Two Policy Levers

Trace how policy choices can affect prices and jobs.

9-12.EC.8 "Explain monetary policy, fiscal policy, and the role of the Federal Reserve."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline each policy tool and circle who controls it. Number the steps in one monetary-policy chain and one fiscal-policy chain to show how each could affect prices or jobs.

A Diner and the Wider Economy

1. At a diner in Ohio, the owner notices that food, rent, and wages have all become more expensive. Customers complain that their paychecks buy less, and some skip dessert. Similar price increases appear across the country. The Federal Reserve, often called the Fed, watches national data on prices and jobs. Congress has given it two long-term goals: stable prices and maximum employment. The Fed cannot set menu prices or order businesses to hire. Instead, it uses monetary policy to influence borrowing and spending across the economy, including choices made by diners and their customers.

2. When inflation stays high, the Fed may raise its target for a short-term interest rate that banks charge one another. That move tends to push up other borrowing rates, though not always immediately. A diner considering a loan for a second location might wait; households may delay buying cars. Slower borrowing and spending can ease pressure on prices. But the same slowdown can reduce hiring or lead to layoffs. If spending instead collapses and unemployment rises, the Fed may lower its rate target to encourage borrowing. Lower rates can support jobs, but too much spending can eventually renew inflation.

3. Congress and the president have another set of tools: fiscal policy, which changes federal spending and taxes. During a downturn, Congress could fund repairs to public buildings. Contractors would hire workers and buy supplies, putting income into the hands of households. Congress could also cut taxes so households keep more of their earnings. Both choices can raise demand, but they may increase the federal budget deficit if spending rises or tax revenue falls without other changes. Unlike the Fed's interest-rate decisions, federal tax and spending changes require legislation. These policies can work together, but their effects depend on timing and economic conditions.

2 ANSWER WITH EVIDENCE

Use the passage

1. How could a Fed rate increase affect the diner's expansion plan and inflation?

2. Why might the Fed lower its rate target when unemployment rises? What risk to prices could follow?

3. How could federal funding for building repairs affect employment, and why might it increase the deficit?

4. How do the decision makers and tools of monetary policy differ from those of fiscal policy?

3 YOUR TURN

Your own words

Imagine factories are closing across the country, unemployment is rising, and prices are steady. Propose one Fed action and one federal fiscal action, explain how each could support jobs, and identify one possible cost or risk.

ANSWER KEY

Two Policy Levers

HIGH SCHOOL · 9-12.EC.8

PART 1 · READ AND MARK

Underline each policy tool and circle who controls it. Number the steps in one monetary-policy chain and one fiscal-policy chain to show how each could affect prices or jobs. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How could a Fed rate increase affect the diner's expansion plan and inflation?	**Higher borrowing rates might lead the diner to delay taking out a loan. Slower borrowing and spending could ease pressure on prices.**
2	Why might the Fed lower its rate target when unemployment rises? What risk to prices could follow?	**Lower rates can encourage borrowing and spending, which can support jobs. If spending grows too much, inflation could return.**
3	How could federal funding for building repairs affect employment, and why might it increase the deficit?	**Contractors could hire workers and buy supplies. The spending could increase the deficit if it is not offset by other changes.**
4	How do the decision makers and tools of monetary policy differ from those of fiscal policy?	**The Fed makes monetary-policy decisions about interest-rate targets to influence borrowing and spending. Congress and the president make fiscal-policy changes to federal taxes and spending through legislation.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

The Fed could lower its interest-rate target, making borrowing more attractive so firms may expand and hire. Congress and the president could approve federal spending to repair aging bridges, creating jobs for construction workers and suppliers. Both actions could raise demand while unemployment is high. The new spending could increase the federal budget deficit unless lawmakers offset its cost.

Accept other plausible federal spending or tax proposals that explain a path to employment. Responses should distinguish the Fed's monetary-policy role from federal fiscal decisions and name a credible risk.