Two Policy Levers

Compare how policy choices affect jobs, growth, and prices.

E.C.10.1 "Compare fiscal and monetary policy and evaluate the impact each has on economic growth, employment, and price stability."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline government policy actions and circle central bank policy actions. Write G, E, or P beside a stated effect on growth, employment, or price stability for each type of policy.

When the Economy Changes Course

1. Imagine a country where shops are losing customers and construction crews are being laid off. The national government votes to repair aging bridges and pays local firms to do the work. This is fiscal policy, the use of government spending and taxes to influence the economy. Firms may hire workers, who then buy more goods, helping other businesses expand. Production and employment could rise as a result. Yet approving projects and starting construction take time. If demand grows faster than businesses can supply goods and services, prices may rise, making stable prices harder to maintain.

2. The country's central bank has another tool: monetary policy, which changes financial conditions, often by adjusting a policy interest rate. To fight the same slowdown, it lowers that rate. Other interest rates may fall, making loans for equipment, homes, and cars cheaper. More borrowing and spending can support production and hiring without waiting for a bridge project to begin. But lower rates cannot force families or firms to borrow when they are worried about the future. If spending rises too quickly while supplies are limited, inflation may increase, weakening price stability.

3. Now imagine demand is surging and prices are climbing rapidly. The government could reduce spending or raise taxes, leaving less money available for purchases. The central bank could raise its policy rate, making many loans more expensive and discouraging borrowing. Both choices can slow spending and ease pressure on prices, but weaker sales can also slow economic growth and reduce hiring. Fiscal decisions require lawmakers to agree on a budget or tax change; a central bank can change its rate sooner, though the effects of that change may take time to spread.

2 ANSWER WITH EVIDENCE

Use the passage

1. During the slowdown, how could bridge spending and a lower policy interest rate each increase growth and employment?

2. How could either policy used to fight the slowdown make price stability harder to maintain?

3. When demand and prices are rising rapidly, compare how the government's choices and the central bank's choice could affect growth, employment, and prices.

4. During a slowdown, why might the government and the central bank each have trouble producing a quick increase in employment?

3 YOUR TURN

Your own words

A crop failure has raised food prices while layoffs spread through other industries. In one paragraph, recommend one fiscal action and one monetary action, compare their likely effects on growth, employment, and price stability, and explain a tradeoff caused by the crop shortage.

ANSWER KEY

Two Policy Levers

HIGH SCHOOL · E.C.10.1

PART 1 · READ AND MARK

Underline government policy actions and circle central bank policy actions. Write G, E, or P beside a stated effect on growth, employment, or price stability for each type of policy. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	During the slowdown, how could bridge spending and a lower policy interest rate each increase growth and employment?	**Bridge spending pays firms that may hire workers, whose purchases help other businesses expand. A lower policy rate may make loans cheaper, encouraging borrowing and spending that support production and hiring.**
2	How could either policy used to fight the slowdown make price stability harder to maintain?	**Either policy could increase spending. If demand rises faster than the supply of goods and services, prices or inflation may rise.**
3	When demand and prices are rising rapidly, compare how the government's choices and the central bank's choice could affect growth, employment, and prices.	**The government could cut spending or raise taxes, while the central bank could raise its policy rate. Both could ease pressure on prices by slowing spending, but both could also slow growth and reduce hiring.**
4	During a slowdown, why might the government and the central bank each have trouble producing a quick increase in employment?	**Government projects take time to approve and start. Lower interest rates may not lead to more borrowing if families and firms are worried about the future.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

The government could fund temporary jobs repairing irrigation canals, directly supporting employment and growth. The central bank could keep its policy rate unchanged instead of lowering it, which would avoid encouraging more borrowing while food prices are rising. Unlike the jobs program, that rate choice would do little to boost hiring soon, but it could help limit pressure on prices. The new canals would not replace this year's lost crops, so even targeted spending could add demand while food remains scarce.

Accept other plausible policy choices if the response distinguishes government action from central bank action and compares effects on growth, employment, and price stability. The tradeoff should recognize that stronger demand cannot quickly replace crops lost in the failure.