Fiscal and Monetary Policy

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We hear a lot of talk about which government policies can help get the economy back on its feet. I thought Iôd provide a quick cheat sheet on just what these various terms actually mean.

This chart shows the complete list of tools that the federal government has to affect the economy. There are two main types of policy, *monetary* and *fiscal*. When you hear monetary policy think Federal Reserve. When you hear fiscal policy, think IRS and federal spending.

The Federal Reserve can alter two things to affect the economy, the Fed Funds rate and the Money Supply.

Interest Rates: The Federal Funds target rate is the interest rate at which private depository institutions, mostly banks, lend the funds they hold at the Federal Reserve to each other, generally overnight. It can be thought of as the rate banks charge each other. This target rate is identified in a meeting of the members of the Federal Open Market Committee which usually meets eight times a year. The New York Fed affects this rate by trading government securities.

Money Supply: The Federal Reserve typically alters the money supply by increasing or decreasing bank reserves. (See white paper of the U.S. Banking System.)

Tax and Spend: What else need be said? Fiscal policy involves the government increasing or decreasing taxes and the amount of federal spending, which letôs face it, pretty much just goes up.