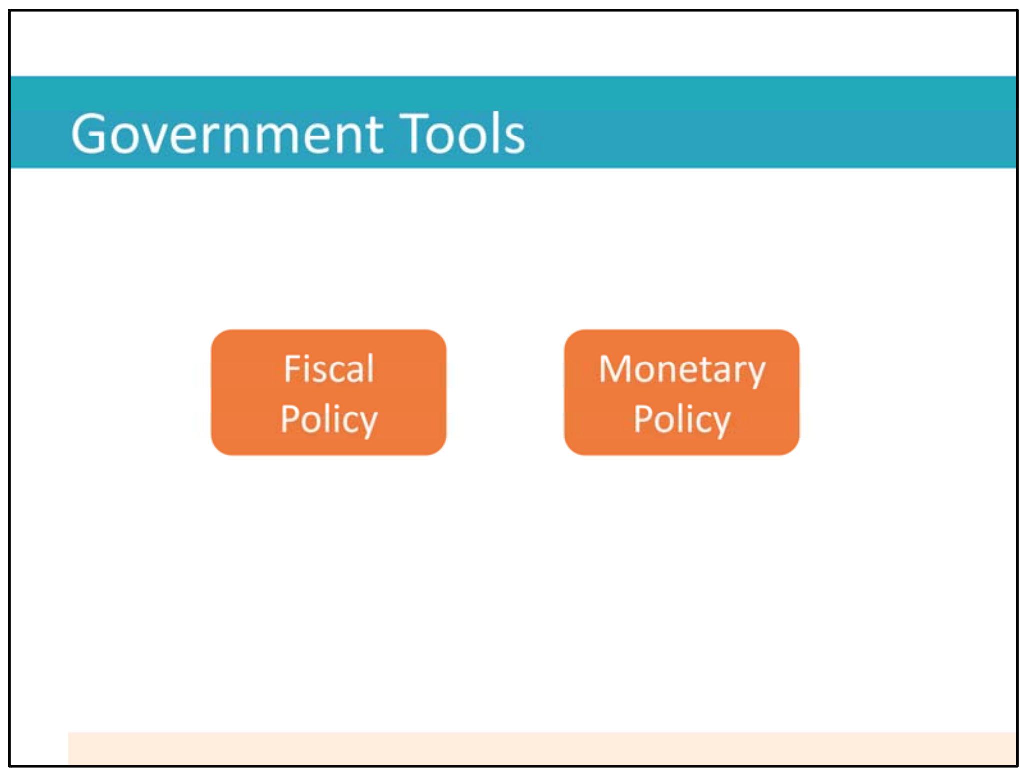
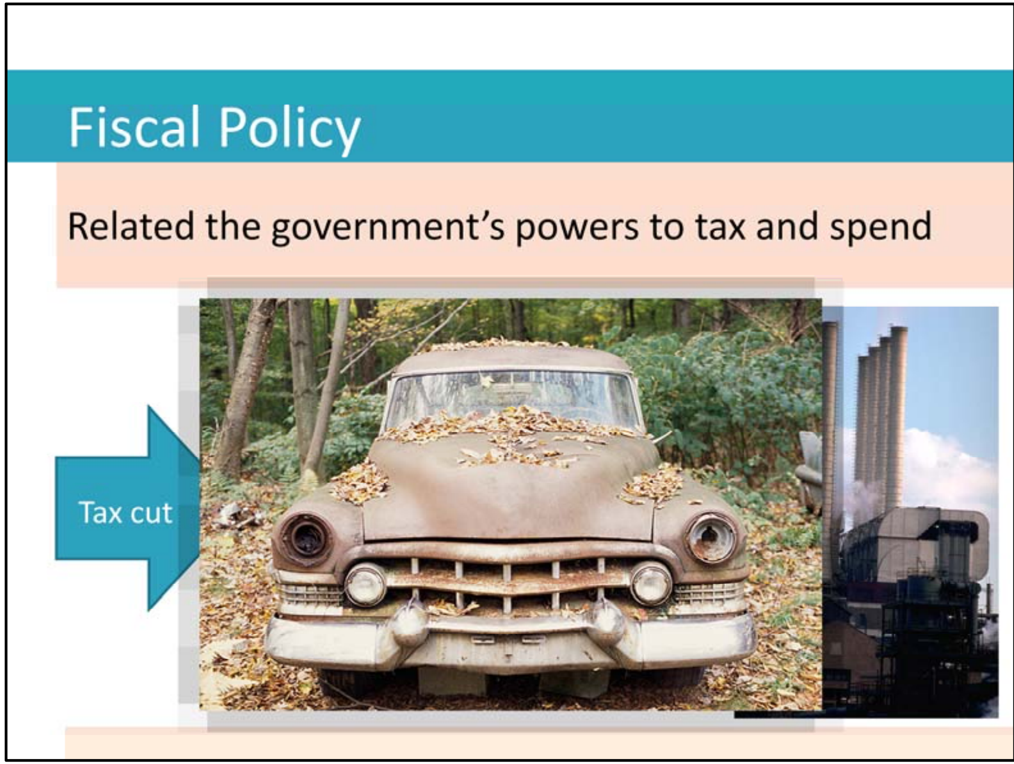
Think back to the lesson on the business cycle. Remember how this cycle showed how the economy grew and contracted over time, and how this was normal? Remember also how we said the graph of the cycle could look like a roller coaster, and wild shifts were good for amusement park rides, but not for the economy.

During these fluctuations in the business cycle, employment and GDP can rise and fall quite a bit. The government tries to reduce the amount that these fluctuate, or smooth out the cycle, so that the bad times aren't as bad, and that growth is steady and sustainable. Producers, consumers, and investors want an economy that doesn't fluctuate unexpectedly. When the economy is stable, investors know what to expect—no huge changes in interest rates, prices, or level of government debt– and they invest more money, which is good for business. Businesses like relatively stable economies because they can plan for the long term without worrying that things will change radically and they might go out of business. Consumers also like stability, because it helps them plan for the long term when they take out loans, or change jobs.



So it's in everyone's interest for the government to keep the economy stable, but how can it do this?

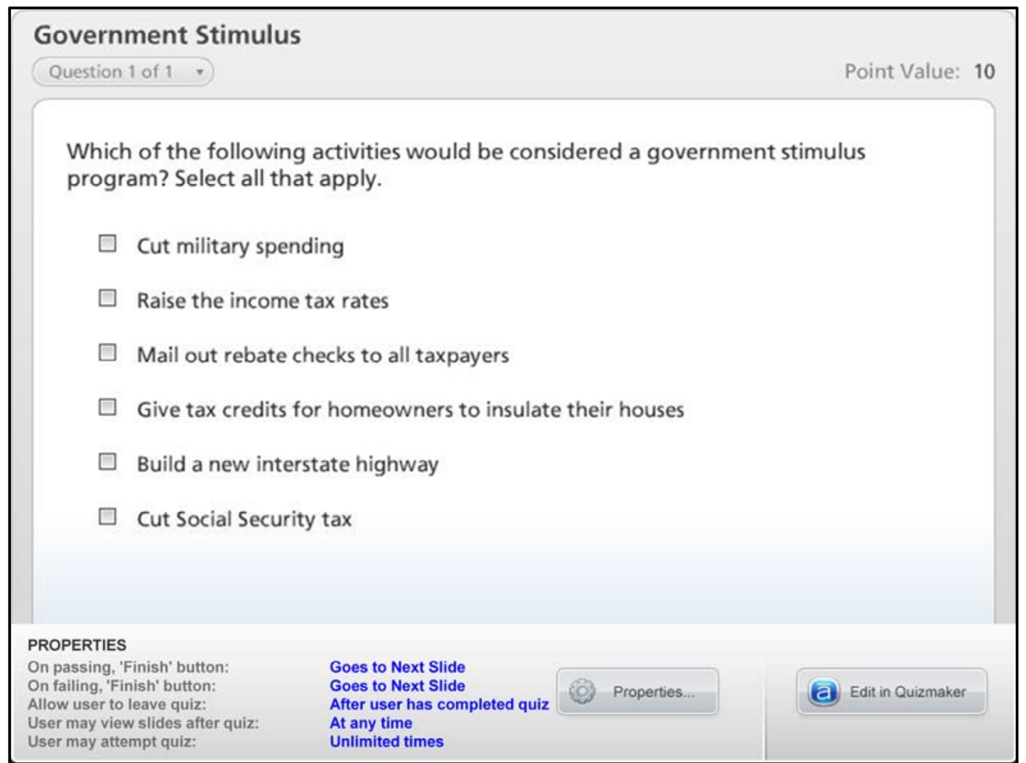
The government has two primary tools to stabilize the economy: through fiscal policy and through monetary policy.



Fiscal policy is related the government's powers to tax and spend. Through these activities, the government can try to influence things like how much businesses produce, how many people are employed, and speed up, or slow down economic growth.

How does this work?
When the economy slows down, the government can cut taxes so that people have more money to invest or buy things, which can help businesses. The government can also spend more money, either by using tax revenues or other monies, or by borrowing the money to stimulate the economy. An example of this is the "Cash for Clunkers" program that President Obama initiated in 2010. This program used government money to get consumers to trade in their old cars for new ones. People saved money on new cars, and automobile companies sold more cars than they would have otherwise. This is called a stimulus program, because it is designed to stimulate the economy.

When the economy is growing so rapidly that it causes inflation, the government can reduce stimulus and other government spending in order to slow the economic growth and keep inflation from getting too high.


Government Stimulus
Question 1 of 1
Point Value: 10
Which of the following activities would be considered a government stimulus program? Select all that apply.
Cut military spending
Raise the income tax rates
Mail out rebate checks to all taxpayers
Give tax credits for homeowners to insulate their houses
Build a new interstate highway
Cut Social Security tax
PROPERTIES
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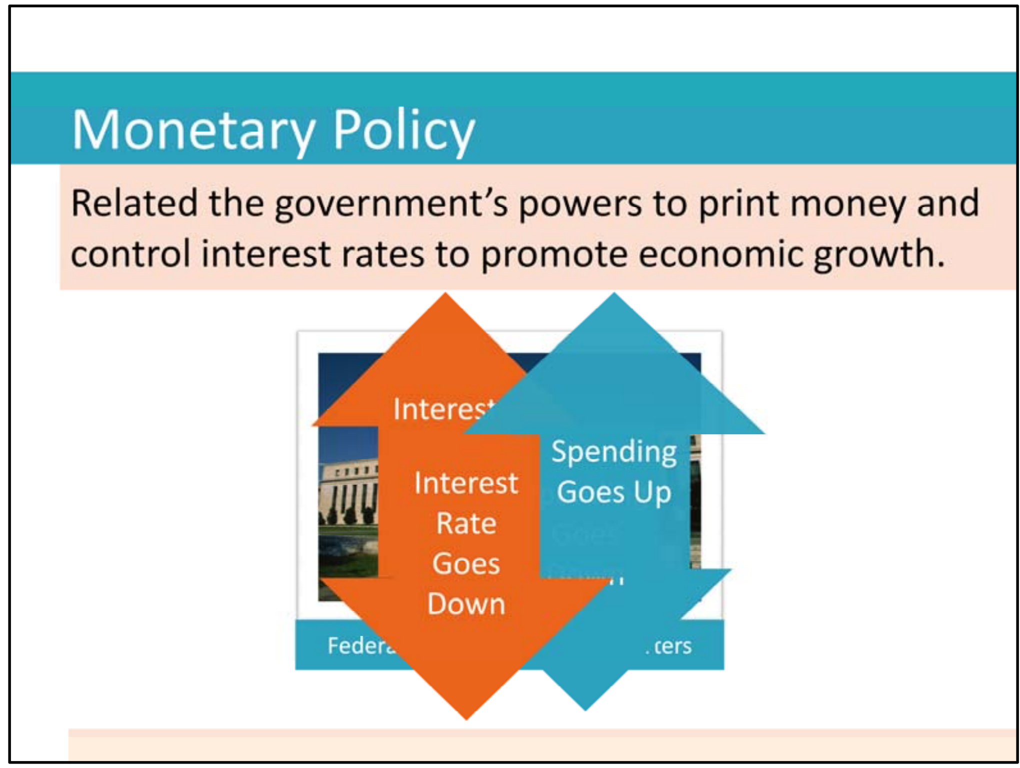
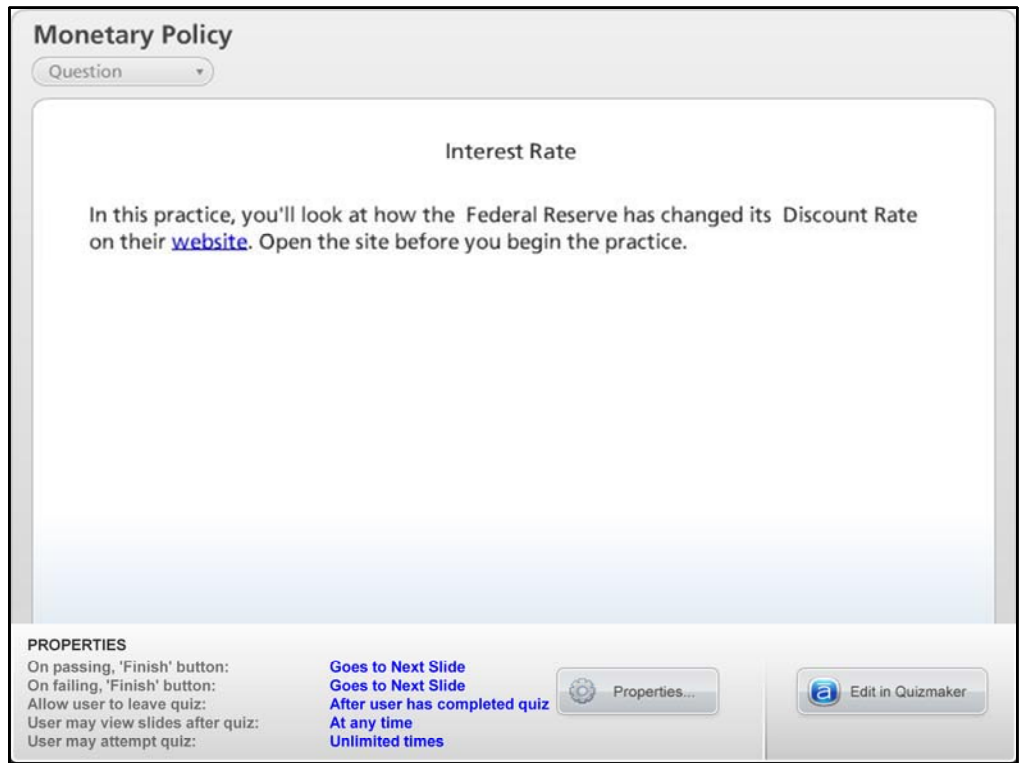


Through monetary policy, the government tries to supply the right amount of money to stabilize the business cycle and promote healthy economic growth.

Monetary policy is the responsibility of the Board of Governors of the Federal Reserve System, often referred to as the Fed or the Federal Reserve. The Fed is the U.S. central bank that was established by Congress in 1913.

What is the right amount of money?
Too much money in the economy can result in people and businesses buying a lot of goods, which often results in higher inflation. When the Fed wants to lower the amount of money in the economy, they will raise a key interest rate, like the Discount Rate. The Discount Rate affects interest rates on all kinds of loans, from car loans to credit card interest rates. As the interest rate goes up, people spend and borrow less because as the cost of borrowing goes up, the price of the goods that you buy with borrowed money goes up as well. As borrowing and spending go down, this helps prevent higher inflation.

When there is too little money in the economy, economic activity can decrease, which can lead to a contraction in the business cycle. In other words, consumers and businesses aren't spending their money. They are holding on to it, usually because either they are worried about a decline in the economy, or the interest rate, the cost of borrowing money, is too high. When the Fed lowers the Discount Rate, banks and other financial companies usually lower their interest rates which encourages people to spend more money.


Monetary Policy
Question
Interest Rate
In this practice, you'll look at how the Federal Reserve has changed its Discount Rate on their website. Open the site before you begin the practice.
PROPERTIES
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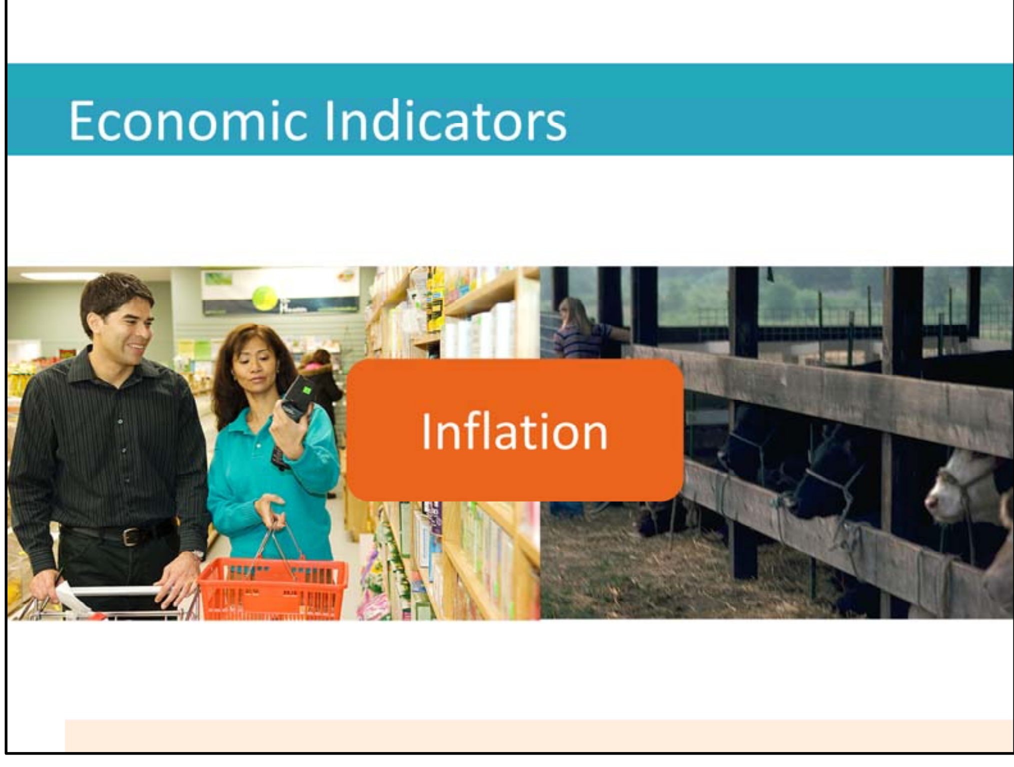


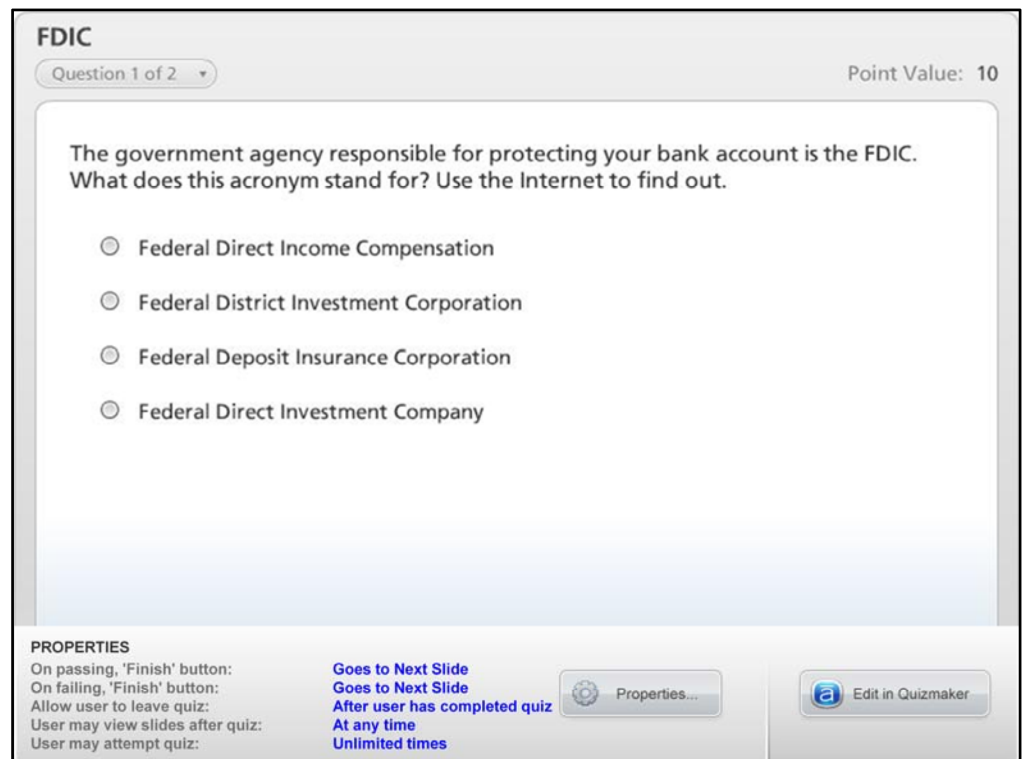
What are some economic indicators that the government uses to help track economic growth and consumer confidence?

One indicator of economic stability is the general level of prices, or inflation. As you learned earlier, when prices rise quickly, it hurts consumers—especially the poor and those on fixed incomes. If prices decline, producers feel the pain.

Let's say that the price of milk suddenly goes up, people who buy milk may have to buy less. If the price suddenly drops, dairy farmers may lose money. Either way, major changes in prices can create problems throughout the economy. The government tries to prevent these sudden, drastic price shifts.

Another indicator of economic stability is the security of our financial institutions, like banks or the stock market. Suppose you go to your bank to get some money out of your account and the doors are locked, no one is there, and a big sign on the door says "Closed—Out of Business." What would you do? How would you get your money? You probably wouldn't trust your money to a bank in the future, and neither would other people.

When you put your money into the bank or buy stock, you want to be sure that your money is protected against fraud or mismanagement. You also want to protect your money from sudden economic downturns, which might lower the amount of interest you earn on your money. To provide this protection, the government monitors and regulates banks and other financial institutions. Some of these regulations protect deposits and retirement pensions. Federal agencies also investigate fraud and manage interest rates and the flow of money through the economy to protect us and provide confidence in financial institutions.


FDIC
Question 1 of 2
Point Value: 10
The government agency responsible for protecting your bank account is the FDIC. What does this acronym stand for? Use the Internet to find out.
Federal Direct Income Compensation
Federal District Investment Corporation
Federal Deposit Insurance Corporation
Federal Direct Investment Company
PROPERTIES
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