Economic and Environmental Policy: Contributing to Prosperity

Chapter 15

Government as Regulator of the Economy

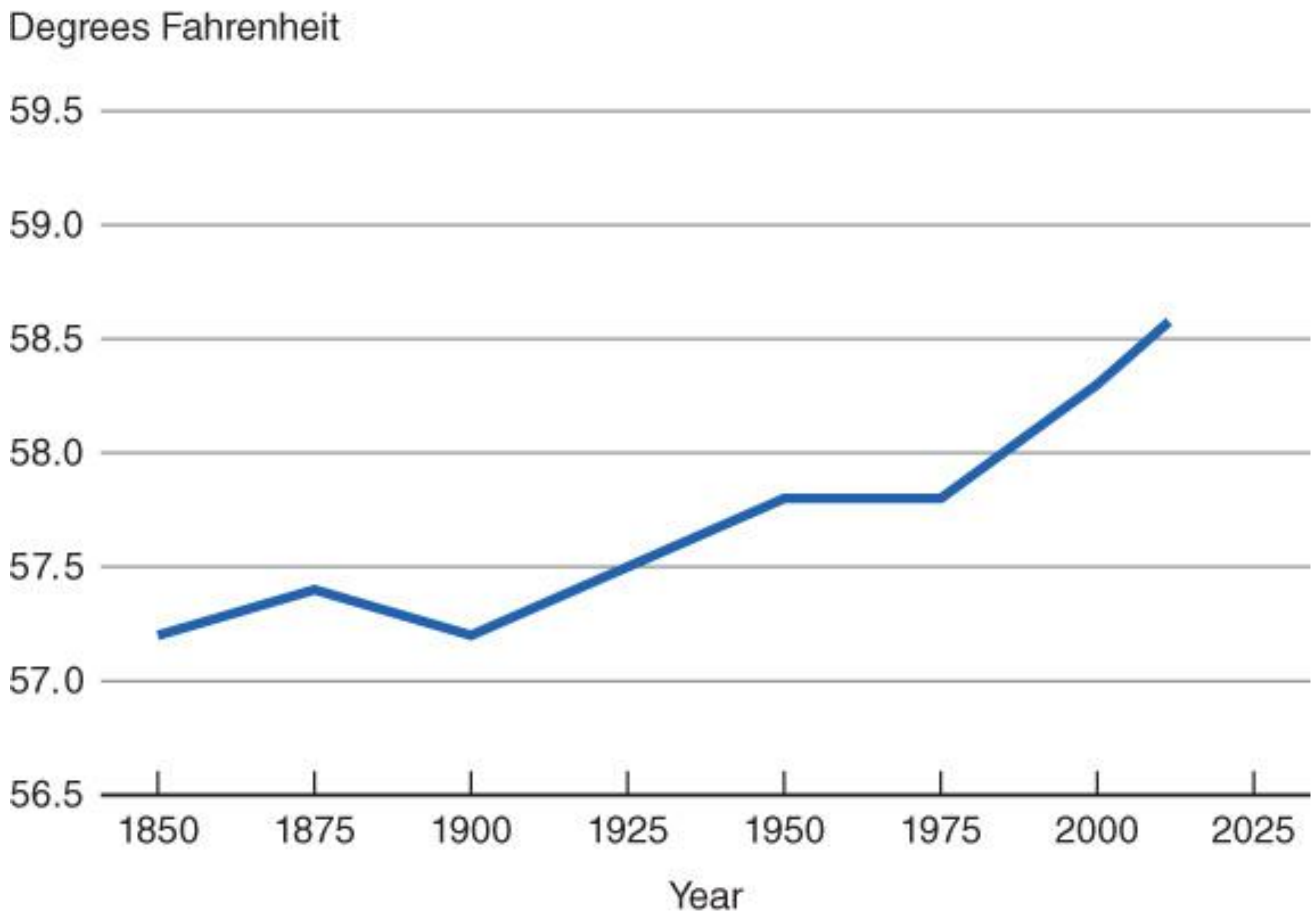
- Efficiency through government intervention
  - Promoting competition
  - Making business pay for indirect costs
  - Deregulation and underregulation
- Equity through government intervention
- The politics of regulatory policy

TABLE 15-1 | The Main Objectives of Regulatory Policy

Objective	Definition	Representative actions by government
Efficiency	Fulfillment of as many of society's needs as possible at the cost of as few of its resources as possible. The greater the output for a given input, the more efficient the process.	Preventing restraint of trade; requiring producers to pay the costs of damage to the environment; reducing restrictions on business that cannot be justified on a cost-benefit basis.
Equity	When the outcome of an economic transaction is fair to each party.	Requiring firms to bargain in good faith with labor; protecting consumers in their purchases; protecting workers' safety and health.

Government as Protector of the Environment

- Conservationism: the older wave
- Environmentalism: the newer wave
  - Environmental protection
  - Global warming and energy policy


Degrees Fahrenheit
59.5
59.0
58.5
58.0
57.5
57.0
56.5
1850
1875
1900
1925
1950
1975
2000
2025
Year

Government as Promoter of Economic Interests

- Promoting business
  - Government promotion of business
    - Government-provided loans
    - Special tax breaks
    - Traditional services: education, transportation, and defense
  - Tax burden has shifted from business to individuals

Government as Promoter of Economic Interests

- Promoting labor
  - National Labor Relations Act of 1935
  - Minimum wage
  - Maximum work week
  - Unemployment benefits
  - Nondiscriminatory hiring practices

Government as Promoter of Economic Interests

- Promoting agriculture
  - Homestead Act of 1862
  - Farm programs to eliminate some farming risk
  - Federal payments account for more than a fourth of net agricultural income
  - American farmers among the most heavily subsidized in the world

Fiscal Policy as an Economic Tool

- Demand-side policy
  - Emphasizes the consumer (demand) component of the supply–demand equation.
  - Government spending to alleviate economic depression or recession
  - Generally preferred by Democratic lawmakers
  - Can result in budget deficit/increased national debt

Fiscal Policy as an Economic Tool

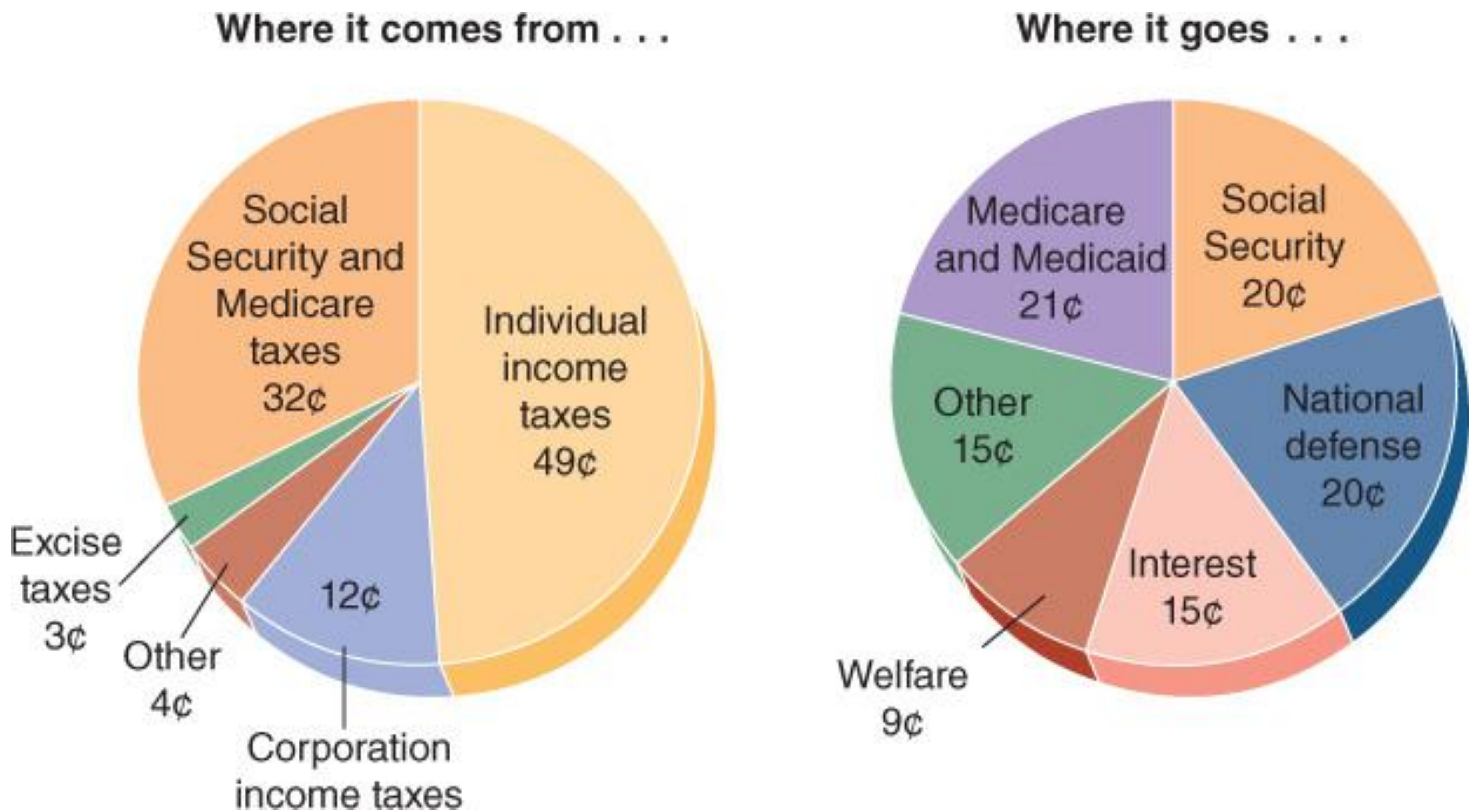
- Supply-side policy
  - Emphasizes the business (supply) component of the supply–demand equation
  - Tax breaks for firms and upper-income individuals intended to encourage business investment with resulting increases in employment and income
  - Generally preferred by Republican lawmakers
  - Can result in budget deficit/increased national debt

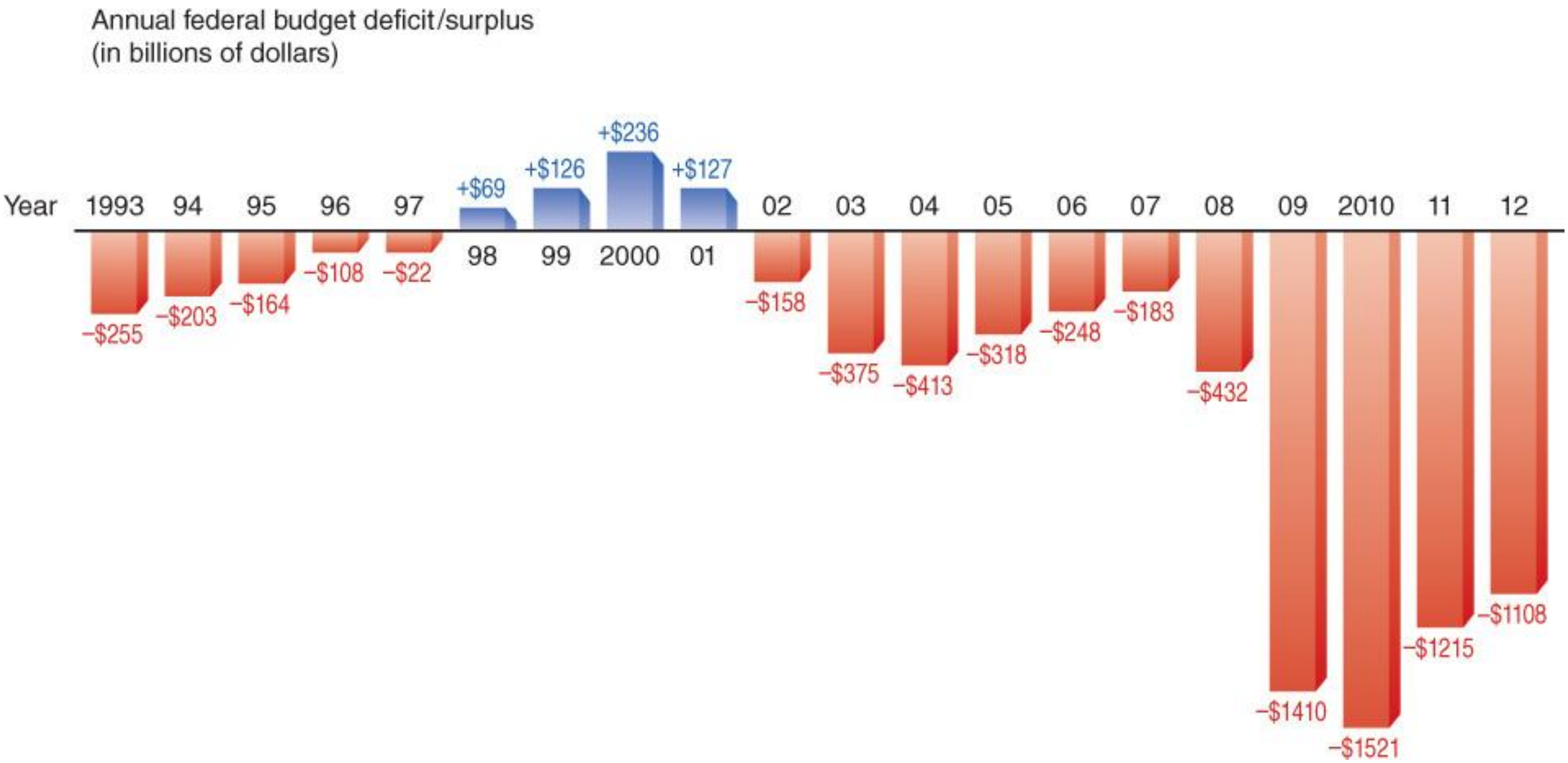
Fiscal Policy as an Economic Tool

- Fiscal policy: practical and political limits
  - Demand-side or supply-side work most effectively with smaller government and balanced budgets
  - Republican and Democratic lawmakers are miles apart on how best to deal with recessionary periods

TABLE 15-2 | Fiscal Policy: A Summary of the Government's Role

Problem	Fiscal policy actions
Low productivity and high unemployment	Demand side: increase spending
	Supply side: cut business taxes
Excess production and high inflation	Decrease spending
	Increase taxes


Where it comes from . . .
Social Security and Medicare taxes 32¢
Individual income taxes 49¢
12¢
Excise taxes 3¢
Other 4¢
Corporation income taxes
Where it goes . . .
Medicare and Medicaid 21¢
Social Security 20¢
Other 15¢
National defense 20¢
Interest 15¢
Welfare 9¢



Annual federal budget deficit/surplus
(in billions of dollars)
Year
1993
94
95
96
97
98
99
2000
01
02
03
04
05
06
07
08
09
2010
11
12
−$255
−$203
−$164
−$108
−$22
+$69
+$126
+$236
+$127
−$158
−$375
−$413
−$318
−$248
−$183
−$432
−$1410
−$1521
−$1215
−$1108

Monetary Policy as an Economic Tool

- The Fed
  - Control over money supply
    - Raise/lower the cash reserve required of member banks
    - Raise/lower interest rate on member banks
  - Fighting an economic downturn
    - Decreasing interest rate on loans to member banks
    - Lowering reserve rate
    - Buying government securities (bonds, notes, etc.)

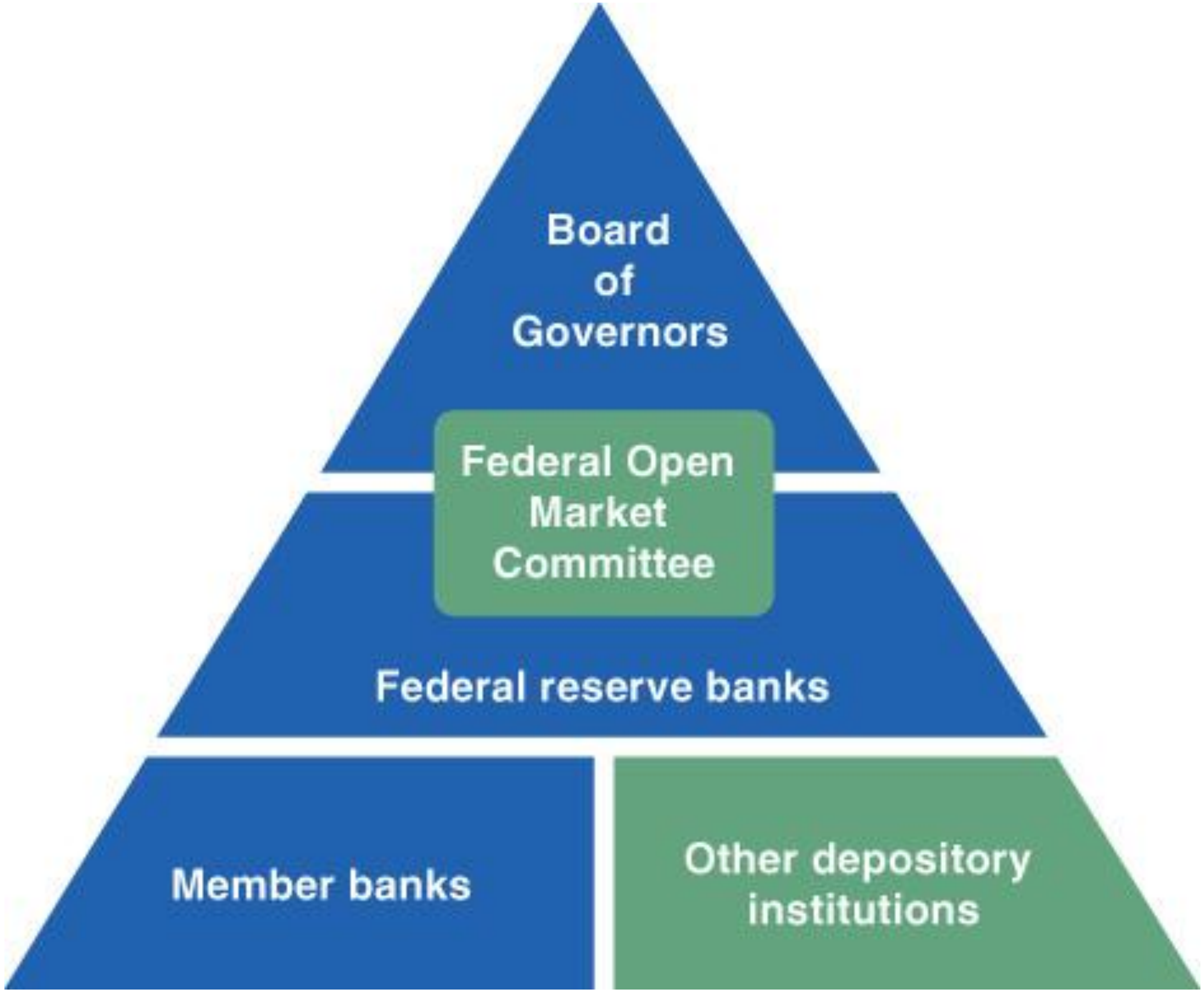
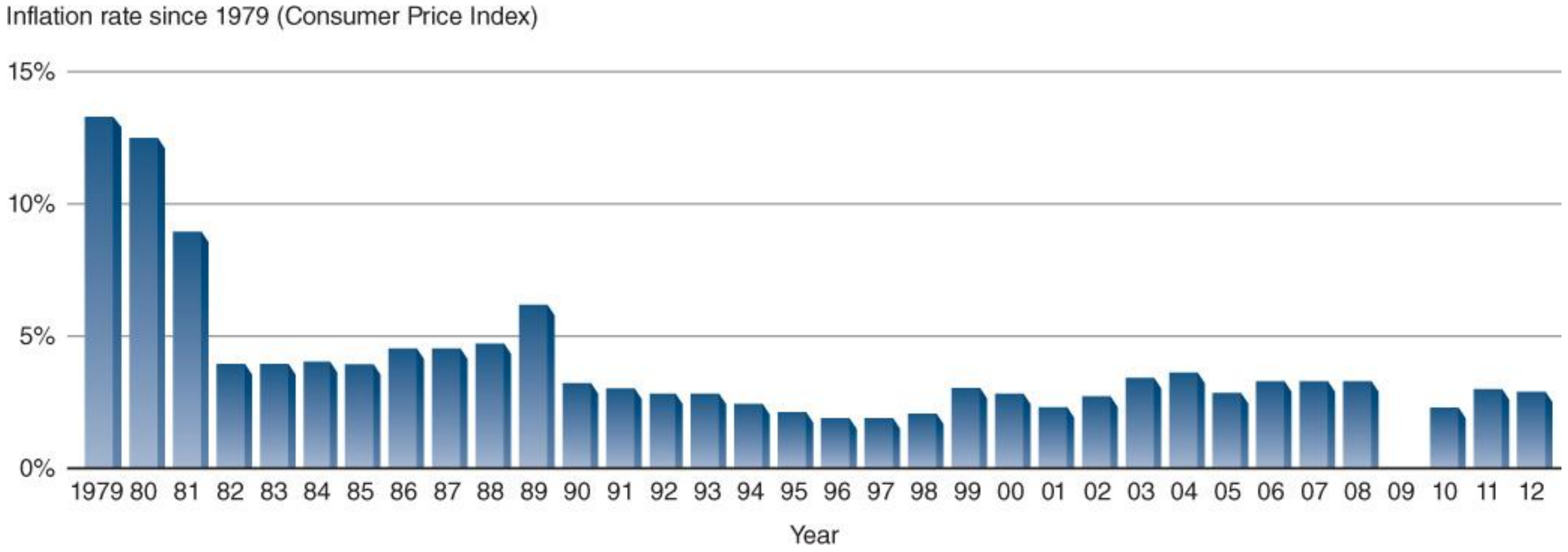

Board
of
Governors
Federal Open
Market
Committee
Federal reserve banks
Member banks
Other depository
institutions

TABLE 15-3 | Monetary Policy: A Summary of the Fed's Policy Tools

Problem	Fed Actions
Low productivity and high unemployment (requires increase in money supply)	Decrease interest rate on loans to member banks
	Lower percentage (reserve rate) of funds banks must hold in reserve
	Buy securities
Excess productivity and high inflation (requires decrease in money supply)	Increase interest rate on loans to member banks
	Raise percentage (reserve rate) of funds banks must hold in reserve
	Sell securities

Monetary Policy as an Economic Tool

- The Fed and control of inflation
  - Opposite of fighting an economic downturn
  - Increasing interest rate on loans to member banks
  - Raising reserve rate
  - Selling government securities (bonds, notes, etc.)
- The politics of the Fed


Inflation rate since 1979 (Consumer Price Index)
15%
10%
5%
0%
1979 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12
Year