

# Managing the Economy

## I. Two Types of Economic Policies

A. Fiscal: taxing and spending considerations (budget matters). Fiscal policy is conducted by Congress and the President.

B. Monetary: regulation of the money supply by the [Federal Reserve Board](#) (“the Fed”). Adjusting interest rates to increase or decrease inflation.

## II. History of economic policy.

A. The Constitution gave Congress power to regulate interstate and foreign commerce.

B. The Industrial Revolution’s excesses led to Congress making greater use of economic regulatory powers.

C. The Great Depression of 1930s led to even greater regulation of the economy by Congress. An unemployment rate of 25%, bank failures, farm crisis, and deflation demanded aggressive actions.

## D.Keynesian economics.

1.During the Depression, the New Deal was influenced by British economist John Maynard Keynes.

2.Keynes suggested that government could manipulate the economic health of the economy through its level of spending. In hard times, government should increase spending (even if it means running large deficits) to stimulate economic health. In inflationary “boom” times, government should decrease spending to “cool down” the economy.

3.Keynes influenced passage of Employment Act of 1946, which made government responsible for maintaining high employment rates.

4.The difficulty posed by Keynesian economics is once government spending rises, it is politically difficult to cut it. This helps to explain why we have such high budget deficits.

5. After taking office in 2009, President Obama proposed an [Economic Stimulus](#) plan to address the recession. It was passed by Congress in February.

## E. Supply-side economics.

1. Definition: cuts in taxes will produce business investment that will compensate for the loss of money due to lower tax rates. Tax rates will be lower, but business will boom, unemployment will go down, incomes will go up, and more money will go into the treasury.

2. Most associated with the Reagan Administration (1981-1989).

3. The Reagan tax cuts were not accompanied by spending cuts, and the national debt tripled from \$1 trillion to \$3 trillion. Since the start of 2001, the national debt has increased from 5.7 trillion to over [10 trillion today.](#)

## F. Monetarism.

1. Whereas Keynesians suggest that the level of government spending is most important for determining the economic health of the nation, monetarists believe that the money supply (monetary policy) is the most important factor.

2. Thus “the Fed” can tighten up the money supply through adjusting interest rates to reduce inflation, or it can loosen up money supply to stimulate the economy.

## III. Modern Developments

### A. The Push for a Balanced Budget

High yearly deficits and a growing national debt have led some to believe that Congress needs to be “tied down” to a constitutional amendment that would require that spending not exceed income.

There is a concern that the economy will suffer if the percentage of the national debt as compared to the Gross Domestic Product keeps increasing.

2. Supporters say that this is the only way to end the “spending bias” of Congress, and that it is the only way to overcome the political difficulties of cutting spending.

3. Opponents say that such an amendment would be “tinkering” with the Constitution that it would decrease needed flexibility in times of crisis, and that Congress would figure out a way of evading the amendment anyway.

4. This amendment was proposed in Congress, but was voted down by the House in 1992.

5. The line-item veto could have precluded the need for such an amendment. The President could have deleted wasteful spending with “the stroke of a pen.”

B. Pay-as-you-go was passed in the early 1990's coupled with an expanding economy led to a balanced budget in the late 1990's.

C. Expiration of pay-as-you-go and the war on terrorism and the wars in Afghanistan and Iraq in the early 2000's led to the resumption of huge budget deficits.

D. Trade policy

1. Increasing trade deficits (where imports exceed exports) have been caused by the expanding economy in China and rising oil prices.

2. Trade deficits have led to calls for protectionism.

3. However, there has been more of a push for free trade rather than for tariffs.

a. Global Agreement on Trade and Tariffs

b. North American Free Trade Agreement

c. World Trade Organization

d. Most-favored-nation status (MFN) for China