

Fiscal and Monetary Policy

Governments use fiscal and monetary policies in order to achieve the economic stability, which means achieving a high economic growth rate, controlling inflation, and full employment of the economic factors.

Fiscal Policy:

Fiscal Policy can be defined as the tools that the government uses to achieve its economic objectives, these tools are government spending and taxes, the government adjusts its spending levels and its tax policies. Fiscal policy can achieve several objectives; the first and the most important objective of fiscal policy is the full utilization of resources, this is will eventually increase the employment rate and improve the standards of living in the economy. Price stability is the second objective of fiscal policy which can be achieved through balancing between the aggregate demand and aggregate supply to avoid prices inflation. Another objective of fiscal policy is to encourage investment, fiscal policy affects the rate of investment in the public sector which in return will affect the rate of investment in the private sector. Other objectives of fiscal policy includes equal distribution of resources, optimization of resource, and to achieve the economic stability.

Fiscal policy can influence the economic factors by adjusting government spending and taxes.

- In case of recession, the government should use expansionary fiscal policy by increasing government spending, decreasing taxes, or a mixture of both. Increasing government spending will create more money in the economy and will help in creating more jobs and more economic growth rate. Decreasing taxes will increase the purchasing power of people which in return will increase the aggregate demand in the economy. By applying this policy, aggregate demand and employment will increase thus the government will achieve higher economic growth.
- In case of inflation, the government may use contractionary fiscal policy by increasing taxes, decreasing government spending, or both. Increasing taxes will decrease the purchasing power of individuals which will result in lower demand. Decreasing government spending will decrease aggregate spending in the economy which will decrease the inflationary gap.

Monetary Policy:

Monetary policy is basically used by central banks and governments to encourage the economic growth or to discourage the growth rate to avoid economic issues such as inflation. By facilitating borrowing and spending to people and businesses, monetary policy will help the economy to grow faster, while limiting spending will make the economy grow slower.

- In case of recession, the government may use expansionary monetary policy by buying government bonds, lowering the interest rate, or lowering the reserve ratio. Thus, the money supply will increase in the economy, unemployment will decrease, and borrowing and spending will be stimulated.
- In developed countries, governments may want to decrease the money supply by using contractionary monetary policy in which governments sell government bonds, raise the interest rate, or raise the reserve ratio. This can help in dealing with economic issues such as inflation.

Fiscal policy and monetary policy together:

Both policies can be used at the same time in order to achieve economic stability. In case of recession, the government will use expansionary fiscal policy by which it increases its spending or reduces its taxes, and at the same time it can use expansionary monetary policy which leads to a decrease in the interest rate and stimulation of investments.

But if the economy suffers from inflation, contractionary fiscal policy will be used by decreasing the government spending or increasing taxes which leads to a lower aggregate demand, at the same time, contractionary monetary policy can be used which leads to an increase in the interest rate and thus a decrease in investments and aggregate demand will occur.

	Fiscal Policy	Monetary Policy
Definition	The use of government spending and tax policy to affect the economy.	The central bank controls the supply of money to achieve economic stability and growth.
Principal	Adjusting the level of aggregate demand to achieve the economic objectives.	Adjusting the supply of money in the economy to control economic factors such as growth, inflation, and unemployment.
Player	Government.	Central Bank
Tools	Government Spending and Taxes.	Interest rate, reserve ratio, and government bonds.

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