Economic Policymaking

Chapter 17

Economic Systems

Market Economy: An economic system in which individuals and corporations, not the government, own the principle means of production, and wages and prices are set by supply and demand.

Command Economy: An economic system where the government makes all decisions about wages, prices and production.

Mixed Economy: An economic system in which the government is involved in economic decisions through its role as regulator, consumer, subsidizer, taxer, employer and borrower.


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Measuring the Economy

- Unemployment and Inflation
  - Unemployment rate: Measured by the BLS, it is the proportion of the labor force actively seeking work but unable to find jobs.
  - Inflation: The rise in prices for consumer goods (and decline in the value of a dollar).
  - Consumer Price Index: The key measure of inflation determine by the price of a fixed basket of goods over time.

Government and the Economy

- Elections and the Economy
  - A poor economy causes presidential approval ratings to decline.
  - Unemployment rates affect presidential elections.
  - Retrospective voters choose based on "what have you done for me lately"?
- Political Parties and the Economy
  - Republicans tolerate unemployment
  - Democrats tolerate inflation

Instruments for Controlling the Economy

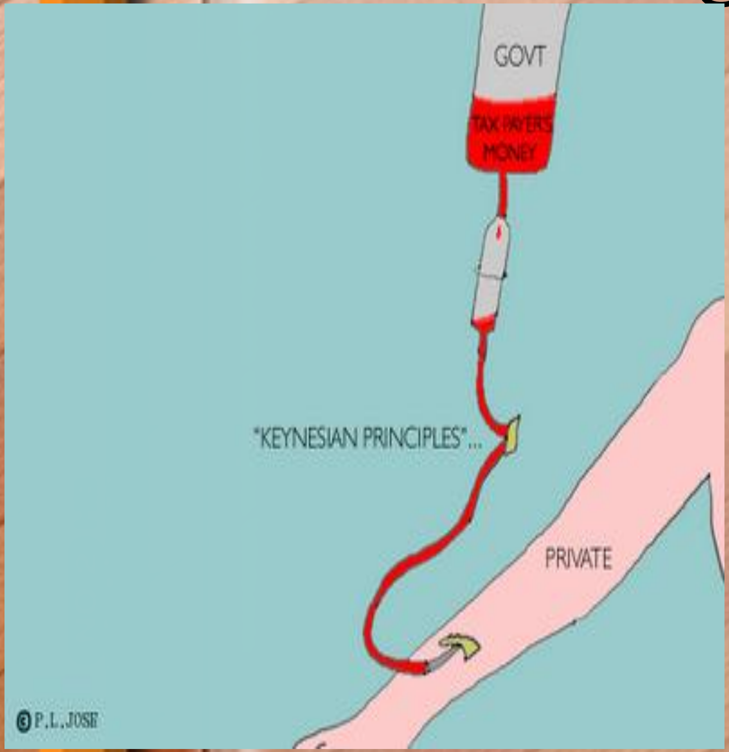
- Monetary Policy
  - The manipulation of the supply of money in private hands. Too much cash and credit result in inflation.
  - The money supply affects interest rates (increasing the money supply results in lower interest rates).
  - The main policymaker is the Board of Governors of the Federal Reserve System- the “Fed.”

Instruments for Controlling the Economy

The Federal Reserve Board

- Sets discount rates (the interest rate to borrow money from the government)
- Sets reserve requirements (how much money banks must have on hand)
- Buying / selling government bonds

Instruments for Controlling the Economy



Keynesian Theory Versus Supply-Side Economics

- **Fiscal Policy**: the impact of the federal budget on the economy.
- **Keynesian Economic Theory**: Government spending and willingness to run a deficit help the economy weather its normal ups and downs.
- Keynesianism supports government efforts to increase the number of jobs and the demand for goods

Instruments for Controlling the Economy

- Fiscal policy: Keynesian Versus Supply-Side Economics
  - **Supply-Side policy**: The theory that high taxes and too much government regulation stifle economic growth.
  - Reduce taxation and government regulation so that people will work harder and businesses can reinvest profits, stimulating economic growth.

Obstacles to Controlling the Economy

- While the government has tools to influence the economy, the government cannot control the economy.
  - The budget is prepared in advance and policies may not impact the economy for several years.
  - Some benefits are indexed for inflation, which makes it hard to control their growth..
  - Foreign problems can affect our economy.
  - The economy is impacted by decisions of private companies and investors.

Arenas of Economic Policymaking

- MNCs, Globalization and the Economy
    - Mergers and acquisitions have created MNCs.
    - Corporations battle for profits in the new technology economy.
    - Government must find ways to control the excess power while maintaining American competitiveness in the global economy.

Arenas of Economic Policymaking

- Regulating Business.
  - Antitrust policy: policies designed to ensure competition and prevent monopolies.
  - Antitrust cases are lengthy and expensive
- Benefiting Business.
  - Government may loan businesses money (auto and bank bailouts)
  - Government collects data that businesses use.

Arenas of Economic Policymaking

- Policies Protecting Consumers
  - **Food and Drug Administration**: Created in 1913 and approves and regulates food and drugs sold in the U.S.
  - **Federal Trade Commission**: Regulates 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: regulates labor-management relations
  - Collective bargaining: union representatives and management determine pay and working conditions
  - **Taft-Hartley Act**: anti-union legislation that allows states to pass “right to work” laws. Employees cannot be required to join a union even in unionized companies.