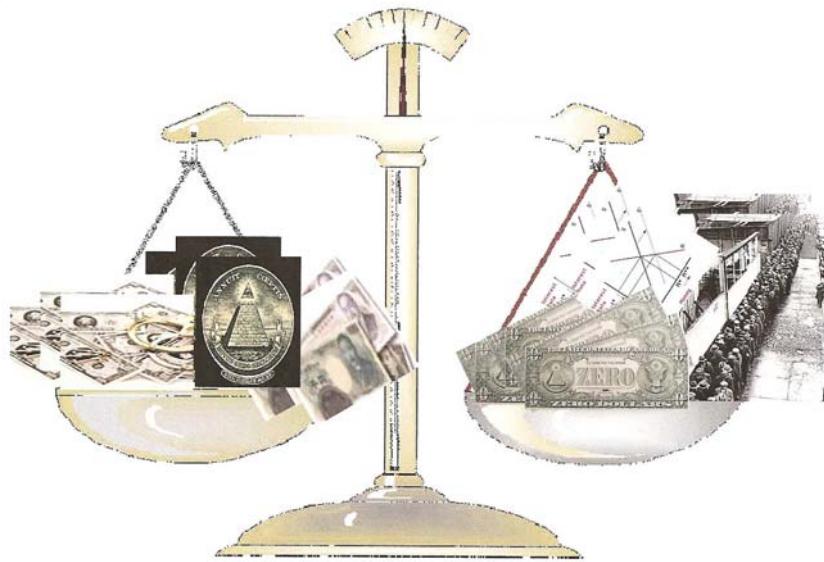


# **The Trial of Monty Terry**

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## LESSON DESCRIPTION

Students study the structure and functions of the Federal Reserve. Then they participate in a reader's theater, acting out the roles typical of a courtroom drama as they determine whether the defendant, *Monty Terry* (monetary policy), is guilty of manipulating the economy, controlling the money supply, and outperforming fiscal policy in solving macroeconomic problems. Testimony from witnesses for the prosecution and for the defense details how the Fed conducts monetary policy to solve macroeconomic problems.

## AGE LEVEL

16–18 years old

## CONCEPTS

Monetary policy

The Federal Reserve

FOMC (Federal Open Market Committee)

Open market operations

Reserve requirement

Discount rate

Tight money or easy money policy

Strong or weak dollar

Capital flight or capital inflow

**Note:** Prior to this lesson students should have already studied and have a basic understanding of fiscal policy, inflation, gross domestic product, exports, imports, net exports, incentives, costs, and benefits.

## NATIONAL CONTENT STANDARDS

### Standard 20—Monetary and Fiscal Policy

- **Benchmark 1 for 12th grade:** Fiscal policies are decisions to change spending and tax levels by the federal government. These decisions are adopted to influence national levels of output, employment, and prices.
- **Benchmark 7 for 12th grade:** In the long-run, inflation results from increases in a nation's money supply that exceed increases in its output of goods and services.
- **Benchmark 8 for 12th grade:** Monetary policies are decisions by the Federal Reserve System that lead to changes in the supply of money and the availability of credit. Changes in the money supply can influence

overall levels of spending, employment, and prices in the economy by inducing changes in interest rates charged for credit and by affecting the levels of personal and business investment spending.

- **Benchmark 9 for 12th grade:** The major monetary policy tool that the Federal Reserve System uses is open market purchases or sales of government securities. Other policy tools used by the Federal Reserve System include increasing or decreasing the discount rate charged on loans it makes to commercial banks and raising or lowering reserve requirements for commercial banks.

### Alabama Course of Study Correlation: Social Studies. Economics, Bulletin 2004, No. 18

- Objective 9: Describe economic stabilization policies of the United States.
- Objective 10: Explain the role of money and the structure of the banking system of the United States.
- Objective 11: Explain the past and present impact of the Federal Reserve Bank on the economy of the United States.
- Objective 12: Explain basic elements of international trade.

## OBJECTIVES

Students will be able to:

- Explain how the Federal Reserve System is organized.
- List the tools the Federal Reserve Board uses to control the money supply.
- Compare and contrast monetary policy tools with fiscal policy tools.
- Identify what government agencies and offices determine both monetary and fiscal policy.
- Evaluate the strengths and weaknesses of monetary policy as compared with fiscal policy.
- Identify easy money and tight money tools that the Fed uses to solve macroeconomic problems such as recession and unemployment.
- Analyze the effects of monetary policy on our nation's net exports, namely, the

appreciation and depreciation of the dollar and how these changes lead to capital flight and capital inflow of foreign investment.

- Explain the effect of monetary policy on net exports and then eventually on equilibrium GDP.

## TIME REQUIRED

Two to three 50-minute class periods

## MATERIALS

- Video: *In Plain English: Making Sense of the Federal Reserve* (DVD), available from the Federal Reserve Bank of St. Louis
  - *The Federal Reserve Today*, 15th edition, available from The Federal Reserve Bank of Richmond
  - Comic book: *The Story of the Federal Reserve System*, available from the Federal Reserve Bank of New York
- Note:* To order all three of the above publications from the Federal Reserve, free of charge, go to [http://www.stlouisfed.org/education/resources/tools/search\\_resource.cfm](http://www.stlouisfed.org/education/resources/tools/search_resource.cfm)
- *Visual 1—What You Will Learn From This Lesson*
  - *Visual 2—The Brief for the Trial of Monty Terry*
  - *Visual 3—Key Terms for Monetary Policy*
  - *Visual 4—Weak Dollar vs. Strong Dollar: What Is the Difference?*
  - *Visual 5—Characters in the Courtroom*
  - *Activity 1—The Fed in a Comic Book* (one copy per group, two pages)
  - *Activity 2—The Brief for the Trial of Monty Terry* (one copy per student)
  - *Activity 3—The Brief for the Trial of Monty Terry* (answers)
  - *Activity 4—Transcript of the Trial of Monty Terry* (one copy per student)
  - *Activity 5—Assessment* (one copy per student, two pages stapled)
  - *Activity 6—Assessment Answers* (two pages)
  - Name tags for each witness
  - A gavel (optional)

## PROCEDURE

### Part 1

1. Display *Visual 1—What You Will Learn from This Lesson*, and review the lesson objectives with the students.
2. Tell the students that they will view a video that will introduce them to the structure and functions of the Federal Reserve. Show the video *In Plain English: Making Sense of the Federal Reserve*.
3. After viewing the video, debrief using the following questions:
  - a. Who created the Federal Reserve System and why? (*Congress passed the Federal Reserve Act in 1913 in response to problems with bank failures and bank panics across the nation.*)
  - b. How many districts make up the Federal Reserve System? (*There are 12 Federal Reserve districts.*)
  - c. What are the three main parts of the Federal Reserve System? (*The Board of Governors, the 12 regional Federal Reserve Banks, and the Federal Open Market Committee*)
  - d. Which of these divisions is responsible for determining monetary policy? (*The Federal Open Market Committee*)  
Explain to students that they will be learning more about monetary policy later.
  - e. Who are the voting members of the Federal Open Market Committee? (*The seven members of the Board of Governors, plus the presidents of five of the regional banks.*)
  - f. What are the three main responsibilities of the Federal Reserve System?  
*(Conducting monetary policy, providing financial services, and supervising and regulating banks)*
  - g. What is the difference between supervising and regulating banks? Who is responsible for these jobs?  
*(Supervising refers to creating rules for acceptable behavior for banking institutions. This function is done by*

*(the Board of Governors. Regulating refers to the enforcement of these rules. This responsibility falls to the 12 regional banks.)*

4. *Optional:* To locate and print out some reproducible bonus activities, go to <http://www.stlouisfed.org/publications/pleng/activities.htm>

These activities include an outline of the video with 20 questions, a vocabulary word search, a word scramble game, and a crossword puzzle. Each of these activities comes with an answer sheet for the teacher. They would be quite useful in reinforcing concepts learned in the video in an enjoyable way and could be used as homework assignments.

5. Distribute copies of *The Federal Reserve Today*.
6. Direct the students to examine the charts on pages 2, 3, and 5 on the organization of the Fed. Read and discuss the material with the class. Ask the students which of the 12 Federal Reserve Banks in the Federal Reserve System serves banks in their area.
7. Explore other charts in this booklet as time permits.

## **Part 2**

8. Display Visual 2—*The Brief for the Trial of Monty Terry*. Tell students that they will soon be conducting a trial for someone named Monty Terry. Call attention to the word “brief” in the title. Explain that a brief is a written legal document that is presented to a court, arguing why a party to the case should prevail. Lawyers must file such a brief before a trial to summarize the information to be considered in the trial. Explain that the lawyers have not yet completed the brief on this visual. The students’ task now is to examine the brief for the coming trial. And they should be trying to figure out who Monty is! (*Answer: Monty Terry is monetary policy.*)
9. Ask students to recall that in previous lessons they have studied about fiscal policy. Use information in the center column on Visual 2 to review fiscal policy with

students. Explain that there is another kind of policy, called monetary policy, that is used to help solve some of the problems we encounter in our economy. Tell students that at the end of today’s lesson they should have the information needed to complete the monetary policy column to the right of the fiscal policy column on Visual 2.

10. Tell students that they will now be exploring information about the Fed and monetary policy using a comic book produced by the Fed. Distribute to each student one copy of the comic book *The Story of the Federal Reserve System*.
11. Divide students into groups of approximately four. Instruct students to select one member of their group to be the recorder. Give the recorder in each group a copy of *Activity 1—The Fed in a Comic Book* (two pages).
12. Instruct students to read their comic books and to work together within their groups to find and record the answers to the questions on the activity page.
13. After all groups have completed *Activity 1—The Fed in a Comic Book*, conduct a class discussion. Rotate from group to group, letting each group in turn provide answers for one of the questions on the activity page until all have been answered, as listed below from the activity page:
  - I. The Balancing Act: Read pp. 1–5 and answer the following questions:
    - A. Why is the job of making monetary policy described on page 3 as “a balancing act”? (*The Fed has to make sure that money and credit do not grow either too slowly or too rapidly.*)
    - B. What happens if money and credit grow too slowly? How will this affect people? (*A recession will occur. Lenders will not have enough money to lend, so interest rates will be high. People will not be able to borrow and buy as many goods and services, so sales will go down. Workers will be laid off.*)

- C. What happens if money and credit grow too rapidly? How will this affect people? (*Inflation will occur, prices will go up, and people will not be able to afford to buy as many goods and services.*)
- D. What are the three main tools the Fed has to prevent both recession and inflation? (*Open market operations, reserve requirements, and the discount rate*)
- II. Open Market Operations: Read pp. 6–8 and answer the following questions:
- A. What are open market operations? (*The Fed carries out open market operations by purchasing or selling large amounts of securities.*)
- B. What happens when the Fed buys securities? (*When securities are purchased, the Fed pays for them, causing much more money to go into circulation and become available for loans to consumers or businesses. This way, the economy grows.*)
- C. What effect does the purchase of securities by the Fed have on interest rates? (*The interest rate is the price paid for borrowing money. Since more money is available to lend, interest rates will go down, thus encouraging people and businesses to spend.*)
- D. What happens when the Fed sells securities? (*When the Fed sells some of its securities, the purchasers pay the Fed large amounts of money for them, thus taking this money out of circulation. Less money is available for loans, and inflation comes under control.*)
- E. What effect does the sale of securities by the Fed have on interest rates? (*Since less money is available to lend, interest rates will go up, and fewer consumers or businesses will borrow and spend.*)

III. Other tools of the Fed: Read pp. 9–12, and answer the following questions:

- A. Another tool of monetary policy is the reserve requirement. How does this work? Why is it seldom used? (*When the Fed raises or lowers the reserve requirement, it changes the percentage of deposits that banks are required to keep on hand, and thus it changes the amount available to lend to consumers or businesses. This tool is not often used, since it makes it hard for banks to plan ahead.*)
- B. Another tool of monetary policy is the discount rate. How does this work? (*When the Fed raises or lowers the discount rate, it influences other interest rates.*)

IV. Financial Services of the Fed: Read pp. 12–23 and answer the following questions:

- A. What financial services does the Fed provide for banks and the public? (*The Fed processes cash, counting bills and shredding old ones; it processes and clears checks; and it provides electronic payment services.*)
- B. What services does the Fed provide for the government? (*The Fed sends out tax refunds and federal employees' paychecks. It also handles savings bonds.*)
- C. What is the relationship between the Fed and other banks? (*The Fed supervises other banks. All banks are subject to regulation by the Fed.*)
- D. Describe the structure of the Fed. (*There are 12 regional banks located across the nation. The Board of Governors is located in Washington, D.C., and consists of seven members, including the chairman. The Federal Open Market Committee—or FOMC—is made up of the seven members of the board plus the presidents of*

*(the 12 regional banks, five of whom are voting members on a rotating basis. It meets eight times per year. The FOMC is the policymaking body for the Fed.)*

- E. The Fed is more independent than any other part of the government. Why? *(The Fed does not depend on any other branch of government for its support, because it is financially self-sufficient, receiving income from interest on the securities it holds and from the financial services that it provides.)*
14. Explain to students that the Fed's monetary policy to increase the supply of money and credit is generally called "Easy Money Policy." The Fed's monetary policy to decrease the supply of money and credit is generally called "Tight Money Policy."
15. Tell students that next they will use the information they found in the comic book to complete the brief for Monty Terry's trial.

### **Part 3**

16. Display *Visual 3—Key Terms for Monetary Policy*, and use it to review the monetary policy information that students had encountered previously.
17. Review information from pages 11-12 in the comic book. Discuss foreign exchange rates and their relationship to the Fed.
18. Display *Visual 4—Weak Dollar vs. Strong Dollar: What Is the Difference?* Use this chart to help students understand foreign exchange. Explain that when the Fed implements a tight money policy, dollars are hard to come by, and they become strong against foreign currency, causing net exports to decline; and when the Fed implements an easy money policy, the dollar becomes weak and net exports increase.
19. Discuss how monetary policy can attract foreign investors, causing capital inflow, or discourage foreign investors, causing capital flight. Explain that when the Fed uses a tight money policy, interest rates go up, attracting foreign investors, and the United States experiences capital inflow; and when the Fed uses an easy money policy, interest

rates go down, and foreign investors go elsewhere to invest their money, causing capital flight.

20. Distribute copies of *Activity 2—The Brief for the Trial of Monty Terry* to each student. Direct students to fill in the information about monetary policy based on the information they have learned.
21. After collecting papers, use *Activity 3—The Brief for the Trial of Monty Terry (Answers)* to guide a discussion of students' answers.
22. Display *Visual 5—Characters in the Courtroom*. Have students look over the list. Be sure they understand that Monty Terry is monetary policy, which is on trial here. Allow students to choose parts so that they will be prepared to begin the trial. Tell students that the gender of the witnesses can be changed in the script as needed. Explain that all remaining students will be on the jury.

### **Part 4**

23. Distribute one copy to each student of *Activity 4—Transcript of the Trial of Monty Terry*.
24. Give each student a large name tag identifying his or her part in the courtroom drama. Explain that the name tags will help them keep up with which character is speaking, and they will better understand each witness's point of view.
25. Explain to the students that they will act out their roles in the court, as they determine whether the defendant, Monty Terry, is guilty on three counts of the indictment—count 1: manipulating the economy, count 2: controlling the money supply, and count 3: outperforming fiscal policy in solving macroeconomic problems. Testimony from witnesses will detail how the Fed conducts monetary policy to solve macroeconomic problems.
26. To make sure that the script flows well as it is read, give students a few minutes to go through their scripts and mark or highlight the parts that they are to read. Tell them to check out their parts and ask questions about anything they do not understand.

27. Explain to students that they should listen carefully to the testimony of the witnesses as they follow along with the script, since it contains information that is important to this unit of study. Tell them to think about the witnesses and what their costs and benefits would be for monetary policy and what their incentives were for easy or tight money policy.
28. Have students read the transcript and dramatize the trial.
29. After the verdict has been rendered by the jury and the judge has announced the sentence for the defendant, debrief the activity with the following questions:
- Why did President Cutter Taxes and Mr. Spender Congressman disapprove of Monty Terry? (*They liked what he did, but they thought that their fiscal policy was better.*)
  - Draw two columns on the chalkboard. Head the first column "Easy Money Policy" and the second column "Tight Money Policy." Ask students to identify and list the witnesses who were related to Easy or Tight Money Policy. (*Easy Money Policy: Mr. Reece Session, Ms. Iona Business, Ms. Wanna Home, Ms. Capital Flight, and Ms. Dollar Isweak. Tight Money Policy: Ms. Ann Flation, Mr. Capital Inflow, and Ms. Dollar Isstrong. Four witnesses—President Cutter Taxes, Mr. Spender Congressman, Mr. I. Amnot Political, and Monty Terry—are not associated with only one policy.*)
  - Which policy did Monty use when Ms. Ann Flation was around and why? (*Tight Money Policy was needed to reduce the money supply and cut spending so that inflation would come under control.*)
  - Which policy was needed when poor old Mr. Reece Session came limping around and why? (*Easy Money Policy was needed to expand the money supply and encourage spending so that the economy would grow again.*)
  - How did easy money policy help Ms. Iona Business? (*When interest rates were low, Ms. Iona Business could get a low cost loan and expand and hire more workers.*)
  - How did easy money policy help Ms. Wanna Home? (*Interest rates were low, and Ms. Wanna Home was able to borrow money to build a house.*)
  - What happened to the dollar in international markets when Monty was conducting his policy? (*When Monty used tight money, dollars were hard to come by, and they became strong against foreign currency, causing net exports to decline. When Monty used easy money, the dollar became weak, and net exports increased.*)
  - How did Monty's policies affect foreign investors? (*When Monty used tight money, interest rates were high, attracting foreign investors, and the U.S. experienced capital inflow. When Monty used easy money, interest rates went down, and foreign investors went elsewhere with their money, causing capital flight.*)
  - How was Monty's policy better than the fiscal policy used by President Cutter Taxes and Mr. Spender Congressman? (*Fiscal policy has many time lags, including recognition, administrative, and operational lags. Monetary policy is fast, flexible, and nonpolitical. However, sometimes consumers and businesses do not respond to monetary policy as expected.*)
30. Remind students to study their trial transcripts for the test.

### **Part 5**

- Review closure questions below with students.
- Administer the test on *Activity 5—Assessment*, as suggested below.

## CLOSURE

Review the main points of the lesson:

1. How is the Federal Reserve System organized? (*There are 12 Reserve Banks located across the nation. There is a seven-member Board of Governors, located in Washington, D.C., which includes the chairman of the Federal Reserve. And there are 12 voting members on the FOMC, the Federal Open Market Committee, which includes the seven board members and five presidents of the regional banks. The FOMC meets eight times each year.*)
2. What macroeconomic problems does a nation face? (*Unemployment, recession, slow growth in the gross domestic product, or GDP, and depression on one hand and inflation on the other hand*)
3. What organizations try to solve these problems in the United States? (*Congress, the president, and the Fed*)
4. How do these organization work to solve these problems? Where do they get help? (*Congress and the president conduct fiscal policy through government spending and raising or lowering taxes. The Fed conducts monetary policy by increasing or decreasing the money supply. The Congressional Budget Office and the General Accounting Office assist Congress with fiscal policy, and the Council of Economic Advisers and the Office of Management and Budget assist the president with fiscal policy. Both have access to the reports submitted by the Fed in the Beige Book.*)
5. What are the tools the Federal Reserve Board uses to control the money supply? (*The reserve requirement, the discount rate, and open market operations, which has a subsequent impact on the federal funds rate.*)
6. What are the similarities between monetary policy and fiscal policy? (*Both use tools to solve macroeconomic problems and thereby stabilize the economy featuring growth in the GDP without inflation.*)
7. What are some of the weaknesses of fiscal policy as compared with monetary policy? (*Weaknesses of fiscal policy include problems with timing, including the lag in recognition that a problem exists, an administrative lag given that changes require legislation from Congress and the president, and the operational lag, because when spending is authorized (for example, on a new highway), it takes time to get the project started. Politics is also a consideration.*)
8. What are some of the strengths and weaknesses of monetary policy as compared with fiscal policy? (*Strengths of monetary policy include that it is nonpolitical, and it is fast and flexible. A weakness is that sometimes consumers and businesses are not responsive to changes in the interest rates when an expansion in the economy is needed.*)
9. What is meant by easy and tight money, and when are these policies used by the Fed? (*Easy money policy occurs when the Fed increases the money supply because it wants to make money cheaper and easier to borrow and spend. This policy would expand the economy. Tight money policy occurs when the Fed decreases the money supply because it wants to make money expensive, thereby discouraging borrowing and spending. This policy will eventually lead to a decrease in prices and will prevent inflation.*)
10. What effect does monetary policy have on net exports and eventually on equilibrium GDP? (*With an easy money policy, imports decline, exports rise, and thus net exports—a component of aggregate demand—increase and equilibrium GDP rises. This approach strengthens the easy money policy. With tight money policy, imports rise, exports decline, and thus net exports—a component of aggregate demand—decrease and equilibrium GDP falls. This approach strengthens the tight money policy.*)
11. What are the effects of monetary policy on the appreciation and depreciation of the dollar, and how does that fluctuation lead to

capital flight and capital inflow? (*Lower interest rates discourage foreign investment, causing capital flight, and the U.S. dollar is weak and depreciates. Higher interest rates attract foreign investment, creating capital inflow, and the U.S. dollar is strong and appreciates.*)

## ASSESSMENT

Distribute one copy of *Activity 5—Assessment* to each student (two pages stapled). Direct students to fill in the information on this court document. Give students time to complete their work. After the students have turned in their papers, go over the answers using *Activity 6—Assessment Answers*, and discuss the correct answers on both pages with students. This assessment, along with the previous “brief,” should serve to evaluate student progress with concepts in this lesson.

## BIBLIOGRAPHY

- *In Plain English: Making Sense of the Federal Reserve.* Video produced by the Federal Reserve Bank of St. Louis.
- *The Federal Reserve Today,* 15th edition. 2003. The Federal Reserve Bank of Richmond.
- *The Story of the Federal Reserve System* (comic book). Federal Reserve Bank of New York.
- McConnell, Campbell R., and Stanley L. Brue. 2005. *Economics: Principles, Problems, and Policies.* 16th edition. New York: McGraw Hill Inc.

## SUMMARY OF PREVIOUS CLASSROOM USE

This lesson served to connect the dots for the students. In earlier lessons, students had identified and diagnosed the macroeconomic problems that can occur in an economy including inflation, recession, slow growth in GDP, and depression. The next sequence of their learning occurred when they posed the key question, “So now, how do we ‘cure’ these problems?” A quick review of earlier content on fiscal policy enabled them to compare and contrast their learning about how and why a second type of policy, monetary policy, is conducted. The use of Federal Reserve videos and publications appealed to different learning styles and provided the basis for completing the assessment. Some enjoyed the DVD and others preferred the succinct presentation of the Richmond Fed’s publication and the more light-hearted manner of *The Story of the Federal Reserve System* comic book. To add some fun and excitement to the lesson, students “performed” different roles as they acted out the *Trial of Monty Terry*. The brief assessed the students’ learning of the material and, of particular note, students were especially attentive to the final assessment, which required them to summarize the testimony of the witnesses. They were able to retain the information much more easily because of the funny names given to the witnesses. At the conclusion of this unit of study, students correctly viewed macroeconomics as an interconnected series of problems and solutions mixed with the dynamics of politics and opinion that necessarily reaches beyond national boundaries into the global economy.

### **Visual 1**

## **What You Will Learn From This Lesson**

**After this lesson you will be able to:**

- Explain how the Federal Reserve System is organized.
- List the tools the Federal Reserve Board uses to control the money supply.
- Compare and contrast monetary policy tools with fiscal policy tools.
- Identify the government agencies and offices that determine both monetary and fiscal policy.
- Evaluate the strengths and weaknesses of monetary policy as compared to fiscal policy.
- Identify easy money and tight money tools that the Fed uses to solve macroeconomic problems such as recession, unemployment, and inflation.
- Analyze the effects of monetary policy on our nation's net exports, including the appreciation and depreciation of the dollar and how that fluctuation leads to capital flight and capital inflow of foreign investment.
- Explain the effect of monetary policy on net exports and then eventually on equilibrium level of GDP (gross domestic product).

## Visual 2

### The Brief for the Trial of Monty Terry

	<b>Fiscal Policy</b>	<b>Monetary Policy</b>
<b>A. Conducted By</b>	The president and Congress	
<b>B. Tools</b>	Taxes Government spending	
<b>C. Goals</b>	Expand (increase equilibrium level of GDP) or contract (decrease equilibrium level of GDP)	
<b>D. What is the solution to the macroeconomic problems of recession, unemployment, slow growth in GDP, and depression?</b>	Expand the economy by decreasing taxes and/or increasing spending	
<b>E. What is the effect of expanding the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in higher domestic interest rates, increased foreign demand for dollars, appreciation of the dollar (a stronger dollar), and a decline in net exports (aggregate demand decreases, partially offsetting the expansionary fiscal policy)	
<b>F. What is the solution to the macroeconomic problem of inflation?</b>	Contract the economy by increasing taxes and/or decreasing spending	
<b>G. What is the effect of contracting the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in lower domestic interest rates, decreased foreign demand for dollars, depreciation of the dollar (a weaker dollar), and a net increase in exports (aggregate demand increases, partially offsetting the contractionary fiscal policy)	

## Visual 3

# Key Terms for Monetary Policy

Easy Money Policy: Policy by the Federal Reserve Board to energize consumers and businesses to borrow and spend to get the economy out of a recession. The Fed increases the money supply. Spending is easier if the price of money (the interest rate) is cheap.

Tight Money Policy: Policy by the Federal Reserve Board to discourage consumers and businesses from borrowing and spending to slow the economy down and stop inflation (which is a general rise in prices). The Fed decreases the money supply. Spending is more difficult if the price of money (the interest rate) is expensive.

Net Exports (Xn): Exports (U.S. goods sold abroad) minus imports (foreign goods bought by U.S. consumers, business, and the government). A positive Xn increases aggregate demand, and a negative Xn decreases aggregate demand and is often referred to as a trade deficit.

Equilibrium GDP: Aggregate demand (spending by consumers, businesses, the government, and net exports) equals aggregate supply (output) of goods (GDP).

**Visual 4**  
**Weak Dollar or Strong Dollar:**  
**What Is the Difference?**

<b>Weak Dollar</b>	<b>Strong Dollar</b>
This is caused by the Fed's easy money policy to cure a slow economy.	This is caused by the Fed's tight money policy to cure an economy that is suffering from inflation.
U.S. consumers have to use more dollars to buy foreign goods.  Result: Exports exceed imports, which increases aggregate demand.	U.S. consumers do not have to use as many dollars to buy foreign goods.  Result: Exports decline and imports rise, thus decreasing aggregate demand.
Dollars are "easier" to come by and are therefore "depreciated."	Dollars are "tighter" to come by and are therefore "appreciated."
U.S. goods do not cost much for foreign buyers.	U.S. goods cost much more for foreign buyers.
This is a bad time to travel abroad.	This is a great time to travel abroad.

## Visual 5

# Characters in the Courtroom

Judge  
Bailiff  
Prosecuting Attorney  
Defense Attorney  
Monty Terry  
Jury

### Witnesses:

President Cutter Taxes  
Mr. Spender Congressman  
Ms. Capital Flight  
Ms. Dollar Isweak  
Ms. Ann Flation  
Mr. I. Amnot Political  
Ms. Iona Business  
Ms. Wanna Home  
Mr. Reece Session  
Mr. Capital Inflow  
Ms. Dollar Isstrong

## Activity 1

### The Fed in a Comic Book

**I. The Balancing Act: Read pp. 1–5 and answer the following questions:**

- A. Why is the job of making monetary policy described on page 3 as “a balancing act”?
  
  
  
  
- B. What happens if money and credit grow too slowly? How will this affect people?
  
  
  
  
- C. What happens if money and credit grow too rapidly? How will this affect people?
  
  
  
  
- D. What are the three main tools the Fed has to prevent both recession and inflation?

**II. Open Market Operations: Read pp. 6–8 and answer the following questions:**

- A. What are open market operations?
  
  
  
  
- B. What happens when the Fed buys securities?
  
  
  
  
- C. What effect does the purchase of securities by the Fed have on interest rates?

**Activity 1 - The Fed in a Comic Book, page 2**

- D. What happens when the Fed sells securities?
  
- E. What effect does the sale of securities by the Fed have on interest rates?

**III. Other Tools of the Fed: Read pp. 9–12 and answer the following questions:**

- A. Another tool of monetary policy is the reserve requirement. How does this work? Why is it seldom used?
  
- B. Another tool of monetary policy is the discount rate. How does this work?

**IV. Financial Services of the Fed: Read pp. 12–23 and answer the following questions:**

- A. What financial services does the Fed provide for banks and the public? (pp. 13–14)
  
- B. What services does the Fed provide for the government? (pp. 16–17)
  
- C. What is the relationship between the Fed and other banks? (pp. 17–18)
  
- D. Describe the structure of the Fed. (pp. 19–22)
  
- E. The Fed is more independent than any other part of the government. Why? (pp. 20–21)

## Activity 2

### The Brief for the Trial of Monty Terry

	<b>Fiscal Policy</b>	<b>Monetary Policy</b>
<b>A. Conducted By</b>	The president and Congress	
<b>B. Tools</b>	Taxes Government Spending	
<b>C. Goals</b>	Expand (increase equilibrium level of GDP) or contract (decrease equilibrium level of GDP)	
<b>D. What is the solution to the macroeconomic problems of recession, unemployment, slow growth in GDP, and depression?</b>	Expand the economy by decreasing taxes and/or increasing spending	
<b>E. What is the effect of expanding the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in higher domestic interest rates, increased foreign demand for dollars, and appreciation of the dollar (a stronger dollar), and a decline in net exports (aggregate demand decreases, partially offsetting the expansionary fiscal policy)	
<b>F. What is the solution to the macroeconomic problem of inflation?</b>	Contract the economy by increasing taxes and/or decreasing spending	
<b>G. What is the effect of contracting the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in lower domestic interest rates, decreased foreign demand for dollars, depreciation of the dollar (a weaker dollar), and a net increase in exports (aggregate demand increases, partially offsetting the contractionary fiscal policy)	

## Activity 3 (Answers)

### The Brief for the Trial of Monty Terry

	<b>Fiscal Policy</b>	<b>Monetary Policy</b>
<b>A. Conducted By</b>	The president and Congress	Federal Reserve Board (Fed)
<b>B. Tools</b>	Taxes Government spending	Tool 1: Reserve requirement Tool 2: Discount rate Tool 3: Open market operations • Federal funds rate
<b>C. Goals</b>	Expand (increase equilibrium GDP) or contract (decrease equilibrium level of GDP)	Easy money policy (increase the equilibrium level of GDP) or tight money policy (decrease the equilibrium level of GDP)
<b>D. What is the solution to the macroeconomic problems of recession, unemployment, slow growth in GDP, and depression?</b>	Expand the economy by decreasing taxes and/or increasing spending	Easy money policy: Tool 1: Decreasing the reserve requirement Tool 2: Lowering the discount rate Tool 3: Buying government securities (The result of using tool 3 leads to a fourth component of Fed policy, the federal funds rate. Target a low rate.)
<b>E. What is the effect of expanding the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in higher domestic interest rates, increased foreign demand for dollars, appreciation of the dollar (a stronger dollar) and a decline in net exports (aggregate demand decreases, partially offsetting the expansionary fiscal policy)	Lower interest rates discourage foreign investment (capital flight). The U.S. dollar is weak (depreciates). Imports rise, exports decline, thus net exports (a component of aggregate demand) increase and equilibrium GDP rises. This approach strengthens the easy money policy.
<b>F. What is the solution to the macroeconomic problem of inflation?</b>	Contract the economy by increasing taxes and/or decreasing spending	Tight money policy: Tool 1: Increasing the reserve requirement Tool 2: Raising the discount rate Tool 3: Selling government securities (The result of using tool 3 leads to a fourth component of Fed policy, the federal funds rate. Target a high rate.)
<b>G. What is the effect of contracting the economy on the international value of the U.S. dollar? The net export effect?</b>	Results in lower domestic interest rates, decreased foreign demand for dollars, depreciation of the dollar (a weaker dollar) and a net increase in exports (aggregate demand increases, partially offsetting the contractionary fiscal policy)	Higher interest rates attract foreign investment (capital inflow). The U.S. dollar is strong (appreciates). Imports decline, exports rise, thus net exports (a component of aggregate demand) decrease and equilibrium GDP falls. This approach strengthens the tight money policy.

## Activity 4

# Transcript of the Trial of Monty Terry

**Bailiff:** All rise.

**Judge:** (*Enters and taps gavel*) You may be seated. Today this court will hear the case of the People v. Monty Terry, who is accused on three counts:

Count 1 of the indictment is that Monty Terry has manipulated the U.S. economy.

Count 2 of the indictment is that Monty Terry has controlled the supply of money in the economy.

Count 3 of the indictment is that Monty Terry has used his policy to outperform fiscal policy in solving macroeconomic problems.

Mr. (Ms.) Prosecuting Attorney, you may now call your first witness.

**Prosecuting Attorney:** The prosecution calls its first witness, Mr. Cutter Taxes, the president of the United States. Everyone please stand.

**Bailiff:** Mr. President, please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**President Cutter Taxes:** Of course I do. I'm the president!

**Judge:** (*Taps gavel*) Everyone may be seated.

**Prosecuting Attorney:** Mr. President, tell us what you think of Monty Terry's actions. Has he been controlling the money supply?

**President Cutter Taxes:** Oh, yes! But I have no problem with Monty conducting his monetary policy. Fact is, controlling the supply of money circulating in the economy is extremely important. Too little money, and problems such as recession, unemployment, slow growth in the GDP, and even depression can occur. Too much money, and inflation can occur.

**Prosecuting Attorney:** So, do you think he should be manipulating the economy this way, Mr. President?

**President Cutter Taxes:** I agree that it can be good to conduct easy money policy to correct an economy suffering from a recession. It also can be good to have a tight money policy to correct inflation. But I think these things are better left to me and my fiscal policy. Former presidents probably agree with me, too.

**Prosecuting Attorney:** Like whom, Mr. President?

**President Cutter Taxes:** FDR's New Deal called for massive spending programs including the TVA, the WPA, and the CCC, to name a few, to get the "circular flow of the economy" going. Both John F. Kennedy, a Democrat, and Ronald Reagan, a Republican, cut taxes during their presidencies to encourage spending by consumers and investment spending by businesses.

**Prosecuting Attorney:** Do you handle fiscal policy all by yourself?

**President Cutter Taxes:** No, presidents don't conduct economic policy alone. In the White House I get advice and recommendations for developing my policy from the Council of Economic Advisers, better known as the CEA. Then I make my recommendations to another branch of government, the Congress, to pass legislation on my taxing and spending policies.

**Prosecuting Attorney:** Thank you, Mr. President. You may step down. Now would be a good time for me to call the next witness for the prosecution, Mr. Spender Congressman.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Mr. Spender Congressman:** Of course I do. I'm a congressman!

**Prosecuting Attorney:** Why do you think Monty is guilty of manipulating the economy, sir?

**Mr. Spender Congressman:** I know for a fact that Monty manipulates the economy by controlling the money supply at the Fed.

**Prosecuting Attorney:** Tell us about the Fed. Just what is it, anyway?

**Mr. Spender Congressman:** The Fed refers to the Federal Reserve Board. This is where Monty starts his policy. The chairman of the Federal Reserve Board and his 12-member Federal Open Market Committee are responsible. They are better known as the FOMC.

**Prosecuting Attorney:** So Monty is not alone in this manipulation?

**Mr. Spender Congressman:** That's right.

**Prosecuting Attorney:** Go on. Tell us what they do at the Fed.

**Mr. Spender Congressman:** They look at a lot of data on consumer spending, investment spending, government spending, and net exports—that's exports minus imports. And they use estimations of the nation's GDP, or gross domestic product, which is the value of all goods and services produced in a nation in a given year.

**Prosecuting Attorney:** Where do they get this data?

**Mr. Spender Congressman:** They get their data from the Bureau of Economic Analysis, better known as the BEA. They also look at data collected by the BLS—the Bureau of Labor Statistics—to analyze unemployment and inflation. The Fed even publishes its opinions in the Beige Book for all to see.

**Prosecuting Attorney:** What are you doing in Congress while Monty is manipulating the money supply?

**Mr. Spender Congressman:** We are busy conducting research, too. The 100 members in the Senate and the 435 representatives in the House use the CBO, the Congressional Budget Office, to assist us in developing sound fiscal policy. We also use the independent government agency called the General Accounting Office (the GAO) to advise Congress on the assets and liabilities of our government.

**Prosecuting Attorney:** How does that help?

**Mr. Spender Congressman:** We know that cutting taxes for consumers and businesses helps cure a recession and promote greater employment, when consumers get to keep more of their money. When they are not paying taxes, they can spend their money on durable goods that last for three years or more—like cars and appliances and nondurable goods like food and clothing. Tax cuts help businesses, too, because they have more money to expand, build factories, and hire more workers.

**Prosecuting Attorney:** So cutting taxes can help. Is there anything else you can do?

**Mr. Spender Congressman:** If you think tax cuts are great, try government spending on projects. Government spending has a greater multiplier effect on the economy than does a tax cut because all of the government appropriation is spent on the projects. With tax cuts, some of the money does not get spent. People save some of it.

**Prosecuting Attorney:** So both you, Mr. Spender Congressman, and President Cutter Taxes agree that Monty is guilty. But you think he should be allowed to continue to help the economy by controlling the money supply. Your complaint is that both of you think fiscal policy is better. Is that right?

**Mr. Spender Congressman:** Yes, that's right. After all, we are elected by the people.

**Judge:** You may now call your next witness.

**Prosecuting Attorney:** The Prosecution calls Ms. Capital Flight to the stand.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Capital Flight:** I do.

**Prosecuting Attorney:** Where you are from, Ms. Flight, and what is your occupation?

**Ms. Capital Flight:** I am an investor from a foreign country.

**Prosecuting Attorney:** Why do you think Monty is guilty of manipulating the economy?

**Ms. Capital Flight:** My relationship with Monty involves something called the net-export effect. When the Fed determines that recession and slow growth are occurring, Monty initiates an easy money policy.

**Prosecuting Attorney:** What is an easy money policy?

**Ms. Capital Flight:** Well, this policy happens when the money supply increases, and with this increase in money, banks charge less for anyone who wants to borrow it. That is, banks charge less interest when they have a lot of money to lend. Monty does this so that more businesses can afford to borrow money and expand the business.

**Prosecuting Attorney:** What's wrong with that?

**Ms. Capital Flight:** Unfortunately, banks also pay less interest to people who deposit money in their savings accounts. Well, I don't want to hurt anyone's feelings, but I will take my money out of U.S. banks and put it into foreign banks paying higher interest rates. So an easy money policy by the Fed decreases my demand for dollars. The dollar is of less value and the value of the dollar no longer appreciates but is instead referred to as "depreciated." That's why they call me capital flight. See ya!

**Prosecuting Attorney:** Your Honor, the prosecution calls its next witness, Ms. Dollar Isweak.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Dollar Isweak:** I do.

**Prosecuting Attorney:** What is your complaint about the defendant, Ms. Isweak?

**Ms. Dollar Isweak:** Well you just heard that the dollar has depreciated, which means the dollar is weak. The more you have of something, the less value it becomes to us. It is a life lesson for all of us.

**Prosecuting Attorney:** I understand that you are saying that the defendant has increased the supply of money, and that increase has caused the dollar to no longer be considered strong. But isn't there good news for our net exports when the Fed conducts easy money policy?

**Ms. Dollar Isweak:** Well, yes. Because the dollar has depreciated in value, it takes more dollars to buy yen and euros, for example. This makes all foreign goods more expensive for U.S. consumers to buy, but it also makes the U.S. goods more affordable to foreign buyers. Imports fall and exports rise, causing net exports to rise, which increases aggregate demand, and thus GDP growth.

**Prosecuting Attorney:** That sounds like good news for our GDP, even if it's not so good for our consumers! I now call our final witness, Ms. Ann Flation.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Ann Flation:** Of course I do. I would never inflate the truth.

**Prosecuting Attorney:** When you are around, affecting the economy, making prices rise, causing too much money to chase too few goods, you really hurt the economy, don't you, Ms. Flation?

**Ms. Ann Flation:** Who's on trial here, me or Monty Terry?

**Prosecuting Attorney:** Your honor, I'd like to make a motion to treat Ms. Ann Flation as a hostile witness.

**Judge:** (*Taps gavel*) So ruled.

**Prosecuting Attorney:** Ms. Ann Flation, what do you think Monty is guilty of, and why?

**Ms. Ann Flation:** Monty is guilty of controlling the money supply and is therefore guilty of manipulating the U.S. economy. I just show up minding my own business, and everyone wants me to leave. Something about me makes their paychecks not go as far. Savers lose their wealth. And those on a fixed income can't buy their groceries. I'm not as bad as my cousin, Hyper Inflation, but everyone hates me anyway. Then Monty comes along and has to make the tough decision to institute a tight money policy.

**Prosecuting Attorney:** How does Monty do that?

**Ms. Ann Flation:** Monty can do this by raising the reserve requirement, raising the discount rate, or selling government securities in the open market. The Fed sells the securities to banks, and the banks pay for the securities with money. This money is then taken out of circulation.

**Prosecuting Attorney:** And then what happens to you?

**Ms. Ann Flation:** Because less money is in circulation, money becomes expensive. That is, interest rates on money borrowed by consumers and business rise. In addition, interest rates member banks charge other member banks for overnight loans, known as the federal funds rates, also rises. And little by little I go away.

**Prosecuting Attorney:** Your honor, the prosecution rests.

**Judge:** Mr. (Ms.) Defense Attorney, you may now call your first witness.

**Defense Attorney:** Your honor, the defense calls Mr. I. Amnot Political.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Mr. I. Amnot Political:** I do.

**Defense Attorney:** Who do you work for, Mr. Political, and where?

**Mr. I. Amnot Political:** My residence is in Washington, D.C., and I work for the Fed.

**Defense Attorney:** Do you, or do you not, think that Monty is guilty of manipulating the economy?

**Mr. I. Amnot Political:** Yes, Monty is guilty but . . .

**Defense Attorney:** But what, sir?

**Mr. I. Amnot Political:** But he does it to help the economy, and politics does not influence his decisions. Gosh, the seven members of the Board of Governors are nominated by the president and confirmed by the Senate for 14-year terms. These terms are staggered so that one member is replaced every two years. The president selects the chairperson from among the members and is appointed and reappointed for four-year terms. Although these members are not elected, they are considered a public policymaking agency in the government bureaucracy.

**Defense Attorney:** Are there any other policymakers that are guilty of manipulating the economy?

**Mr. I. Amnot Political:** Yes. The FOMC, the Federal Open Market committee, conducts open market operations that involves the buying and selling of government securities including Treasury bonds, Treasury bills, and Treasury notes on a daily basis.

**Defense Attorney:** You may now step down. The defense calls its next witness, Ms. Iona Business.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Iona Business:** I do.

**Defense Attorney:** Do you, or do you not, think that Monty is guilty of manipulating the economy?

**Ms. Iona Business:** Yes, Monty is guilty but . . .

**Defense Attorney:** But what, madam?

**Ms. Iona Business:** I remember when the economy was in a recession in 1992 and my old neighborhood was dying. No one was spending money, businesses were not receiving orders, the factors of production, land, labor, capital, and entrepreneurship were not needed, and no money was returning to the households in the form of rent, interest, wages, and profits. There was no circular flow in the economy.

**Defense Attorney:** And then what happened?

**Ms. Iona Business:** Then Monty came in like a doctor healing a sick patient, like a carpenter building a house, like a mechanic repairing a car's engine. Monty knew the supply of money needed to be increased. Borrowing money needed to be easier (and cheaper). So Monty used the tools available to him.

**Defense Attorney:** What tools did he use?

**Ms. Iona Business:** First, he lowered the reserve requirement from 12 percent to 10 percent. This is the amount of money member banks have to keep on reserve in their vaults or at the Fed and cannot lend out. Second, he lowered the discount rate, which is the rate the Fed charges member banks for loans. Next, he set a lower target for the

federal funds rate. This is the rate member banks charge other member banks for overnight loans. Finally, he bought government securities in the open market.

**Defense Attorney:** What good did that do?

**Ms. Iona Business:** These purchases "pumped" money into the economy. Bottom line: I got my groove back, as they say. I went to my bank, borrowed less expensive money, paid less interest, opened the doors to my business, and hired my workers back, and before long the whole neighborhood was back.

**Defense Attorney:** So is Monty guilty or is he not?

**Ms. Iona Business:** I'm afraid the answer is yes. Monty is guilty. But I am better for it! If I had to wait for those politicians to recognize the problem, and get the president and Congress to agree that a fiscal policy package of taxing and spending was needed to tackle the problem, and then to mail the tax rebate checks or begin the building project, then my neighborhood may never have survived.

**Defense Attorney:** The defense now calls Ms. Wanna Home.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Wanna Home:** I do.

**Defense Attorney:** Where you are from, Ms. Home, and what is your occupation?

**Ms. Wanna Home:** I am a teacher and I live right here in this country. I agree with Ms. Iona Business. My husband and I had never owned our own home until Monty began to implement his easy money policy to cure the recession.

**Defense Attorney:** Did that help you get a home of your own?

**Ms. Wanna Home:** Yes. Interest rates dropped so much that we were able to borrow the money we needed to build our first home. Those fancy economists say that "housing starts" is one of 12 leading economic indicators. They say that spending just one dollar on building a new house multiplies throughout the economy as much as 40 times. I don't know much about those economists, but I could see it all around me.

**Defense Attorney:** Where did you see it?

**Ms. Wanna Home:** My one house put a lot of folks back to work—plumbers, carpenters, roofers, and a lot more. And the money they made was spent in places that put a lot of other folks back to work. So yes, Monty is guilty, but I am the better for it!

**Defense Attorney:** The prosecution calls its next witness, Mr. Reece Session.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Mr. Reece Session:** (*speaking slowly*) I'm moving a little slowly today, but I'll try to pick up the pace. I've been declining for two consecutive quarters, or in layman's terms, six months. But yes, I will tell the truth.

**Defense Attorney:** What do you think Monty is guilty of, and why?

**Mr. Reece Session:** I agree with Ms. Iona Business and Ms. Wanna Home. Monty is guilty of controlling the money supply and is therefore guilty of manipulating the U.S. economy. You heard them, I am no good for the economy and Monty is there for the rescue. Monty lets me creep in town for a visit, but if I have been around for two consecutive quarters of declining GDP, then he starts to act. Everything has slowed down. People look at me and are so very sad. Almost depressing, if you ask me.

**Defense Attorney:** So you are glad Monty controls the money supply and manipulates the economy?

**Mr. Reece Session:** Yes, it is a welcome relief when Monty institutes an easy money policy. Using any or all of the Fed tools increases the money supply, which means that the price of money, or interest rates, falls. Consumers buy new houses and new cars. Businesses invest in new factories. Unemployment falls, GDP output rises, and prices eventually increase, which is good news for the suppliers. And then I'm out of here!

**Defense Attorney:** The defense calls Mr. Capital Inflow to the stand.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Mr. Capital Inflow:** I do.

**Defense Attorney:** Where you are from, Mr. Inflow, and what is your occupation?

**Mr. Capital Inflow:** I am an investor from a foreign country.

**Defense Attorney:** Do you or do you not think Monty is guilty of manipulating the economy?

**Mr. Capital Inflow** Yes, Monty is guilty, but I benefited from his policies.

**Defense Attorney:** How were you benefited?

**Mr. Capital Inflow:** Well, unlike my friend, Ms. Capital Flight, I stayed around the U.S. banks. When Monty realized inflation was looming, he acted with deliberate speed. He instituted a tight money policy.

**Defense Attorney:** Tell us about this tight money policy. How does it work?

**Mr. Capital Inflow:** Monty raised the reserve requirement, raised the discount rate, and had the FOMC sell government securities in the open market, which in turn meets the targeted goal of having a higher federal funds rate. The supply of money decreased and banks had less money to lend. Because there was less money, the money they did have for loan was expensive, reflected in higher interest rates. I loved this. I took my

money out of banks in other foreign countries and put it into U.S. banks. I appreciated the value of the dollar.

**Defense Attorney:** The prosecution calls its next witness, Ms. Dollar Isstrong.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Ms. Dollar Isstrong:** I do.

**Defense Attorney:** Do you also believe that Monty manipulates the economy, Ms. Isstrong?

**Ms. Dollar Isstrong:** Well, you just heard that the dollar has appreciated. That means the dollar is strong. The less you have of something, the more valuable it becomes to us. It is a life lesson for all of us.

**Defense Attorney:** I understand that you are saying that the defendant has decreased the supply of money and that has caused the dollar go from weak to strong. This would cause our net exports to decrease. How can this tight money policy be good?

**Ms. Dollar Isstrong:** Because the dollar has appreciated in value, it takes fewer dollars to buy yen and euros, for example. This makes all foreign goods less expensive to U.S. consumers, but it also makes all U.S. goods more expensive to foreign buyers. Our imports rise and our exports fall, causing net exports to fall, which decreases aggregate demand and thus lowers GDP growth. The net export effect strengthens tight money policy.

**Defense Attorney:** That sounds like bad news for the GDP!

**Ms. Dollar Isstrong:** Yes, I realize that it does, but remember, the U.S. economy was suffering from inflation. Without intervention from Monty, our country suffers. No one wants that, so the Fed steps in, uses Monty's tools, and stabilizes the economy.

**Defense Attorney:** We now call our final witness, the defendant, Mr. Monty Terry himself.

**Bailiff:** Please raise your right hand. Do you swear to tell the truth, the whole truth, and nothing but the truth?

**Judge:** Mr. Terry, do you realize that you do not have to testify against yourself?

**Monty Terry:** Yes, I know. But I just want to get this all cleared up.

**Defense Attorney:** You have heard the testimony for you and against you. What do you have to say for yourself?

**Monty Terry:** I'll have to admit that I am guilty of manipulating the U.S. economy. And yes, I am guilty of controlling the supply of money, but that is what I am supposed to do. The president and the Congress conduct fiscal policy by changing taxing and

government spending to cure the macroeconomic problems facing our nation. But they have problems with it, though.

**Defense Attorney:** What problems do they have?

**Monty Terry:** They have lots of time lags. There is a recognition lag while they figure out what is needed. And there is an administrative lag while they try to get legislation going to do the job. And there is an operational lag while they try to get the projects in motion.

**Defense Attorney:** Do you have time lags like that?

**Monty Terry:** Not as much. I have as one of my functions the responsibility to control the supply of money in circulation. I can do this with speed and flexibility and without political influences. Yes, I will admit that sometimes I can make money really cheap and easy but that consumers and businesses still refuse to borrow for consumer items and business growth. Yes, I will admit that I cannot control the speed or velocity at which consumers and businesses spend each dollar. But overall, your honor, I do a good job, and I plead for your mercy. Let me continue to manipulate the money supply, and I promise I will never tax you to death!

**Judge:** Ladies and gentlemen of the jury, you have heard the testimony, and now you have to decide for yourself. On count number one of the indictment: Does Monty Terry manipulate the U.S. economy? How do you find?

**Jury:** We find the defendant guilty.

**Judge:** On count number two of the indictment: Does Monty Terry control the supply of money in the economy? How do you find?

**Jury:** We find the defendant guilty.

**Judge:** On count number three of the indictment: Does Monty Terry's policy outperform fiscal policy in solving macroeconomic problems? How do you find?

**Jury:** We find the defendant guilty.

**Judge:** I agree with the jury, that the defendant is guilty on all three counts of the indictment. And now I am prepared to render the sentence for this defendant. Because I am a monetarist, I sentence Monty Terry to continue "artful management" and resist the temptation to join the "inflation targeting" crowd.

**THE END**

## **Activity 6 — Assessment**

# Court Document

# The People of the United States of America

v.

# Monty Terry

Here is a summary of the information pertinent to this case:

1. How is the Federal Reserve System organized?
  2. What are the similarities between monetary policy and fiscal policy?
  3. What are the strengths and weaknesses of monetary policy and fiscal policy?

**Here is a summary of the testimony of witnesses to this case:**

1. President Cutter Taxes
  2. Mr. Spender Congressman

3. Ms. Capital Flight

4. Ms. Dollar Isweak

5. Ms. Ann Flation

6. Mr. I. Amnot Political

7. Ms. Iona Business

8. Ms. Wanna Home

9. Mr. Reece Session

10. Mr. Capital Inflow

11. Ms. Dollar Isstrong

12. Monty Terry

## Activity 6 — Assessment Answers

# Court Document

The People of the United States of America

v.

Monty Terry

Here is a summary of the information pertinent to this case:

1. **How is the Federal Reserve System organized?**  
*(A seven member Board of Governors which includes the Chairman of the Federal Reserve Board, 12 regional banks, 12 members of the FOMC, or Federal Open Market Committee.)*
2. **What are the similarities between monetary policy and fiscal policy?**  
*(Both use tools to solve macroeconomic problems and thereby stabilize the economy featuring growth in the GDP without inflation.)*
3. **What are the strengths and weaknesses of monetary policy and fiscal policy?**  
*(Weaknesses of fiscal policy include problems with timing, including the recognition lag that a problem exists, an administration lag given that changes require legislation from the Congress and the president, and the operational lag that when spending on a new highway is authorized, for example, it takes time to get things started. Politics, too, is a consideration. Strengths of monetary policy include that it is non-political, it is fast, and it is flexible. Weaknesses include that sometimes consumers and businesses are not responsive to changes in the interest rates when an expansion in the economy is needed.)*

Here is a summary of the testimony of witnesses to this case:

1. **President Cutter Taxes** testified for the prosecution that his office (along with Congress) conducts fiscal policy and that spending and taxing programs are more effective than monetary policy at stabilizing the economy. He also cited examples of how President Roosevelt, President Kennedy, and President Reagan advocated fiscal policies that got a slow economy moving again. He testified that the CEA (Council of Economic Advisers) assists him in the development of the policy.
2. **Mr. Spender Congressman** testified for the prosecution that with the help of the Congressional Budget Office (CBO) and the General Accounting Office (GAO), Congress conducts fiscal policy. Further, he testified that spending programs create a greater multiplier effect than do taxing programs, but both are more effective than monetary policy at stabilizing the economy, in his opinion. He stated that the chairman of the Fed, along with the 12-member FOMC, conducts monetary policy with the help of data collected by the BLS and the BEA.

3. **Ms. Capital Flight** testified that as a foreign investor, she takes her money out of U.S. banks when the Fed conducts easy money policy. Her money leaves the U.S. because the dollar is of less value, earns less interest for her, and has depreciated.
4. **Ms. Dollar Isweak** testified that when the dollar has depreciated, foreign goods become more expensive to U.S. consumers and all U.S. goods become more affordable to foreign buyers. Imports fall and exports rise, causing net exports to rise, which increases aggregate demand and thus GDP growth.
5. **Ms. Ann Flation** testified that the Fed controls her by instituting a tight money policy. This is accomplished by raising the reserve requirement, raising the discount rate, and/or selling government securities in the open market, which in turn meets the target of having a higher federal funds rate.
6. **Mr. I. Amnot Political** testified that the seven members of the Board of Governors of the Fed are nominated by the president and confirmed by the Senate for 14-year staggered terms. The Fed is an independent regulatory agency of the federal bureaucracy and is free of political pressure and election cycles.
7. **Ms. Iona Business** testified that the Fed's use of an easy money policy during the recession enabled her business to grow.
8. **Ms. Wanna Home** testified that she was able to buy her first home when the Fed's easy money policy resulted in banks lowering the interest rates charged for money. In turn, the housing industry enjoyed a boom that multiplied throughout the economy, bringing in more jobs and an end to the recession.
9. **Mr. Reece Session** testified that the Fed acts when a recession is hurting the economy and that a recession, by definition, is two consecutive quarters of declining GDP.
10. **Mr. Capital Inflow** testified that foreign investors keep their money in U.S. banks when the Fed institutes a tight money policy to alleviate the burdens of inflation. The tools available for a tight money policy include raising the reserve requirement, raising the discount rate, and selling government securities, which in turn raises the federal funds rate. This witness appreciated the value of the expensive dollar and deposited money in U.S. banks to earn greater interest.
11. **Ms. Dollar Isstrong** testified that when a tight money policy is instituted, foreign goods become less expensive to U.S. consumers, and all U.S. goods become more expensive to foreign buyers. Imports rise and exports fall, causing net exports to fall. This component of aggregate demand therefore decreases, thus lowering GDP growth. The Fed's goal of alleviating inflation was met.
12. **Monty Terry** chose not to plead the Fifth Amendment and instead testified against himself. He admitted guilt to manipulating the economy and to controlling the supply of money. He admitted that monetary policy has time lags and that people may not react to the Fed policies as designed, but he believes that monetary policy is better than fiscal policy.