AIR Review
The Government and the Economy

Government and the Economy

- The Federal government uses spending and tax policy to maintain economic stability and foster economic growth. The Federal Reserve System uses monetary tools to regulate the nation's money supply and moderate the effects of expansion and contraction in the economy.
- The Fed controls the money supply by telling the banks what interest rates to charge. Strong economy creates higher interest rates to constrict the economy. Weak economy creates lower interest rates to expand the economy.

Money Supply

- Strong economy creates higher interest rates (AKA discount rate) to constrict the economy (slow economic growth). The Fed would also print less money when constricting the economy. In this economic situation the Fed would raise the reserve requirement (tell the banks to keep more of their money) and raise the interest / discount rate.
- Weak economy creates lower interest rates to expand the economy (encourage economic growth). The Fed would print more money when expanding the economy. The Fed would reduce the reserve requirement (tell banks to increase loans) and lower the interest / discount rate.

Budget & Taxes

- Congress has two ways to reduce government debt. Raise taxes and cut spending.

- Many government programs are _entitlements_ (programs that have guaranteed spending due to citizens who meet eligibility requirements). Social Security is the largest entitlement, others include Medicare, Medicaid, unemployment, food stamps, and veteran pensions.

- _Entitlements_ make it very difficult to cut government spending. The government knows spending on many of the programs will go up. More people collect Social Security each year.