Chapter 17
Economic Policy Making
Government, Politics, and the Economy

- **Introduction**
  - **Capitalism:**
    - An economic system in which individuals and corporations, not the government, own the principal means of productions and seek profits
  - **Mixed Economy:**
    - An economic system in which the government is deeply involved in economic decisions through its role as regulator, consumer, subsidizer, taxer, employer and borrower
  - **Multinational Corporations:**
    - Businesses with vast holdings in many countries
Government, Politics, and the Economy

- Economic Policy at Work: An Illustration
  - Government Regulation and Business Practices
    - Securities and Exchange Commission regulates stock fraud
    - Minimum wage: the legal minimum hourly wage for large employers
    - Labor union: an organization of workers intended to engage in collective bargaining
    - Collective bargaining: negotiations between labor unions and management to determine pay and working conditions
Government, Politics, and the Economy

- Wal-Mart and the World Economy
  - Wal-Mart (the largest company in the world) epitomizes America’s imbedding in the world economy.
  - The proportion of U.S. GDP accounted for by international trade is 30%.
  - Wal-Mart takes full advantage of “comparative advantage.”
  - Offshore outsourcing is a key concern of the new global economy.
Government, Politics, and the Economy

“It’s the Economy, Stupid”: Voters, Politicians, and Economic Policy

- Economic trends affect who voters vote for.
- Economic conditions are the best predictor of voters’ evaluation of the president.
- Republicans worry about inflation.
- Democrats stress importance of unemployment.
Government, Politics, and the Economy

- Two Major Worries: Unemployment and Inflation
  - Unemployment Rate: measured by the Bureau of Labor Statistics (BLS), the proportion of the labor force actively seeking work, but unable to find jobs
  - Inflation: the rise in prices for consumer goods
  - Consumer Price Index: the key measure of inflation that relates the rise in prices over time
Government, Politics, and the Economy

Figure 17.1  Unemployment: Joblessness in America, 1960–2005

Figure 17.2  Inflation: Increases in the Cost of Living, 1960–2005

Policies for Controlling the Economy

- Monetary Policy and “the Fed”
  - Monetary Policy: the manipulation of the supply of money in private hands—too much cash and credit produces inflation.
  - Money supply affects the rate of interest paid.
  - Main policymaker is the Board of Governors of the Federal Reserve System—the “Fed”
    - Created in 1913 to regulate lending practices of banks and thus they money supply.
Policies for Controlling the Economy

- Monetary Policy and “the Fed” (continued)
  - The Feds instruments to influence the supply of money in circulation:
    - Sets the federal funds rate
    - Buys and sells government bonds
  - Through the use of these actions, the Fed can affect the economy.
  - Laissez-faire: principle that government should not meddle in the economy
Policies for Controlling the Economy

- Fiscal Policy of Presidents and Parties
  - Fiscal Policy: the policy that describes the impact of the federal budget on the economy
  - Keynesian Economic Theory: government spending and deficits help the economy weather its normal ups and downs
  - Government’s job is to increase demand of goods
Instruments for Controlling the Economy

Fiscal Policy of Presidents and Parties, (continued)

- Supply-Side Economics: the policy that says there is too much taxation and not enough money to purchase goods and services
- Reduce taxation and government regulation then people will work harder, and thus create a greater supply of goods
Some think politicians manipulate the economy to win reelection.

But there are problems with that:
- Things like the budget are prepared in advance of when they go into effect
- Government makes economic policy slowly
- Some benefits are indexed
- Capitalism can also affect the economy
- Federal government spends less than 20 percent of GDP
Politics, Politics, and the International Economy

- Protectionism: the economic policy of shielding an economy from imports
- World Trade Organization (WTO): the international organization that regulates international trade
- Free trade is controversial as jobs have increasingly been outsourced.
  - But short-term pain equals long-term gain
Arenas of Economic Policymaking

Business and Public Policy
  - Corporate Corruption and Concentration
    - Increased incidence of bankruptcy and scandals
    - Increased number of corporate mergers
    - Antitrust policy: a policy designed to ensure competition and prevent monopoly, which is the control of a market by one company
Business and Public Policy (continued)

- **Regulating and Benefiting Business**
  - New wave of regulation
    - Congress passed law in 2002 that toughened penalties for stock fraud
    - Creation of Accounting Oversight Board to regulate accounting industry
  - Businesses benefit from regulation, too
    - Copyrights, inventions, and patents
    - Government may loan businesses money.
    - Government collects data that businesses use.
Arenas of Economic Policymaking

- Consumer Policy: The Rise of the Consumer Lobby
  - Consumers historically have had little government protection.
  - Food and Drug Administration (FDA): created in 1913; approves foods and drugs sold in the U.S
  - Federal Trade Commission (FTC): responsible for regulating false and misleading trade practices, which now includes consumer lending practices
Arenas of Economic Policymaking

Labor and Government
- Government historically sided with business over labor unions.
- National Labor Relations Board (NLRB): regulates labor-management relations; created in 1935 by the Wagner Act
- The Taft-Hartley Act (1947) continued to guarantee unions the right of collective bargaining, but prohibited various unfair practices by unions.
- Government now provides unemployment compensation and a minimum wage.
Understanding Economic Policymaking

- Democracy and Economic Policymaking
  - Voters expect more of politicians that they can control
  - Sometimes economic theory and democratic theory may be at cross purposes.
  - It is difficult to make decisions that hurt groups or involve short-term pain for long-term gain.

- Economic Policymaking and the Scope of Government
  - Liberals tend to favor more while conservatives favor less government involvement in the economy.
Summary

- Political and economic sectors are closely intermingled.
- Voters expect a lot from politicians, more than they can deliver on the economy.
- Two major instruments available to government for managing the economy—monetary and fiscal policies.