Study Outline
Chapter 16: Economic Policy

I. Introduction
    A. The politics of deficit spending
        1. 1999 / 2000 financial "miracle" (first surplus since 1969)
        2. Uniform public opinion versus divided politicians
            a. Cut spending?
            b. Raise taxes?
        3. Rapid growth of economy and increase in personal income and incoming taxes reduced deficit
        4. New Debate: What to do with the extra money?
            a. Republicans: return it to the taxpayers
            b. Democrats: spend it on new programs
            c. Economic Growth and Tax Relief Reconciliation Act of 2001
            d. 2010 expiration and increase in spending on federal programs
            e. Future economic conditions are difficult to predict

II. The politics of American economic prosperity
    A. Health of American economy creates majoritarian politics
        1. Voters influenced by their immediate economic situation
        2. Voters worry about the nation as a whole as well as their own situations
        3. Voting behavior and economic conditions correlated at the national level but not at the individual level
            a. People understand what government can and cannot be held accountable for
            b. People see economic conditions as affecting them indirectly, even when they are doing well
    B. What politicians try to do
        1. Elected officials tempted to take short-term view of the economy
        2. Government uses money to influence elections, but government will not always do whatever is necessary
            a. Government does not know how to produce desirable outcomes
            b. Attempting to cure one economic problem often exacerbates another
        3. Ideology plays a large role in determining policy
            a. Democrats tend to want to reduce unemployment
            b. Republicans tend to want to reduce inflation

III. The politics of taxing and spending
    A. Inconsistency in what people want out of majoritarian politics
        1. No tax increases
        2. No government deficit
        3. Continued (or higher) government spending
    B. Proposals to spend projected budget surplus in 1999
        1. Tax cuts
        2. New or enlarged government programs
        3. Reduce the debt
    C. Difficult to make meaningful tax cuts
        1. Politicians get reelected by spending money
        2. Increased spending more popular than cutting taxes

IV. Economic theories and political needs
    A. Monetarism--inflation occurs when there is too much money chasing too few goods (Milton Friedman); advocates increase in money supply about equal to economic growth
    B. Keynesianism--government should create right level of demand
        1. Assumes that health of economy depends on what fraction of their incomes people save or spend
        2. When demand is too low, government should spend more than it collects in taxes by creating public works programs
        3. When demand is too high, government should increase taxes
    C. Planning--free market too undependable to ensure economic efficiency; therefore government should control it (John Kenneth Galbraith)
        1. Wage-price controls

        2. Industrial policy--government directs investments toward particular industries
    D. Supply-side tax cuts--need for less government interference and lower taxes (Arthur Laffer)
        1. Lower taxes would create incentives for investment
        2. Greater productivity would produce more tax revenue
    E. Ideology and theory: people embrace an economic theory partly because of their political beliefs
    F. Reaganomics
        1. Combination of monetarism, supply-side tax cuts, and domestic budget cutting
        2. Goals not consistent
            a. Reduction in size of federal government
            b. Increase in military strength
        3. Effects
            a. Rate of growth of spending slowed (but not spending itself)
            b. Military spending increased
            c. Money supply controlled
            d. Federal taxes decreased
            e. Large deficits incurred and dramatically increase the size of the national debt
            f. Unemployment decreased

V. The machinery of economic policy-making
    A. Fragmented policy-making; not under president's full control
        1. Council of Economic Advisers
            a. Members chosen are sympathetic to president's view of economics and are experts
            b. Forecasts economic trends
            c. Prepares annual economic report for president
        2. Office of Management and Budget
            a. Prepares estimates of federal government agencies; negotiates department budgets
            b. Ensures that agencies' legislative proposals are compatible with president's program
        3. Secretary of the Treasury
            a. Reflects point of view of financial community
            b. Provides estimates of government's revenues
            c. Recommends tax changes; represents the nation before bankers and other nations
        4. The Fed (Federal Reserve Board)
            a. Independent of both president and Congress
            b. Regulates supply and price of money
        5. Congress most important in economic policy making
            a. Approves taxes and expenditures
            b. Consents to wage and price controls
            c. Can alter Fed policy by threatening to reduce its powers
    B. Effects of interest group claims
        1. Usually majoritorian: economic health good for all
        2. Sometimes interest group: free trade (e.g., NAFTA)

VI. Spending money
    A. Conflict between majoritarian and client or interest group politics
    B. Sources of conflict reflected in inconsistencies in public opinion
    C. Politicians have incentive to make two kinds of appeals
        1. Keep spending down and cut deficit
        2. Support favorite programs of voters

VII. The budget
    A. Earlier practices
        1. Merely adding expenditures before 1921
        2. No unified presidential budget until 1930s
        3. Separate committee reactions after that
    B. Congressional Budget Act of 1974: procedures
        1. President submits budget
        2. House and Senate budget committees analyze budget
        3. Budget resolution in May proposes budget ceilings

        4. Members informed whether or not spending proposals conform to budget resolutions
        5. Committees approve appropriations bills, Congress passes them, and sends them to the president for signature
        6. Hard to make big changes in government spending because of entitlements
        7. Big loophole: Congress not required to tighten government's financial belt
        8. Failures of the process after 1981

VIII. Reducing Spending
    A. Gramm-Rudman Balanced Budget Act (1985) called for:
        1. A target cap on the deficit each year, leading to a balanced budget
        2. A spending plan within those targets
        3. If lack of agreement on a spending plan exists, automatic across-the-board percentage budget cuts (a sequester)
    B. "Smoke and mirrors" and failure of the Act
        1. Plan was unpopular, but "necessary"
        2. Congress and president found ways to increase spending about "target" anyway
    C. New strategies
        1. Congress votes for a tax increase
        2. Passage of Budget Enforcement Act of 1990
            a. Imposed a cap on discretionary spending (i.e., nonentitlements)
            b. No limit on mandatory spending (i.e., entitlements) but did impose a "pay-as-you-go" approach

IX. Levying taxes
    A. Tax policy reflects blend of majoritarian and client politics
        1. "What is a 'fair' tax law?" (majoritarian)
            a. Tax burden is kept low; Americans pay less than citizens in most other countries
            b. Requires everyone to pay something; Americans cheat less than others
        2. "How much is in it for me?" (client)
            a. Requires the better-off to pay more
            b. Progressiveness is a matter of dispute: hard to calculate
            c. Many loopholes: example of client politics
        3. Client politics (special interests) make tax reform difficult, but Tax Reform Act passed (1986)
    B. The rise of the income tax
        1. Most revenue derived from tariffs until 1913 and ratification of Sixteenth Amendment
        2. Taxes then varied with war (high), peace (low)
            a. High rates offset by many loopholes: compromise
            b. Constituencies organized around loopholes
        3. Tax bills before 1986 dealt more with deductions than with rates
        4. Tax Reform Act of 1986: low rates with smaller deductions
        5. Will Bush tax cuts expire in 2010 or be made permanent?