What is macroeconomic policy and how is it conducted?

Macroeconomic policy refers to actions of the federal government and the Federal Reserve System designed to alter conditions in the economy. The two principal types of macroeconomic policy are fiscal policy and monetary policy.

Fiscal Policy refers to changes in government spending and/or taxation designed to alter macroeconomic conditions. Fiscal policy in the U.S. is the joint responsibility of Congress and the President.

Monetary policy is conducted by the **FED** (Federal Reserve System not the 'federal government') and refers to changes in monetary variables such as the money supply (M1, M2, etc) or interest rates such as the federal funds rate or the discount rate.

Specifically, the **Federal Open Market Committee (FOMC)** meets about every six weeks to set a 'target' for the federal funds rate. The FOMC consists of twelve members. Seven FOMC members are the seven members of the Board of Governors of the Federal Reserve System. The remaining five members are selected from presidents of the twelve Federal Reserve district banks. The District Bank of New York always has a seat on the FOMC while the other four District Bank seats are selected on a rotating basis.

The federal funds rate refers to the interest rate that commercial banks charge each other for (usually overnight) loans needed in order to meet reserve requirements. The FED acts as a broker between banks in these transactions. The federal funds rate influences the interest rates that individuals and commercial borrowers pay because if banks must pay a higher rate of interest to borrow, they will probably charge the rest of us a higher interest rate.

The **discount rate** is the rate that the FED charges when it makes loans directly to commercial banks so that they can meet their reserve requirements. For many years, the FED has discouraged use of the discount window (borrowing by banks directly from the FED).

Contractionary and expansionary are terms applied to both monetary and fiscal policy. An expansionary policy (fiscal or monetary) is an attempt to stimulate the economy (move the Aggregate Demand Curve up and to the right). A contractionary policy (fiscal or monetary) is an attempt to reduce economic activity (move the Aggregate demand curve down and to the left).

An **expansionary fiscal policy** consists of increasing government spending and/ or decreasing taxes. An **expansionary monetary** policy refers to increasing the money supply or reducing interest rates such as the federal funds rate.

A **contractionary fiscal policy** consists of reducing government expenditures and/or increasing taxes. A **contractionary monetary policy** consists of reducing the money supply or increasing interest rates. .

An **automatic stabilizer** refers to changes in government expenditures or taxes that do not require policy makers to take any action. An example of an automatic stabilizer is unemployment insurance. During a recession when more people are unemployed, government expenditures on unemployment insurance automatically increase without specific action of Congress or the President. Another example of an automatic stabilizer is that tax revenues automatically decline during recessions and increase during expansions.

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