Ms. Yellen said was discussed at the meeting. The Fed boosted its portfolio, or balance sheet, after the 2008 financial crisis with several rounds of asset purchases aimed at stimulating the economy by lowering long-term rates.”

https://www.wsj.com/articles/fedraises-interest-rates-remains-on-track-to-keep-tightening-1489600935

Opinions expressed by the author of the quote is solely theirs and do not represent the official position of the Federal Reserve Bank of Richmond or the Federal Reserve System.
B. “Upside risks to the economy are that growth will continue and perhaps even defy the skeptics who say the rapid 2018 pace is the result only of temporary fiscal stimulus that won't last. That upside carries with it the possibility of inflation, both in price pressures and market valuations that could force the Fed into hiking even more aggressively than the market thinks.”


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1. “[According to one economist], the Fed’s newfound confidence appears to be fueled by a surge in consumer and business sentiment, rooted largely in President Trump's plan to cut taxes and regulations and boost federal spending, and a rise in inflation close to the Fed’s annual 2% target.”

https://www.usatoday.com/story/money/2017/03/13/trump-clouds-picture-fed-considers-interest-rate-hikes/99034434/
2. “The Fed anticipates hiking rates three times in total in 2018, part of an ongoing move away from the extraordinary measures it took to stimulate the economy during and after the Great Recession. But the central bank opened the door to potentially doing four hikes. Higher rates are likely to be welcomed by savers but not by borrowers, who will face more expensive loan terms.”


Opinions expressed by the author of the quote are solely theirs and do not represent the official position of the Federal Reserve Bank of Richmond or the Federal Reserve System.
3. “The national debt, which has exceeded $21 trillion, will soar to more than $33 trillion in 2028, according to the budget office. By then, debt held by the public will almost match the size of the nation’s economy, reaching 96 percent of gross domestic product, a higher level than any point since just after World War II and well past the level that economists say could court a crisis.”


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4. “U.S. banks are set to push up borrowing costs on credit cards and other types of loans while keeping interest rates on saving products largely unchanged. Within minutes of the Fed’s quarter point increase, lenders ... said they would lift their ‘prime rates,’ which are used to determine borrowing costs.”


Opinions expressed by the author of the quote are solely theirs and do not represent the official position of the Federal Reserve Bank of Richmond or the Federal Reserve System.
5. “President Donald Trump called for deep reductions in business tax rates and major changes to the individual tax system ... which include a 15% tax rate for all businesses, lower individual rates, a bigger standard deduction to benefit middle-income households.”
6. “The fulcrum of Powell’s policy is straight out of modern economic theory — keeping inflation expectations low and stable. Measures of what the public expects longer-run inflation to be can be somewhat hazy, but most gauges show them at low and stable rates. If they ever broke free, the Fed would act aggressively. ‘I am confident that the FOMC would resolutely “do whatever it takes” should inflation expectations drift materially up or down or should crisis again threaten,’ Powell said.”


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7. “With the unemployment rate at a 17-year low of 4.1%, President Donald Trump ... enacted tax cuts of at least $1.5 trillion over 10 years and spending increases worth $300 billion over two years that will swell federal budget deficits. These measures could boost household and business spending and push up inflation. Mr. Powell’s testimony acknowledged how the tailwind from fiscal stimulus could shift the Fed’s focus.”


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9. “We at the Federal Reserve must remain squarely focused on our congressionally mandated goals. The economy has essentially met the employment portion of our mandate and inflation is moving closer to our 2 percent objective. This outcome suggests that our goal-focused, outlook-dependent approach to scaling back accommodation over the past couple of years has served the U.S. economy well.”


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Handout 11: Student Notes

Student Name: ____________________________________________________   Date: ______________

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Handout 12: Group Venn Diagram Worksheet

Student Names: ____________________________________________________________

Date: ______________
Handout 13: Student Assessment

Student Name: ____________________________________________________   Date: __________________

Write the letter next to the term that best matches the definitions below.

1. __Maximum Employment ______ b) Financial charges imposed by governments to fund public services.
2. __Price Stability ______ c) Low, stable inflation over an extended period of time.
3. __Fiscal Policy ______ d) Job markets performing at their best possible sustainable levels.
4. __Dual Mandate ______ e) Spending, taxing and borrowing decisions of the federal government.
5. __Taxes ______ f) A rise over time in a nation’s production of goods and services.
6. __Monetary Policy ______ g) The Fed’s task to promote maximum employment and stable prices.
7. __Economic Growth ______

Answer the questions below in complete sentences.

8. What are the main goals of Fiscal Policy?

__________________________________________________________________________________
__________________________________________________________________________________

9. The buying and selling of securities and paying interest on bank reserves are both examples of what?

__________________________________________________________________________________
__________________________________________________________________________________

10. Read the following quote and explain in complete sentences whether it discusses Fiscal Policy, Monetary Policy or both.

   “Taking substantial action at this point, though, would send what could be a negative message to the market — that the balance sheet runoff, which former Chair Janet Yellen said would be ‘like watching paint dry,’ is running into snags and requires corrective action. However, the Fed would have no choice if there are indications that it can’t control the market movements, particularly considering the record level of Treasury debt the government has issued this year.”

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