Homework #12

Using IS-LM diagrams, graph the course of fiscal and monetary policy during the following events:

the recession of 1974-75

- The Tax Reduction Act of 1975 provided a tax rebate of $8 billion that was paid out in the second quarter of 1975. The tax rebate and other reductions increased consumer spending, which contributed to the economic recovery that began soon after the new laws went into effect.
- The economic expansion caused demand for money to rise, but the Fed was simultaneously expanding the money supply, so nominal interest rates did not change very much.

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the recession of 1980-82

- At the urging of Pres. Reagan, Congress passed a huge tax cut in the summer of 1981. The tax cut led to an increase in consumer spending which helped to lift the economy out of recession.
- As the economy recovered in late 1982, demand for money increased. Nonetheless, interest rates actually fell because the Fed (which had been slowing the growth of the money supply since 1979) suddenly began to expand the money supply sharply in the spring of 1982.

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the recession of 1990-91

- The U.S. economy entered a mild recession in mid-1990. Real GDP began to rise in the second quarter of 1991, but because unemployment remained high, Pres. Bush wanted a tax cut to stimulate the economy. Congress and the Fed were concerned about the effect that a tax cut would have on the already large budget deficit however, so no fiscal stimulus was passed.
- The Fed did reduce interest rates, but the monetary stimulus was small and did not reduce unemployment enough to help Pres. Bush win re-election.

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Pres. Clinton's first budget, 1993-94

- In the summer of 1993, Congress passed Pres. Clinton's first budget which increased taxes and reduced government spending.
- Simultaneously, the Fed pursued an expansionary monetary policy which drove interest rates down to 30-year lows.
- In late 1994, the economy's period of slow growth had ended and a robust expansion began.