

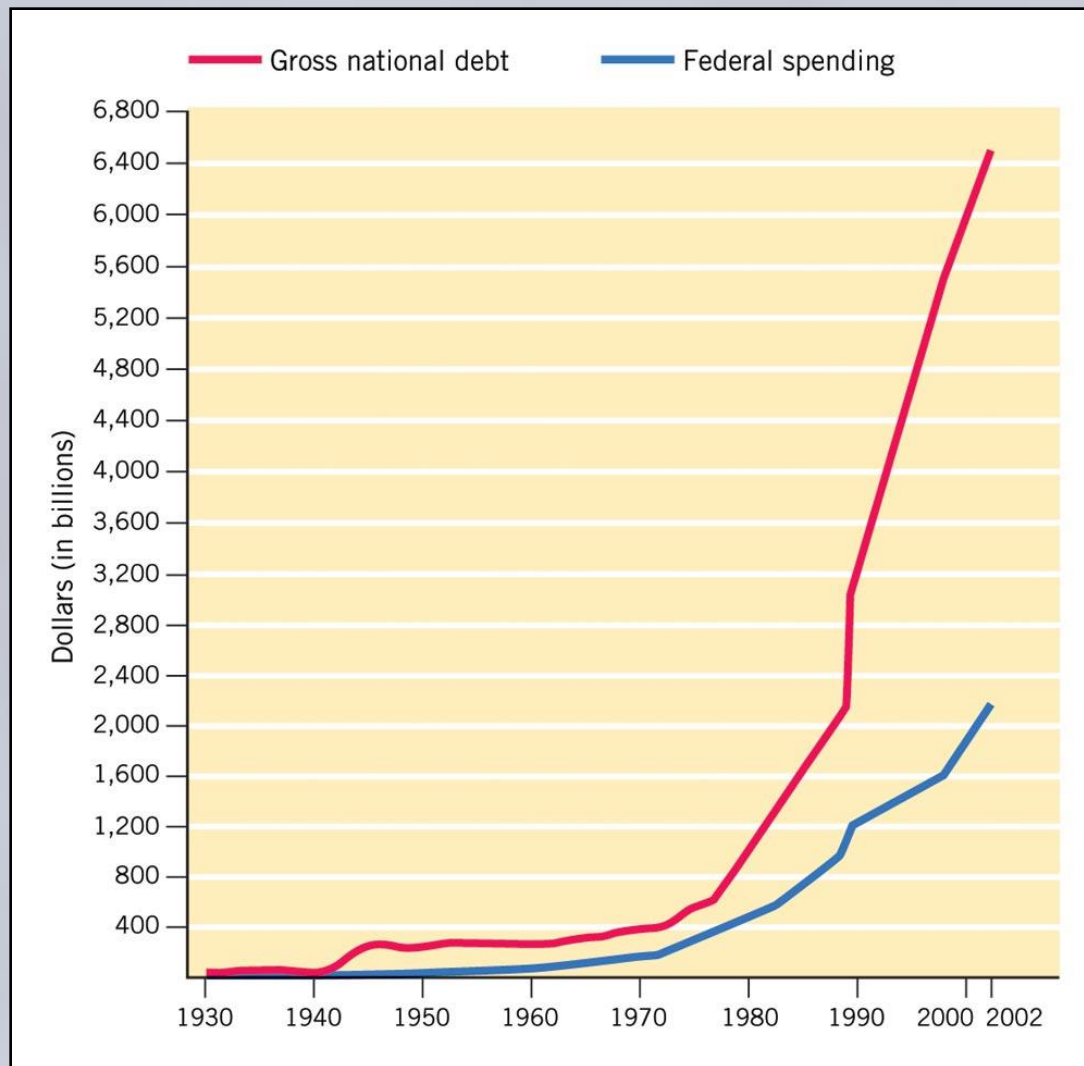
Chapter Eighteen

Economic Policy

Politics and Economics

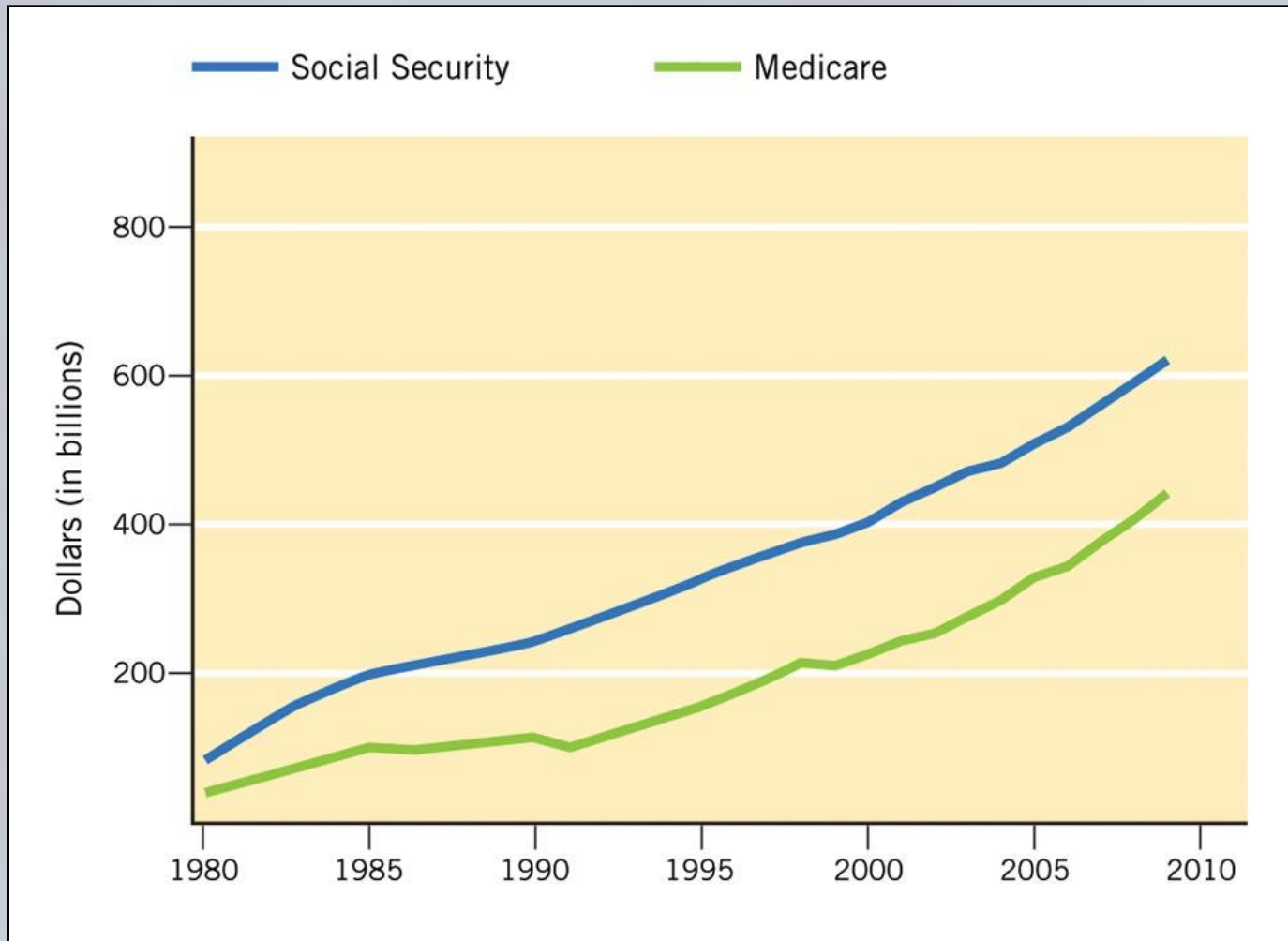
- **Deficit:** when expenditures exceed revenues
- **National debt:** the total amount of deficits we have had since George Washington was president
- Debt is currently about 40% of GDP

Figure 18.3: History of the National Debt



Economic Reports of the President, various years.

Figure 18.4: When Will The Crunch Come? Projections of the Growth in Federal Spending



Congressional Budget Office, *The Economic and Budget Outlook: An Update* (July 1, 1999).

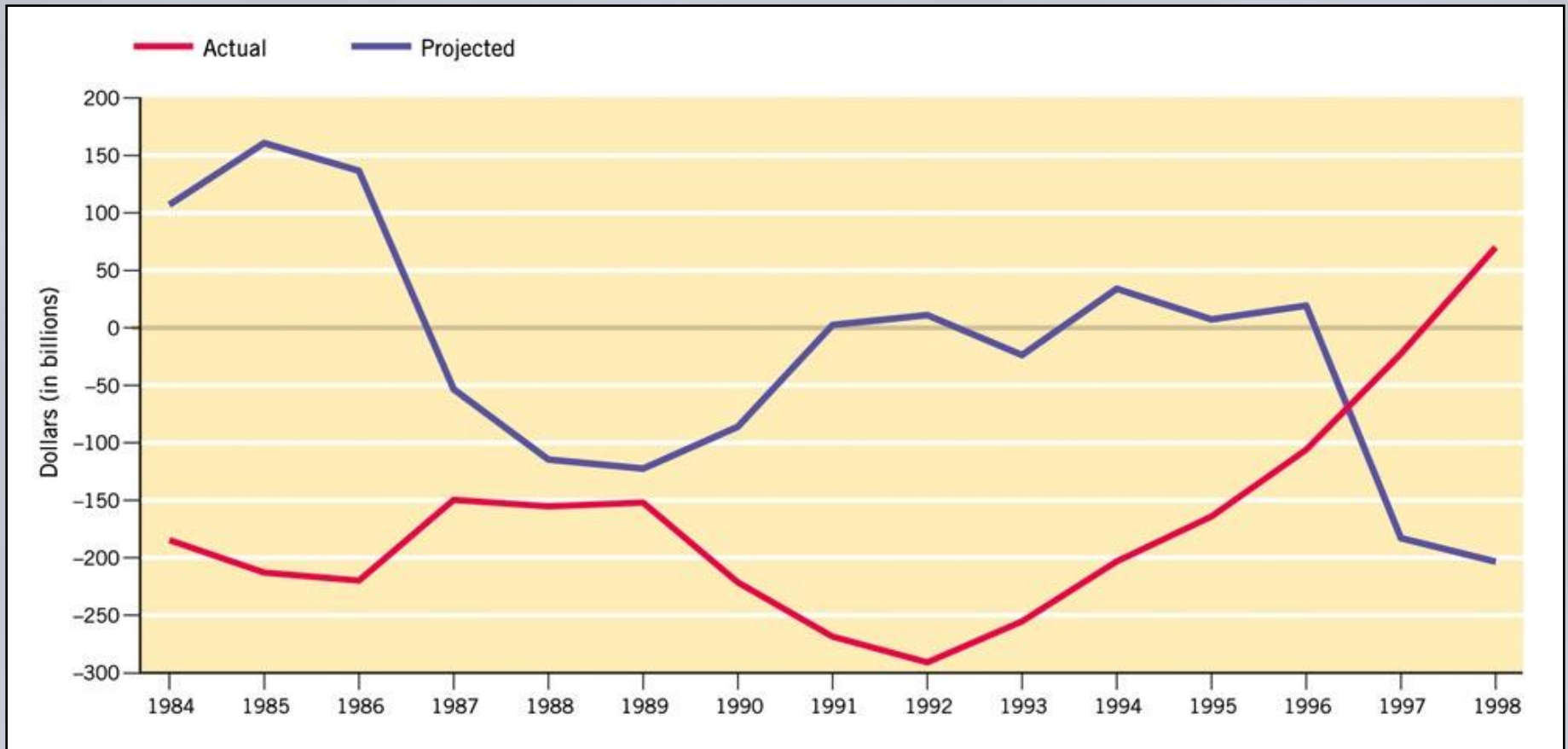
Policy Debates

- Both the deficit and balanced budget proposals have led to policy debates
- Republicans: Economic Growth and Tax Relief Reconciliation Act of 2001, one of only three large tax cuts since WWII
- Democrats: Most tax cuts end in 2010; spending was increased to many federal programs

Uncertainty

- Economic forecasts are always uncertain – September 11th attacks and subsequent military actions had significant economic implications
- When nation is in recession, tax revenues decrease and spending on social programs may increase

Figure 18.2: Bad Economic Guesses



National Journal (January 30, 1999), 251.

The Politics of Prosperity

- Voters see connections between the nation as a whole and their own situations
- Voting behavior and economic conditions are not always correlated at the national and individual levels—people do not always vote in line with their pocketbooks

Politicians and the Economy

- Elected officials are tempted to take a short-term view of the economy and satisfy the self-regarding voter
- Government does not know how to produce all desirable outcomes
- Economic pressures are often inter-related

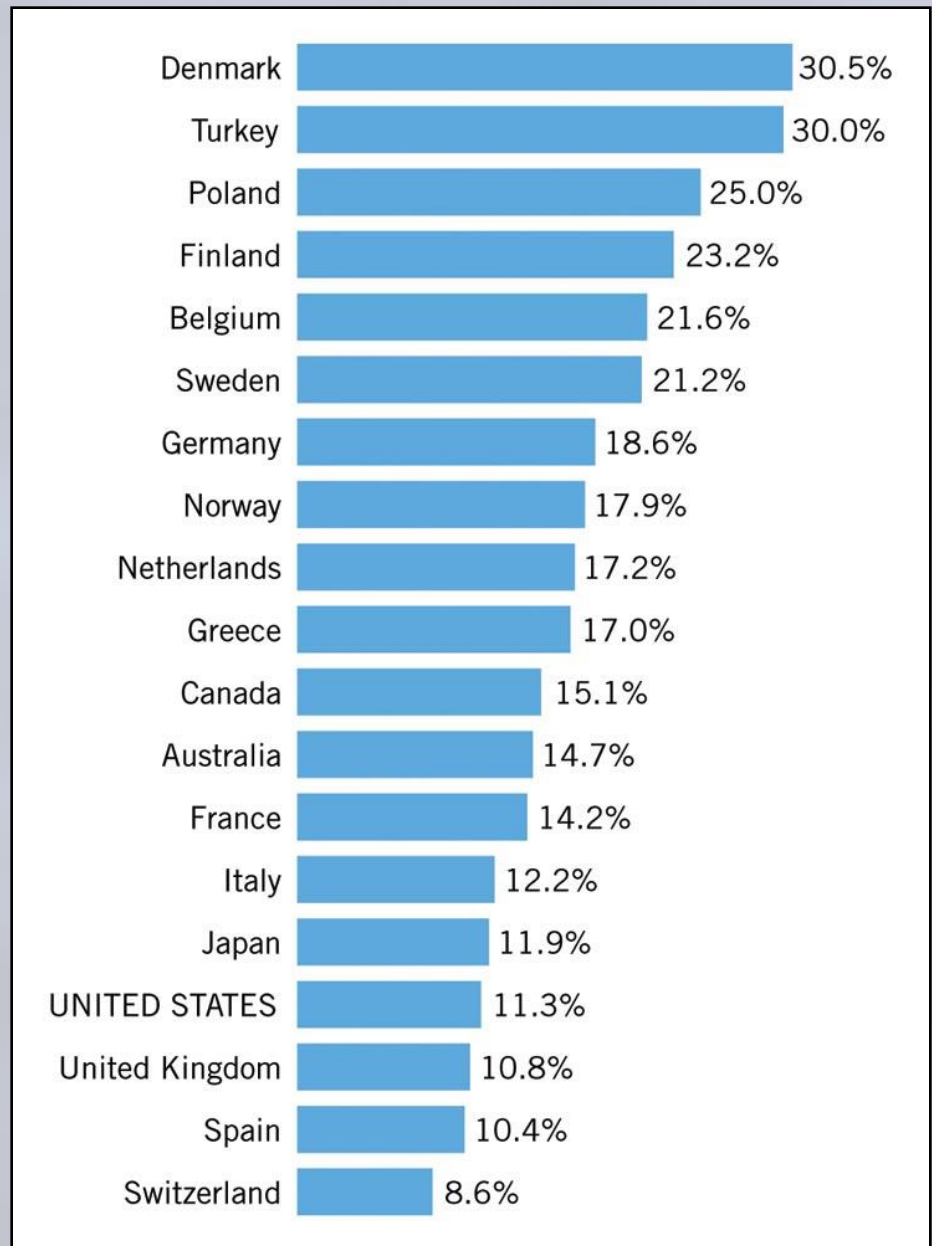
Ideology and the Economy

- Ideology plays large role in shaping policy choices
- Democrats tend to want to reduce unemployment
- Republicans tend to want to reduce inflation

The Politics of Taxing and Spending

- Majoritarian politics yields conflicting recommendations: lower taxes, less debt, new programs are all wanted
- Meaningful tax cuts are politically difficult; new programs tend to be more popular with politicians

Figure 18.5: Tax Burdens in Democratic Nations Taxes as a Percentage of Income of a Family with Two Children



Statistical Abstract of the United States, 2003, Table 1344.

Monetarism

- **Monetarism:** inflation occurs when there is too much money chasing too few goods
- Monetarists advocate increasing the money supply at a rate about equal to economic growth and then letting the free market operate

Keynesianism

- Assumes that the health of the economy depends on what fraction of their incomes people save or spend
- When demand is too low, the government should pump money into the economy by spending more than it collects in taxes

Supply-Side Tax Cuts

- There is a need for less government interference in the market and lower taxes
- Lower taxes would create incentives for investment
- Greater economic productivity will then produce more tax revenue

Reaganomics

- Combination of monetarism, supply-side tax cuts, and domestic budget cutting
- Military spending increased sharply
- Money supply controlled—cut inflation but allowed interest rates to rise

Reaganomics

- Personal income taxes were cut, but Social Security taxes were increased
- Large deficits were incurred, dramatically increasing size of national debt
- Stimulated economy—unemployment decreased, business activity increased

Economic Policy Making

- **Council of Economic Advisers:** professional economists sympathetic to the president's view of economics
- **Office of Management and Budget:** prepares estimates of amounts to be spent by federal government agencies; negotiates department budgets
- **Secretary of the Treasury:** reflects the point of view of the financial community

The Federal Reserve Board

- Members are appointed by the president, confirmed by the Senate; serve a nonrenewable fourteen-year term; removable for cause
- Somewhat independent of both the president and Congress

The Federal Reserve Board

- Regulates the supply and price of money
- Sets monetary policy: the effort to shape the economy by controlling the amount of money and bank deposits and the interest rates charged for money

The Budget

- **Budget:** a document that announces how much the government will collect in taxes and spend in revenues and how those expenditures will be allocated among various programs
- **Fiscal year:** time period covered by the budget, running from October 1 to September 30 of the following year

Congressional Budget Act of 1974

- President submits budget
- House and Senate budget committees analyze the budget, with the Congressional Budget Office
- Each committee proposes to its house a budget resolution that sets a total budget ceiling and ceilings for each of several spending areas

Congressional Budget Act of 1974

- Congress considers appropriations bills and sees whether they are congruent with the budget resolution
- Appropriations bills cannot make big changes in the budget because approximately $\frac{2}{3}$ of government spending is on entitlements

Gramm-Rudman Balanced Budget Act (1985)

- Called for automatic cuts from 1986–1991, until the federal deficit disappeared
- If there was a lack of agreement between the president and Congress on the total spending level, there would be automatic across-the board cut (a sequester)
- The president and Congress still found ways to increase spending

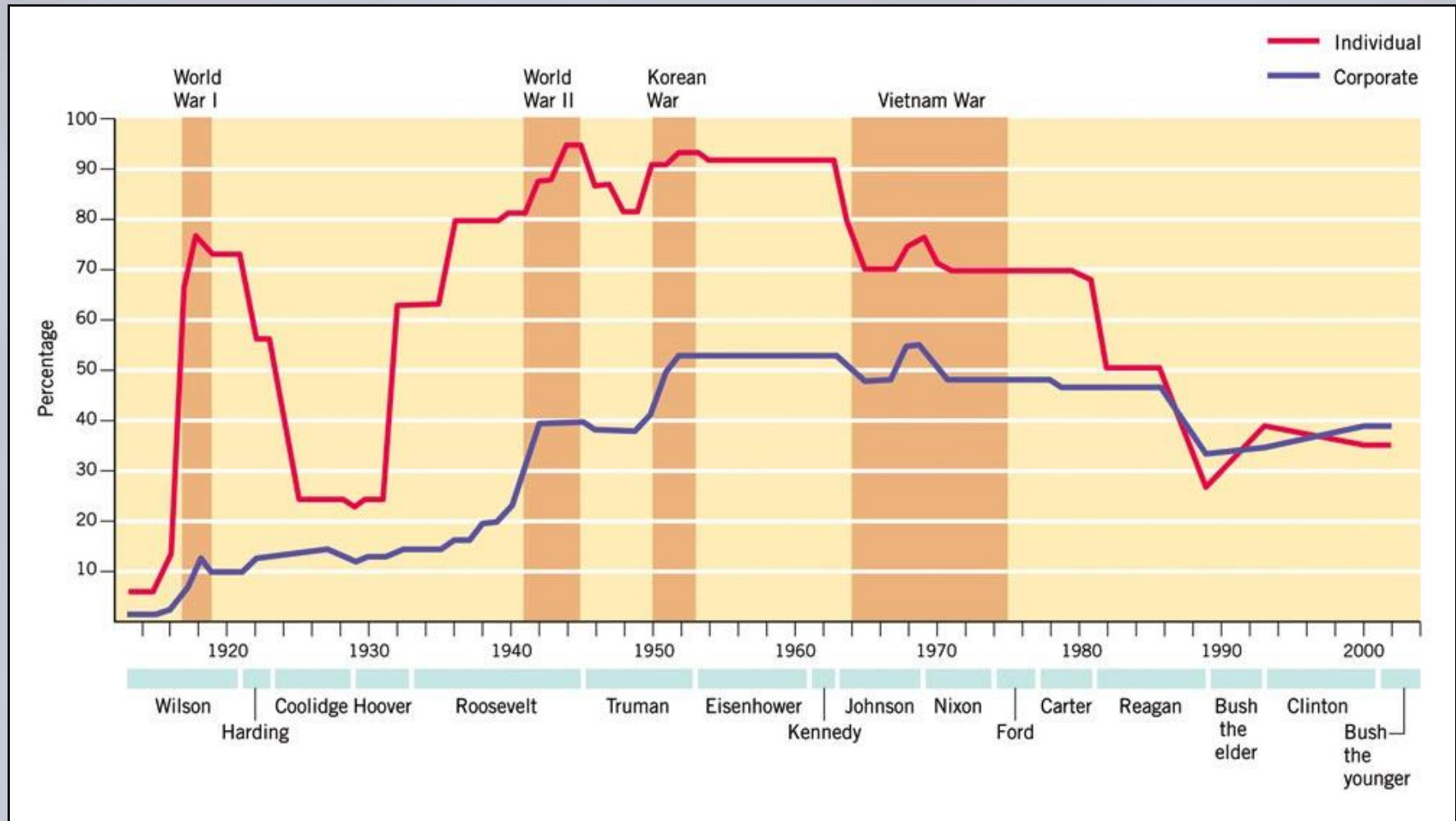
1990 Budget Strategy

- Congress voted a tax increase and the Budget Enforcement Act capped non-entitlement (discretionary) funding
- If entitlement spending increased, there had to be cuts in discretionary spending or taxes had to be raised

Levying Taxes

- Most revenue was derived from tariffs until ratification of the Sixteenth Amendment (1913)
- Taxes then varied with war (high) and peace (low)

Figure 18.6: Federal Taxes on Income, Top Percentage Rates, 1913-2002



Updated from *Congressional Quarterly Weekly Report* (September 18, 1993), 2488.

Levying Taxes

- George H.W. Bush and Clinton increased tax rates, keeping deductions low
- Balanced budget switched policy debates to tax cuts, but Social Security and Medicare policy problems remain