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The Role of Government in the Economy

The debates over the role for Government in a market economy are still keeping on and the issue is being widely discussed at the present time. An economy based on free enterprise is generally characterized by private ownership and initiative, with a relative absence of government involvement. However, government intervention is being necessary from time to time to ensure economic opportunities to be fair, dampen inflation and stimulate growth.

Government plays a big role in the American free enterprise system. In the United States there are agencies to regulate safety, health, environment, transport, communications, trade, labor relations, and finances. Regulation ensures that business serves the best interests of the people as a whole. Some industries as nuclear power, for instance, have been regulated more closely over the last few years than ever before. In other fields the trend has been towards deregulation or reduction of administrative burden on the economy.

The U.S. economy has a tradition of government intervention for specific economic purposes including controlling inflation, limiting monopoly, protecting the consumer and providing for the poor. The government also affects the economy by controlling the money supply and credit usage. Economists call the amount of money circulating in the national economy the economic money supply. When the money supply is too high it results in too much money circulating in the national economy and is followed by creating upward price pressure on goods and services as well as steady rise in inflation. This has the effect of decreasing the value of the dollar. The Federal Reserve Board (the Fed) decreases the economic money supply by selling bonds it already owns. By doing so, the Fed is attempting to decrease upward price pressure, curb inflation and increase the value of the dollar.

When the economy is growing too slowly, or in a recession, the economic money supply is too low. This leads to an imbalance in the supply and demand for goods and services, meaning that supply of goods and services is too high while demand is too low. In the case of slow economic growth or recession, the Fed buys government bonds to increase the economic money supply. By doing so, the Fed is attempting to increase demand for goods and services, avoid job losses and prevent the economy from slowing even further. When the Fed decreases the money supply by selling bond it already owns, it increases interest rates.

This increases the amount of money that banks are required to keep on hand to cover their liabilities, called a "reserve requirement." Increased reserve requirements leave banks with less money to lend to consumers. In most cases it discourages borrowing and slows an economy that is growing too rapidly. Such a situation can have an extremely negative impact on the economy, causing job losses and drastic wage reductions.