Economic recession

Business

Introduction Economic recession is a significant problem in all economies which may lead to collapse of different economic sectors. The federal government is responsible for applying different economic policies in order to get the economy out of recession. Expansionary monetary policy is a monetary policy whose aim is to increase the amount of money supply in the economy.

Expansionary economic policies encourage economic growth. The Central Bank or the Ministry of Finances control the monetary policy. Expansionary fiscal policy, on the other hand, is a fiscal policy where the government spends more money than the tax revenues especially during the recession. The government increases its budgets to influence different economic activities. These policies have different effect to the economy in general. Both, the Federal Reserve Bank (The Fed), and the Congress use the policies either independently, or together in order to produce the desired effects.

Thesis Statement The essay is aimed to prove the thesis statement, that if the both, the expansionary monetary policy and the expansionary fiscal policy could be applied together to move an economy out of recession, then they would be more effective than using each in isolation. This would mean that the Fed and the Congress would have to use these policies together to move the economy from recession. Expansionary Fiscal Policy Expansionary fiscal policy tends to increase purchases by the government. It also decreases taxes, with a choice to increase the transfer payments in order to correct the contraction problems of a business cycle. The expansionary fiscal policy's main objective is to stimulate the economy, bridge the recessionary gap and provide a significant decrease in the unemployment rate.

To stimulate the economy, the policy would have to increase the aggregate expenditures and aggregate the demand. This can be executed by increasing government spending. The federal government therefore would have to increase its purchases and transfer payments and at the same time reduce taxes. The main causes of the policy are budget deficits or smaller budget surplus for the government which earlier experienced high budget surpluses. The government's purchases are simply part of the GDP that the government buys. These are the expenditures made by the government in order to purchase final goods and services.

The goods are used in government offices, service provision by the government, relief food, medical services and all other government projects. The government can increase expenditures on services by increasing salaries for its employees such as teachers and doctors. This leads to a significant increase in the employment level as well as boosts incomes. The government may also use taxes as another tool for expansionary fiscal policy. Taxes are simply levies on personal incomes of the households, both in terms of salaries and profits from entrepreneurship.

For the expansionary fiscal policy the government reduces taxation rates or may rebate earlier taxes charged. This reduces the amount of taxes and inreases the disposable income for the households. This, in its turn, leads to a boost in the economy. Many economies prefer this tool since it is easier to administer tax reductions other than increase government expenditures. The Federal Government controls the tax system using the Internal Revenue Service (IRS) (Bourguignon & Silva 2008). The third fiscal tool that the government would apply is the transfer payments.

These are payments that the government makes to the public without goods or services in return. They include social security benefits to the disabled, elderly, poor people's welfare and unemployment compensation. The government increases transfer payments by either increasing the actual payments to those who qualify or increase the frequency of payments. This increase leads to rise in expenditures for the households and leads to a boost in the economy. The households can pay for the products and thus more employment cases.

The expansionary fiscal policy is successful in closing the recessionary gap by enabling a full employment of resources. Recession leads to low aggregate production levels due to under-utilization of resources. Increase in the household's disposable income promotes expenditure and later leads to higher production. Expansionary Monetary PolicyExpansionary monetary policy leads to an increase in money in circulation, with decreases in interests' rates. Its main objective is to stimulate the economy in correcting a problem of contraction in business-cycle. It also seeks to reduce unemployment in the economy.

Previously, the government would increase the money supply by printing more currency which lead to inflation and further economic problems. The best way to increase money in the economy is to boost economic activities that lead to money creation. This is possible through the fractional-reserve banking process. The Federal Reserve System holds the monetary authority and therefore controls monetary policy. The Fed can use three different tools to increase the amount of money in supply. The expansionary monetary

policy also affects the interest rates since more money in circulation motivates the banks to lower their interest rates.

The first tool that the Fed may use is the Open Market Operations is buying or selling of Treasury securities. This instrument controls money supply, banks' reserves, and interest rates. It is easy, flexible and quite effective for the Fed to use this tool; hence it is the most common one. It runs it by using the Federal Open Market Committee, and the New York Federal Reserve Bank undertakes its implementation. In this tool, the Fed purchases the U.

S. Treasury securities through Open Market Operations. The Fed pays the banks for the securities. Then the banks invest their increased reserves by lending it to the public with low interest rates (Mody & Pattilo 2006). As a result, this leads to an increase in the money in circulation, thus leading to higher demand for products, expenditure, investments, production and finally employment. The second tool that the Fed may use is the Discount Rate.

This is the rate the Fed charges commercial banks for reserve loans. The Fed's main aim at the timess of its establishment was to prevent collapse of commercial banks due to the decrease in reserves. The Fed sets this rate according to the economic situation of different states, with approval from the Board of Governors in these states. In the expansionary monetary policy the Fed reduces the discount rates. This encourages commercial banks to borrow from the Fed.

With an increase in bank reserves, the commercial banks further lend money to the public with lower interest rates. This increases the amount of money

in circulation in the economy. The Fed always uses this tool as a signal for open market operations since most commercial banks do not borrow from its reserves. The third tool is the alteration of Reserve requirements. These are the rules the Fed sets for commercial banks to maintain the ratios of its deposits. The Fed's Reserve requirements on commercials banks range from 10% of liquid deposits to 0% of deposits in savings.

These reserve requirements ensure that the banking system remains stable. They also reduce panics and inabilities to pay for running costs as the bank's reserves diminish. In the expansionary monetary policy, the Fed lowers its reserve requirement ratio. The banks have more reserves at their disposal and therefore more money available for lending. This encourages the households to borrow money from the commercial banks in order to increase their consumption power.

This leads to increased consumption in products and investment. It leads to an economic stimulus as there is effective resources' utilization. The Fed can either use the three tools separately or together to increase the amount of money in circulation in the economy and reduce interest rates significantly. The stimulation of the economy is possible from these objectives since they induce the economic process. This process begins by increasing expenditures on the aggregate production, especially on investment and consumption expenditures.

This increase in aggregate production leads to effective utilization of resources (Franzese 2002). This further raises employment rates leading to reduction in unemployment statistics. This is the specific objective of the

expansionary monetary policy. Therefore, this policy is successful in tackling the recession problem. Conclusion From the essay one can judge that both the expansionary monetary and the fiscal policies can stabilize the economy.

This does not mean that they are mutually exclusive. The fiscal and the monetary policies must mutually agree to avoid the situation where they would negate each other. The Fed and the Congress must all agree on the best method to expand the economy that is experiencing recession. An expansion in the fiscal policy would require a subsequent expansion in the monetary policy in order to complement it. A fiscal policy which contradicts itself would also negate an expansionary monetary policy. Therefore, the essay proves the thesis that if both the expansionary monetary policy and the expansionary fiscal policy could be applied together to move an economy out of the recession, then they would be more effective than using each of them in isolation.

This would ensure a faster and more effective economic boost and therefore faster recovery.