Answer on Question#37110 – Economics – Macroeconomics

monetarists argue that only monetary policy can impact the output levels. If they are right what happens when the government cuts taxes? Cuts spending? How can the Feds make a difference?

Solution

According to monetarists, tax and fiscal policy will not affect the amount of aggregate nominal demand as they represent only a "transfer" of income from one sector to another based on the so-called "policy of displacement". So, if government cuts taxes it will lead to the increase in firms' profit and decrease in government revenues. If government cuts spending it will lead to decrease in firms' profit.

The difference between monetary and fiscal policies is that the first one involves changing the interest rate and influencing the money supply and the second one involves the government changing tax rates and levels of government spending to influence aggregate demand in the economy.