US FISCAL AND MONETARY POLICY

Fiscal Policy

Fiscal policy: The means by which the government sets its spending levels and tax rates to influence the economy's behavior.

Discretionary fiscal policy: The actions the government takes on an ad hoc basis to change taxes or spending.

Automatic stabilizers: Predetermined policies designed to offset fluctuations in the business cycle.

Multiplier effect: A series of increases in consumer spending that results from an initial increase in government purchases.

Marginal propensity to consume (MPC): The fraction of extra income that a consumer spends.

Government purchases multiplier: When you multiply this number by the initial increase in government purchases, you get the total impact on real GDP.

$$\text{government purchases multiplier} = \frac{1}{1 - \text{MPC}}$$

Tax multiplier: When you multiply this number by the initial increase in taxes, you get the total impact on real GDP.

$$\text{tax multiplier} = \frac{-\text{MPC}}{1 - \text{MPC}}$$

Budget surplus: When tax revenues exceed government expenditures.

Budget deficit: When government expenditures exceed tax revenues.

Crowding out: When government borrowing causes a decrease in private investment.

Loanable funds: The sum of money that people or businesses decide to save, which then becomes available to be loaned.

Monetary Policy

Central bank: A national bank that governs a nation's banking system.

Federal Reserve (FED): The central bank of the US.

Required reserve ratio (RRR): The minimum fraction of deposits that commercial banks are required by law to keep in reserves.

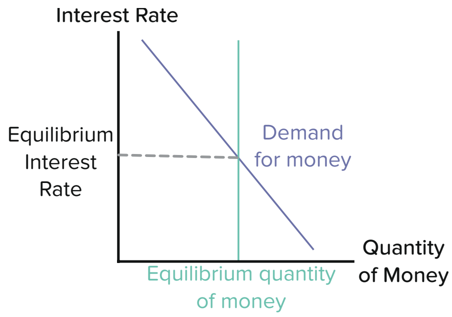
Money: Any asset that people are generally willing to accept in exchange for goods and services or for payment of debts.

Money supply: The quantity of money available in the economy.

Money multiplier (mm): The amount of money that banks generate with each dollar of reserves.

$$\text{money multiplier} = \frac{1}{RRR}$$

Money market: The collection of buyers and sellers of money.



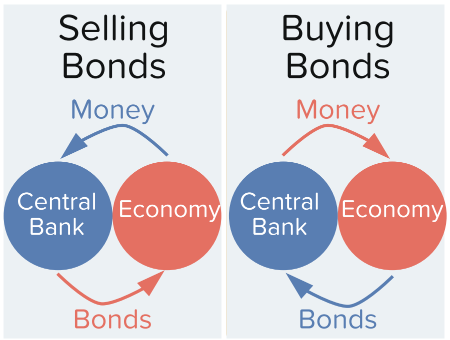
Money market equilibrium: The state where the quantity of money demanded equals the quantity of money supplied, resulting in the equilibrium interest rate.

Monetary policy: The actions the central bank takes to manage the money supply and interest rates in order to achieve macroeconomic policy goals.

Expansionary monetary policy: When a central bank uses its tools to increase the money supply, lower interest rates, and increase aggregate demand.

Contractionary monetary policy: Decreases the money supply, raises interest rates, and decreases aggregate demand.

Discount rate: The interest rate on the Fed's loans to commercial banks.



Open market operations: The buying and selling of government bonds.

Quantity theory of money: Says that the money supply has a direct and proportional relationship with the inflation rate.