Proceedings of the 2nd International Conference on Management Research and Economic Development
DOI: 10.54254/2754-1169/85/20240840

Comparative Analysis of the Monetary Policy and Fiscal Policy: Take the United States as an Example

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Abstract: After the financial crisis of 2008, the United States encountered economic challenges again in 2019. During this time, a large number of problems ensued as a result of behaviors such as mandatory restrictions and voluntary behavioral changes by households and businesses, and the initial wave of COVID-19 infections led to a historic contraction of economic activity. In order to gain the experience and backbone to deal with the economic crisis calmly next time, it is desirable and effective to extract experiences and inspirations from past events. In that case, the troubles brought by major events and the solutions at that time are necessary to be analyzed. The Great Depression of 2008 and COVID-19 of 2019 brought a heavy blow to the economic market, and the different responses of the U.S. in the face of the blows of these two periods provide good examples for the study of monetary policy and fiscal policy. This paper focuses on the differences between monetary and fiscal policies on economic fluctuations in the United States at two important time points, 2008 and 2019. Through comparative analysis, it is concluded that monetary policy and fiscal policy have different manipulators and implementation targets, as well as different efficiency and flexibility in their roles.

Keywords: Monetary policy, Fiscal policy, US, Difference, Combine

1. Introduction

Karagiannis et al. mentioned in a book that since the financial crisis of 2008, the U.S. economy has entered a new era, which has led to the emergence of many new ideas and policy trends. This means that the occurrence of new events is often accompanied by the rise of a large number of ideas and that people's brainstorming is nurtured in the midst of a crisis and accompanied by a variety of novel perspectives [1]. Everything that happens is bound to happen. All people need is a decision that requires wisdom and unparalleled courage, which is destined to shape the future of this old and young nation [2].

Then, in the first half of 2020, the Gross Domestic Product (GDP) of the United States fell by a cumulative 10 percent, and the measured unemployment rate spiked to a new post-World War II high of 14.8 percent in April. In this environment, proper policy guidance is indispensable. Consequently, there is a need to study fiscal and monetary policy, which after all have an empirical role that cannot be replicated [3].

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The initial study of macroeconomics can help gain a basic understanding of monetary policy and fiscal policy, as well as the significant impact of monetary policy and fiscal policy on the market. In order to further understand the characteristics, similarities, and differences between monetary and fiscal policies, this paper takes the responses made by the United States in 2008 and 2019 respectively as examples to launch the study of these two policies.

In this paper, the author analyzes U.S. monetary and fiscal policies from three perspectives: the manipulator behind the scenes, the target, and the speed and flexibility of impact. The author uses comparative analysis to illustrate their significance and effectiveness, as well as the differences between them. This paper can help its readers obtain a better understanding of the strengths and weaknesses of the two policies. In times of major economic crises, the combination of the two policies can often have unintended positive effects.

2. Different Decision-Making Bodies

The U.S. government has three direct sources of funding: taxes, borrowing, and money creation, all of which correspond to fiscal and monetary policy [4].

Monetary policy is often thought of as a set of tools used by a country's central bank to control the overall money supply and promote economic growth, using strategies that include revising interest rates and varying bank reserve requirements to change the money supply. For example, to stimulate a weak economy, the central bank will lower interest rates to reduce borrowing costs while increasing the money supply. In 2008 and 2020, monetary policy in the United States took this approach. Conversely, if the economy is growing too fast, the central bank may implement a tight monetary policy to maintain economic stability by, for example, raising interest rates [5]. These decisions all come from the central bank.

Fiscal policy, on the other hand, determines the way in which the central government makes money and spends money through taxation, and it is a measure taken by the government to influence the direction of the economy. In order to stimulate the economy, the government lowers taxes while increasing its own spending, and in order to cool down an overheated economy, the government raises taxes and reduces spending. Keynesianism, for example, views the economy as a machine with multiple levers. One of those levers is government spending. If a person wants to pull the lever, she or he can increase government spending without raising taxes, and the machine will start to heat up. The result is higher prices throughout the economy, known as inflation. Fiscal policy is one such economic policy that is controlled by the government, and its controller is the government's finance department.

While this seems to make monetary and fiscal policy different in nature, monetary policy is not as closely tied to politics and government, as fiscal policy is. However, in a recent paper, William Luther and Alexander William Salter point out that monetary policy is inherently political [6]. Precisely because fiscal policy is highly political, we cannot ignore political and institutional arrangements when discussing fiscal policy [7]. When monetary policy is carefully analyzed, central bank decisions are still inextricably linked to government decisions, for example, the country's main direction of development, development strategies, and shifts in the center of gravity can have a significant impact on the economy. Further, behind-the-scenes manipulation of central bankers by politicians and their proxies exists and has always existed.

3. Different Policy-Making Targets

After the above analysis, it can be concluded that the object of monetary policy is the money in circulation, namely the total amount of money in the market. While the direct object of fiscal policy is the government's income and expenditure, and the indirect object is the people. In other words,

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governments can redistribute wealth through taxation and social welfare changes, for instance, transferring the assets of the rich to the poor, thereby ensuring a more equitable society. This shows that there is a big difference between monetary policy and fiscal policy in terms of the object of action.

In 2008, the global economic depression occurred, and the United States implemented the monetary policy and fiscal policy at the same time, in order to offset the situation of economic recession, stabilize the financial system, and promote economic recovery [8]. First, the Federal Reserve lowered interest rates through monetary policy and implemented quantitative easing to stimulate lending and economic activity. Immediately after the crisis, people's satisfaction with the government and the economy declined, but satisfaction with health care and education services rose. Additionally, as time passed between, people's negative perceptions of the government shifted to positive ones, which can be attributed to the government's success in correcting the immediate negative effects of the crisis. Conversely, some people saw the problems faced by other countries and appreciated the short-term performance of their governments in dealing with the crisis. However, over time, they gradually became more critical. Besides, the COVID-19 pandemic forced the government to implement policies to revitalize the economy and improve services in sectors such as health and education [9]. These policies were, to some extent, also part of fiscal policy. During the COVID-19 period, the policies of the United States are also worth exploring with great interest, as they learned from the lessons of the 2008 financial crisis and quickly introduced crisis-responsive fiscal and monetary policies to stimulate economic growth. The United States implemented three rounds of fiscal stimulus programs, in addition to a series of presidential memorandums and executive orders signed by the President of the United States. At the same time, the Federal Reserve actively cooperates with the implementation of fiscal policy, zero federal benchmark interest rate, and unlimited quantitative easing, the use of a variety of tools for financial rescue program capital injection, to the market to inject a large amount of liquidity. From these perspectives, it is not difficult to see that the roles of monetary policy and fiscal policy are very different in terms of mode and object.

4. Different Modes of Operation

In past experience, monetary policy has played an important role, but in practice, interest rate cuts have not been effective in restoring normal growth. People no longer seem to believe that monetary policy should be used to stabilize prices when there is price volatility or market instability; nowadays it is difficult to reach a consensus on this point of view, and it is simply believed that monetary policy should be used in financial and economic crises, but how it should be used and how it should intervene in the development of the economy is problematic. In other words, people no longer believe that monetary policy can be used to stabilize prices and intervene to solve economic problems [10]. In the 2008-2009 recession, there was a liquidity trap, and interest rate cuts were not enough to encourage consumption and investment. In the classic case of the Great Recession of 2008, in response to the financial crisis, the Federal Reserve implemented unconventional monetary policies, including quantitative easing. At the same time, the U.S. Congress passed fiscal stimulus packages, such as the Troubled Asset Relief Program (TARP) and the American Recovery and Reinvestment Act (ARRA), in response to the recession. This is due to the fact that monetary policy acts indirectly on the economy, so it will be less efficient, but it has the advantage of being able to propose solutions based on real-time movements and put them into effect immediately. The political nature of fiscal policy does not allow it to adapt quickly to changes in the current situation. Overall, the United States uses a combination of monetary and fiscal policies to achieve macroeconomic goals, emphasizing flexibility and adaptability to different economic challenges.

For example, in recent years, the Federal Reserve has managed inflation and employment by adjusting interest rates, while at the same time, the government has proposed fiscal measures such as tax reform and the COVID-19 outbreak bailout program, which have also had an impact on the economic situation. Economic markets were largely affected by the global outbreak of COVID-19 at the end of 2019, with a sharp drop in employment and tremendous turmoil in financial markets [3]. The FED, in its eight meetings of the 2020 national monetary policy to resist the negative effects of COVID-19, maximize employment, and stabilize financial markets and prices. Whereas U.S. fiscal policy focuses on stimulating demand, from a supply perspective, the persistence of the epidemic has caused disruptions in the U.S. domestic supply chain and a decline in the willingness of the labor force to be employed, which has slowed down the process of production recovery. As consumption grew significantly faster than production recovery, this resulted in a widening of the U.S. supply-demand gap and an increase in import demand [11]. The reason that monetary policy is the first to have an impact is that monetary policy adjustments tend to be able to take effect relatively quickly, whereas the impact of fiscal policy can be delayed due to bureaucratic procedures and legislative approvals.

This shows the difference in speed of impact between the two, in addition to the large difference in flexibility between the two. Monetary policy can be adjusted more quickly to changing economic conditions, but changes in fiscal policy often require legislative approval, which makes them more rigid. Overall, much of the difference between the two policies in terms of speed of impact and flexibility stems from the politically regulated and procedurally complex nature of their operation.

5. Conclusion

Finally, it is concluded that monetary policy is the FED's way of influencing the economy by adjusting the supply of money in the market through buying and selling in the financial markets, while fiscal policy is the U.S. Treasury's way of macro-regulating the direction of money to influence the economy by adjusting taxes and government purchases, among other things. Moreover, monetary policy is effective in controlling inflation and influencing short-term interest rates, but its impact on real economic output may be limited [12]. Fiscal policy, while powerful in stimulating demand and addressing long-term problems, may face implementation challenges and potential political constraints. It is common to combine the two policies in periods of economic downturn, capitalizing on their different degrees of flexibility and speed of impact, using monetary policy to address immediate problems and fiscal policy to address longer-term structural challenges. Therefore, to use a better combination of the two policies, we need to understand the differences and find the right balance to make good decisions that keep the economy stable and growing. In the days ahead, repeated comparative thinking and in-depth research will be necessary, and the effects, strengths, and weaknesses of the various measures taken in past major events are strong references that will make us more capable of dealing with and reacting to future emergencies as they occur. The importance of uncertainty, policymaker preferences and targeting is very relevant when combining monetary and fiscal policy.

In addition, data are also very important, and more rigorous speculation through precise analysis of data is a very important step in policymaking [13]. In addition, with the change in the world structure, more influencing factors should be taken into consideration, this paper only cites the economic crisis of 2008 and the economic turmoil of the COVID-19 period to compare and analyze the similarities and differences between the two policies, which is not analyzed in depth in many aspects. Moreover, the research in this paper specifically takes the United States as an example, while the economic structure of the United States is not universal and does not have reference value in many countries. Therefore, a more specific classification analysis should be reflected in each country separately, and then different countries for the same period of economic fluctuations to make policy changes for comparison, to derive some potential policy characteristics, so that we can understand more about the advantages and disadvantages of monetary policy and fiscal policy, and have a more reasonable planning and utilization of it.

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