ECONOMIC POLICY

I. MAKING ECONOMIC POLICY
   a. Review the market decline on page 489

II. AN INTRODUCTION TO ECONOMIC POLICY
   a. Framers wanted a government strong enough to promote free trade, protect patents and trademarks, enforce contracts between individuals and businesses; also to build basic infrastructure
   b. Divided responsibility for economic prosperity between the executive and legislative branches
   c. Article I, Section 8 gives the Congress the power to borrow, coin, and print money
   d. Article II, Section 2 gives the president the power to appoint the officers of government, including the Secretary of the Treasury
   e. Framers succeeded in protecting and promoting capitalism
   f. Part of the government's role is to stay out of the way of the free market and promote the national welfare through:
      i. FISCAL POLICY – using federal spending and taxation to stimulate or slow the economy
      ii. MONETARY POLICY- manipulates the supply of money that individuals and businesses have to keep the economy from swinging wildly from boom to bust and back
   g. Designed to smooth the fluctuations in the business cycle: 4 stages
      i. EXPANSION- economy produces new jobs and growth

ii. CONTRACTION- slowing of economy
iii. RECESSION- where economy reaches a trough of slow growth
iv. RECOVERY – economy rebounds
v. GOAL IS TO LOWER FLUCTUATIONS

h. Two yardsticks to measure the performance of the economy"
    i. INFLATION – overall increase or reduction in prices of goods and services
        1. Overall rise is risk in expansion
    ii. UNEMPLOYMENT- number of people actively looking for work at any given time
        1. Problem mostly during contraction and recession
    iii. Theory is unemployment increases when inflation drops and unemployment decreases when inflation increases
        1. STAGFLATION is when both unemployment and inflation increase; no growth and inflation or recession and inflation
    iv. Measure inflation by the CONSUMER PRICE INDEX which is a market basket of consumer goods
    v. Measure unemployment by the UNEMPLOYMENT RATE – %age of willing workers that are currently unemployed divided by total work force

i. Other measures to track the economy:
    i. Budget deficit, balance of trade,
    ii. Most important measure is year over year measure of REAL GROSS DOMESTIC PRODUCT (REAL GDP) – GDP without inflation; total value of all goods and services in the U.S. economy

III. FISCAL POLICY
   a. Congress and the president generate fiscal policy by taxing, borrowing, and spending money
   b. Increased government spending and lower taxes is a fiscal policy of expansion in the economy; to get economy out of recession
   c. Decreased government spending and higher taxes is a fiscal policy of contraction in the economy; to stop the economy from overheating
   d. THE FEDERAL BUDGET
      i. Federal government spends about 23% of GDP annually
      ii. WHERE THE MONEY COMES FROM – review figure 18-1 on page 492
         1. INDIVIDUAL INCOME TAXES- ratified under the 13th Amendment in 1913; start of the progressive era
         2. PAYROLL TAXES – Social Security and Medicare
         3. CORPORATE INCOME TAXES
         4. EXISE TAXES – taxes on sale of liquor, tobacco, gas
         5. OTHER SOURCES
         6. BORROWING – comes from a BUDGET DEFICIT; borrow from citizens, banks, and even foreign government by selling Treasury bills, notes and bonds- review figure 18-2 on page 493
      iii. Giving the people the power over taxation was a major achievement in the development of self-government
      iv. Also can impose a TARIFF on imported goods; raises revenue

v. Government needs to decide how to levy taxes; who incurs the burden?
   1. PROGRESSIVE TAX- tax percentage increases as income increase; income tax is a progressive tax
   2. REGRESSIVE TAX- tax percentage increases as income decreases; gas tax
   3. PROPORTIONAL TAX – tax remains at same percentage no matter amount of income; flat tax

vi. U.S. needs to pay interest on its borrowing; Treasury bills, notes and bonds; if the U.S. faces and deficit and needs to borrow money, the sum total of all deficits is the NATIONAL DEBT which is what we pay interest on
   1. Not as desperate as people think
      a. 90% of debt payments are to U.S. citizens and corporations
      b. Economic strength and size of economy is significantly more than debt total

vii. WHERE THE MONEY GOES- Spent on benefit payments to individuals and national defense
   1. In 2006 nearly ½ of all federal spending went to required (mandatory) benefit payments to individuals, such as Social Security, Medicare, Medicaid and other social programs
   2. Review figure 18-3 on page 494

e. THE BUDGET PROCESS
   i. Today, by law (Budget and Accounting Act of 1921) the president is required to submit

an annual budget proposal for all agencies together

ii. THE EXECUTIVE BRANCH- Federal government's fiscal year begins every October 1st

1. Starts two years in advance
2. OFFICE OF MANAGEMENT AND BUDGET (OMB) is responsible for overseeing the budget process on behalf of the president
3. Once the give and take between the staffers of the OMB and the president is finished, the OMB director gives the president a single document showing the revenues and expenditures of the federal government; president reviews and makes adjustments
4. President must submit the budget recommendations and accompanying message to Congress between the first Monday in January and the first Monday in February

iii. THE LEGISLATIVE BRANCH

1. Under the Constitution, Congress must appropriate the funds and raise the taxes
2. Appropriations are subject to a potential presidential veto
3. Congress starts process by approving initial budget resolution that sets broad spending and revenue goals for the process
4. Moves forward with hearings on the 13 giant appropriation bills that actually spend money

5. Congress adopted the Budget and Impoundment Control Act of 1974 to strengthen its role in the budget process; forces the president to fully inform Congress on all revenue and spending changes
    a. Also created the CONGRESSIONAL BUDGET OFFICE (CBO), an independent agency that prepares budget data on behalf of Congress; analyzes budget and reports back to Congress

f. TAX EXPENDITURES
    i. Final type of fiscal policy that uses the tax code to provide special tax incentives or benefits to individuals and businesses for economic goals such as home ownership, retirement savings, and college education
    ii. More than $90BB in 2008
    iii. Tax breaks
    iv. Carries out public policy objectives; encourage behavior

g. THE POLITICS OF TAXING AND SPENDING
    i. In addition to raising funds, taxes also promote economic growth and reward certain type of behavior, such as charitable contributions
    ii. As much as taxpayers complain, most want everything government provides and more
        1. Critics argue between the best type of tax
            a. Progressive such as income
            b. Excise because it taxes luxury goods

iii. SALES TAX in Europe is slightly different; they use VALUE ADDED TAX- which taxes a good or service at each stage of production and distribution, rather than just to the final customer
    1. Infuses a large amount of money to the federal government

IV. MONETARY POLICY
  a. Main idea is that prices, incomes, and economic stability reflect growth in the amount of money that circulates through the economy at any one time
    i. Money Supply is the key factor affecting the economy's performance
  b. THE FEDERAL RESERVE SYSTEM
    i. Monetary Policy is made by the Board of Governors of the FEDERAL RESERVE SYSTEM – Created by Congress in 1913 to establish banking practices and regulate currency in circulation and the amount of credit available
      1. Chair consists of 6 members of the FED's Board of Governors and are appointed by the president with Senate consent to 14 year terms; different members' terms expire every two years
      2. Independent regulatory commission
      3. Current FED chair is Ben Bernanke
    ii. FED has three basic tools for influencing the economy
      1. Change interest rates banks must pay the FED to borrow money; FEDERAL FUNDS RATE

a. Increasing rate reduces money supply and decreasing rate increases money supply
b. PRIME RATE banks charge best customers is linked to the Fed Funds Rate
c. Review figure 18-4 on page 498 with economic conditions

2. The FED buys and sells federal debt – OPEN MARKET OPERATIONS – buys and sells Treasury Bills, Notes and Bonds
   a. Buying bonds will increase the money supply
   b. Selling bonds will decrease the money supply
3. The FED determines the RESERVE RATIO banks must have on hand
   a. Higher reserve ratio decreases money supply
   b. Lower reserve ratio increases money supply

c. GOVERNMENT AND ECONOMIC POLICY
   i. Based on the situation in the Great Depression and the election of FDR in 1932, differing philosophies emerged on the relative amount of government intervention into the economy
      1. First theory is LAISSEZ-FAIRE (hands off) ECONOMICS
         a. Reduce spending, lower taxes, curb power of labor, reduce the size and scope of the government and leave business alone

2. Second theory deeply influenced by Harvard economist, John Maynard Keynes was to increase government spending and investment since the private sector could not do that in a deep recession – KEYNSIAN ECONOMICS
3. Actual third theory developed in the 1980s by Reagan saying that tax cuts will spur the economy due to more money in people's hands; SUPPLY SIDE ECONOMICS- tax cuts increase the supply of money available in the economy

V. PROMOTING THE ECONOMY
   a. Federal government not only tries to smooth the business cycle, it tries to promote sustained economic growth
   b. PROMOTE ECONOMIC GROWTH – first goal
      i. Department of Commerce is the most visible advocate of business
         1. Protects intellectual property through "the progress of science and useful arts" – Article I
      ii. Department of Agriculture is a powerful advocate of the farming industry
   c. PROMOTING INTERNATIONAL TRADE
      i. Worries about international competition often lead to PROTECTIONISM - a policy of erecting trade barriers to protect domestic industry
         1. Most economists oppose it; prevents efficiencies

ii. Many less trade barriers today than previously; however the U.S. currently has a significant TRADE DEFICIT with other nations, especially China
    1. Problem is that the U.S. is exporting too little
    2. Is the U.S. getting fair treatment by other countries?
    3. DUMPING- or selling goods into the U.S. much cheaper than they sell in their home country- is a practice that hurts our economy
    4. SUBSIDIZING their exports to the U.S. is also a practice that hurts our economy

iii. WORLD TRADE ORGANIZATION (WTO) - 1947
    1. Enforces trade agreement with over 130 countries and accounts for 4/5 of the world's trade
    2. WTO founded the General Agreements on Tariffs and Trade (GATT); resolves disputes and issues fines and penalties when necessary
    3. U.S. has tried to focus the GATT negotiations to increased agricultural trade, foreign investment, and the protection of technological innovations and intellectual property
    4. Labor unions, environmentalists and human rights advocates oppose based on overseas low-paying jobs and promotion of human rights and environmental violations

iv. NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) – 1992
    1. Free trade zone in North America
    2. Had a tremendous impact on Canada, U.S., and Mexico

VI. REGULATING THE ECONOMY
  a. 2ND goal is to regulate business activities that may create unfair advantages
     i. Constitution explicitly provides for the Congress to regulate commerce among the states
     ii. Congress established many agencies to deal with the flow of commerce and consumer and business protection
  b. PREVENTING CORPORATE ABUSE
     i. Regulation is any attempt by the government to control the behavior of corporations, other governments or citizens
     ii. The U.S. has a competitive market economy with relatively little government regulation; relies on private enterprise and market incentives to carry out most production and distribution
     iii. Conservatives tend to overstate costs of regulation while liberals tend to overstate benefits and understate costs
  c. TYPES OF CORPORATE REGULATION
     i. Two types of regulatory agencies
        1. Independent agencies under the president's control
           a. Heads have no specified time and serve at the pleasure of the president

2. Independent regulatory commissions insulated from control of Congress or the president
    a. Appointed by president and confirmed by Senate and have specific periods of time in office

d. REGULATING BUSINESS
   i. Three waves: 1910. 1930, 1960
   ii. Most important responsibility is to maintain competition
      1. Do not want MONOPOLY – one firm dominates; or OLIGOPOLY – few firms dominate
      2. Need to enact ANTI-TRUST LEGISLATION
      3. Late 19th century was dominated by TRUSTS – large monopolies; government responded in 1890 by passing the SHERMAN ANTI-TRUST ACT
      4. Passed CLAYTON ACT in 1914 to add to the antitrust arsenal; cannot charge different prices to different buyer and no INTERLOCKING DIRECTORATES

e. REGULATING THE USE OF LABOR
   i. Federal regulations protect workers in the following areas:
      1. PUBLIC CONTRACTS – Walsh Healey Act of 1936; fair compensation plus paid overtime
      2. WAGES AND HOURS- Fair Labor Standards Act of 1938; maximum of 40 hrs. per week

        3. CHILD LABOR – Fair Labor Standards Act outlawed child labor
        4. INDUSTRIAL SAFETY AND OCCUPATIONAL HEALTH- Occupational Safety and Health Act of 1970 created first safety program
    ii. Wagner Act of 1935 allows unions to organize
    iii. Taft-Hartley Act of 1947 outlawed the CLOSED SHOP - previous union membership a condition of employment; allowed UNION SHOP- new employees are obligated to join the union within a stated period of time
        1. Allowed courts to issue LABOR INJUNCTIONS forbidding acts that are harmful to the rights and properties of an employer or community (striking)
        2. Structured the process of COLLECTIVE BARGAINING
f. REGULATING COPORATE MARKETS
    i. Securities Exchange Act of 1934 created the SEC which monitors the markets and ensures companies report their operating statements accurately
        1. Puts the investor first and ensures honesty
g. PROTECTING THE ENVIRONMENT
    i. Clean Air and Waters Act in the 1970s; limits on pollution and regulated how much corporations can pollute the environment
    ii. Most controversial environmental regulations are ENVIRONMENTAL IMPACT STATEMENTS- statement

required from all agencies for any project using federal funds to assess the potential effect of the new construction or development on the environment

        1. Critics claim too much governmental interference

    iii. 1990 Congress amended the Clean Air Act to create more regulation on emissions, pollution control- "cap and trade"- allow a certain amount and after that, need to pay or trade for additional pollutants

h. CORPORATE RESPONSIBILITY
    i. CORPORATE SOCIAL RESPONSIBILITY – efforts by corporations to improve their reputation by paying attention to their contributions to the social good

VII. THE DEREGULATION MOVEMENT

a. DEREGULATION – a policy promoting cutbacks in the amount of federal regulation in specific areas of economic activity
    i. Began in 1977 with airline, trucking and railroad industries
    ii. Creating new procedures to limit amount of regulation
b. DEREGULATING TRANSPORTATION
    i. Began regulating in 1938 with the Civil Aeronautics Board (CAB)
        1. Abolished it in 1978
        2. Generally resulted in lower fares, though critics worry about safety
        3. Mergers recently have worsened the problems and created near oligopolies and monopolies;

c. DEREGULATING TELECOMMUNICATIONS
    i. As compared to transportation, which deregulation came in steps, telecommunications came in a single, massive bill called the TELECOMMUNICATIONS ACT OF 1996
        1. Broke up long standing monopolies like AT&T, while creating competition for phone, cable, Internet
        2. Created to controversies: V-chip for parental control and new regulations on Internet content

VIII. A CONTINUED FEDERAL ROLE
a. Congress and the president know that the federal government must be active in the economic life of the nation
b. Most Americans want the government to have a limited role in economic affairs
c. Citizens exert a great deal of influence on economic policy; mostly by free market use of purchasing goods and services