

*University of Mujahid Abdelhafid Boussouf – Mila*

*Faculty of Economics, Commercial & Management Sciences*

*Departement Of Tronc Commun*

*Lectures On : English economic terminology*

*Addressed To 1st Year Students – 2nd Semester*

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*Academic Year 2025-2026*

# ***Fiscal and monetary policy***

## **Introduction**

Fiscal and monetary policies are the two main tools used by governments and central banks to manage the economy. They influence economic growth, inflation, unemployment, and overall economic stability. Understanding their mechanisms is essential for analyzing macroeconomic performance.

## **1. Fiscal Policy**

Fiscal policy is a key tool that governments use to influence economic activity. It affects aggregate demand, economic growth, inflation, and employment. By adjusting government spending and taxation, policymakers aim to stabilize the economy during different economic cycles.

### **1.1. Definition of Fiscal Policy**

Fiscal policy refers to the use of government revenue (taxes) and expenditure (spending) to achieve macroeconomic objectives. It is controlled by the government (Ministry of Finance).

In short: Fiscal policy = government decisions on spending and taxation to influence the economy.

### **1.2. Objectives of Fiscal Policy**

The main goals of fiscal policy are:

- ✓ Stimulate economic growth during a recession.
- ✓ Control inflation during periods of rapid economic growth.
- ✓ Reduce unemployment.
- ✓ Influence income distribution.

### **1.3. Types of Fiscal Policy**

#### **➤ Expansionary Fiscal Policy**

- ✓ Involves increasing government spending or reducing taxes.
- ✓ Used to boost aggregate demand and reduce unemployment.
- ✓ Example: Building infrastructure projects or lowering income tax.

#### **➤ Contractionary Fiscal Policy**

- ✓ Involves reducing government spending or increasing taxes.
- ✓ Used to reduce inflation and control excessive demand.
- ✓ Example: Increasing VAT or reducing subsidies.

### **1.4. Tools of Fiscal Policy**

#### **➤ Government Spending**

- ✓ Direct spending on infrastructure, education, healthcare, defense.
- ✓ Increases employment and stimulates demand.

#### **➤ Taxation**

- ✓ Increasing or decreasing taxes affects disposable income.

- ✓ Tax cuts → more consumption; Tax hikes → reduce inflation.
  - **Transfer Payments and Subsidies**
- ✓ Social welfare, unemployment benefits, subsidies to businesses.
- ✓ Supports income redistribution and demand stabilization.

### **1.5. Effects of Fiscal Policy**

#### **➤ Positive Effects:**

- ✓ Stimulates economic growth.
- ✓ Reduces unemployment.
- ✓ Improves social welfare through transfers.

#### **➤ Potential Negative Effects:**

- ✓ Budget deficits if spending exceeds revenue.
- ✓ Risk of inflation if too much money is injected.
- ✓ Debt accumulation over time.

Fiscal policy is a vital tool for economic stabilization. By adjusting government spending and taxation, it can stimulate growth, control inflation, reduce unemployment, and promote social welfare. Effective fiscal policy requires careful planning to balance economic benefits with budgetary sustainability.

## **2. Monetary Policy**

Monetary policy is one of the main tools used to manage a country's economy. It focuses on controlling the money supply and interest rates to achieve macroeconomic objectives such as price stability, economic growth, and employment. Unlike fiscal policy, which is controlled by the government, monetary policy is managed by the central bank (e.g., Bank of Algeria).

### **2.1. Definition of Monetary Policy**

Monetary policy is the management of money supply and interest rates by a country's central bank (e.g., Bank of Algeria) to influence economic activity.

In simple terms: Monetary policy = controlling money and credit to stabilize the economy.

### **2.2. Objectives of Monetary Policy**

The main goals of monetary policy include:

- ✓ Control inflation.
- ✓ Stabilize the currency.
- ✓ Promote economic growth.
- ✓ Reduce unemployment.

### **2.3. Types of Monetary Policy**

#### **➤ Expansionary Monetary Policy**

- ✓ Central bank lowers interest rates or increases money supply.
- ✓ Encourages borrowing and spending.
- ✓ Used during economic recessions.

➤ **Contractionary Monetary Policy**

- ✓ Central bank raises interest rates or reduces money supply.
- ✓ Discourages borrowing and spending.
- ✓ Used to control high inflation.

**2.4. Tools of Monetary Policy**

- ✓ **Open Market Operations (OMO):** Buying or selling government securities.
- ✓ **Discount Rate:** Interest rate charged to commercial banks.
- ✓ **Reserve Requirements:** Portion of deposits banks must hold.

**2.5. Effects of Monetary Policy**

➤ **Positive Effects:**

- ✓ Helps control inflation.
- ✓ Stimulates economic growth during slowdowns.
- ✓ Stabilizes financial markets and currency.

➤ **Potential Negative Effects:**

- ✓ High interest rates can reduce investment and consumption.
- ✓ Excessive money supply may cause inflation.
- ✓ Poorly timed policies can destabilize the economy.

Monetary policy is a crucial tool for economic management. By regulating money supply and interest rates, central banks can influence inflation, growth, and employment. Coordination with fiscal policy enhances its effectiveness, ensuring a stable and healthy economy.

**3. Differences Between Fiscal and Monetary Policy**

Fiscal and monetary policies are both essential tools for managing the economy, but they differ in objectives, tools, authorities, and effects. Below is a clear comparison:

**Table 1: Key differences between fiscal and monetary policy**

Aspect	Fiscal Policy	Monetary Policy
<b>Definition</b>	Use of government spending and taxation to influence the economy.	Use of money supply and interest rates by the central bank to influence the economy.
<b>Controlled by</b>	Government	Central Bank
<b>Main tools</b>	Government spending, taxation	Interest rates, money supply, reserve requirements
<b>Primary focus</b>	Aggregate demand through taxation & spending	Money supply and credit availability
<b>Effect speed</b>	Usually slower	Usually faster
<b>Examples</b>	Stimulus packages, tax cuts	Lowering interest rates, quantitative easing

#### 4. Interaction Between Fiscal and Monetary Policy

Fiscal and monetary policies are two main tools for managing the economy. While fiscal policy is controlled by the government through spending and taxation, monetary policy is managed by the central bank through money supply and interest rates. Their interaction is crucial because the effectiveness of one often depends on the other.

✓ Both policies aim to stabilize the economy, but they work differently.

✓ **Coordinated policy:** Expansionary fiscal policy combined with expansionary monetary policy can effectively boost economic growth.

✓ **Conflict:** Sometimes fiscal expansion can increase inflation, requiring a contractionary monetary policy to counteract it.

#### Example

During the **2008 global financial crisis:**

✓ Governments worldwide used expansionary fiscal policies (stimulus packages).

✓ Central banks used expansionary monetary policies (low interest rates, quantitative easing).

✓ Result: Coordinated policies helped stabilize financial markets and support economic recovery.

#### Conclusion

Fiscal and monetary policies are essential tools for economic management. Fiscal policy focuses on government spending and taxation, while monetary policy focuses on money supply and interest rates. Understanding both helps policymakers maintain economic stability, control inflation, reduce unemployment, and promote sustainable growth.

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