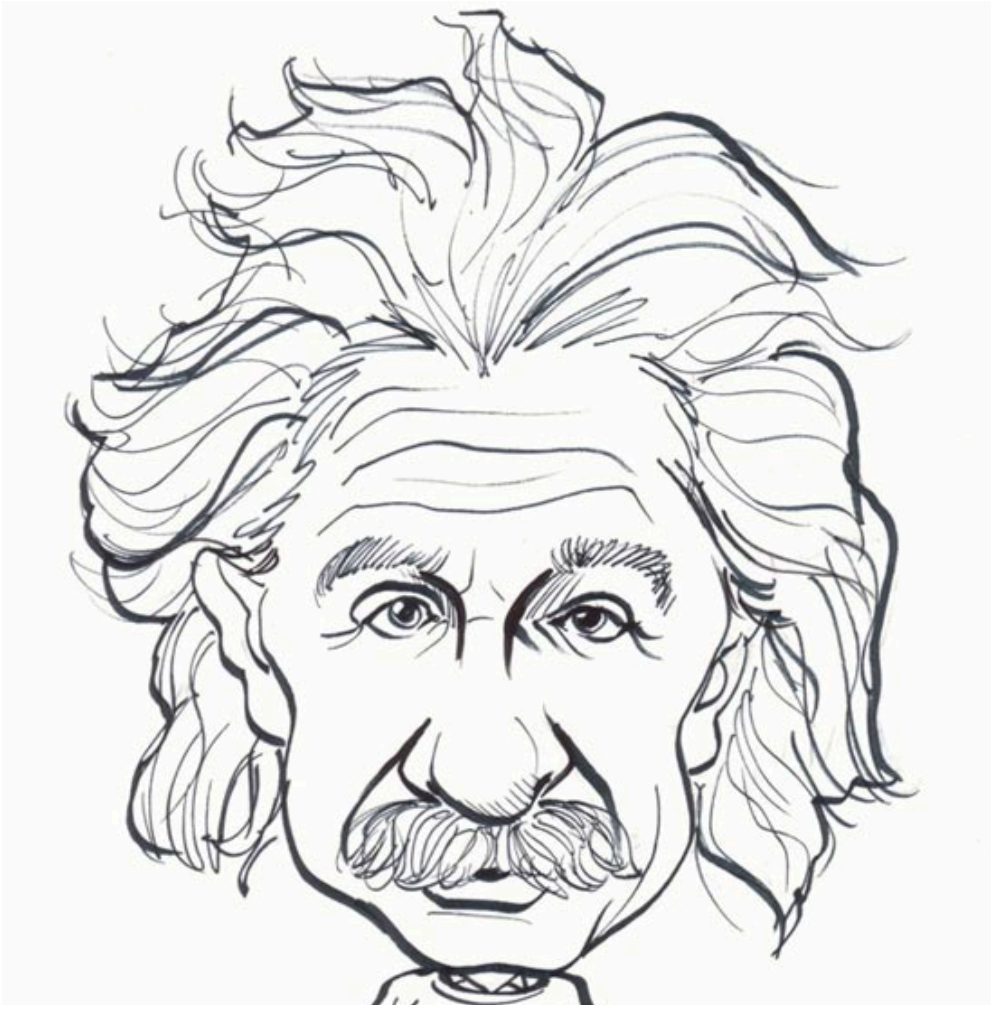
AP
U.S. Government & Politics
Quick Notes



UNIT 7
PUBLIC POLICY

the jerry perez experiment

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AN INTRODUCTION TO ECONOMIC POLICY

How much responsibility should the government have for keeping the United States economy healthy? That question has been answered in many different ways throughout our history. Until the twentieth century the country followed the laissez-faire (literally, "to leave alone") policy, which required a free market without any intervention from government. With President Franklin Roosevelt's New Deal era of the 1930s came Keynesian economics, or the opposite belief that the government should manage the economy. Today the U.S. economic policy lies somewhere in between - government should regulate and sometimes manage, but should allow a free market whenever possible. Political and business leaders disagree on how much control is enough.

POWER TO MANAGE THE ECONOMY

- **Congress**
  - Power to tax
  - Power to pay the debts of America
  - Power to "provide for the common defense and general welfare"
  - Power to borrow money and appropriate money
  - Congress is not bound by a balanced-budget requirement >> U.S. government regularly runs large deficits
  - Congress must approve of the president's budget
- **President**
  - No formal powers over taxation and spending
  - Influence over the federal budget has expanded dramatically over time
  - Most important role is submission of the budget >> Outlines the president's priorities and spending recommendations

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TWO TYPES OF ECONOMIC POLICIES

The government uses both fiscal and monetary policy to manage the economy

- **Fiscal Policy**
  - Refers to the taxing, spending, and borrowing activities of the national government
  - Conducted by the President and Congress
    - President proposes the budget and Congress passes it
- **Monetary Policy**
  - Refers to the regulation of the money supply, controlling inflation, and adjusting interest rates
  - Controlled by the "Fed" or Federal Reserve Board

THE BUDGET PROCESS

- **Executive Branch**
  - Agencies prepare their estimates of budget needs and present them to the Office of Management and Budget (OMB = charged with overseeing the budget process on behalf of the president).
  - Amount requested is typically based upon the amount granted in the previous year.
  - OMB reviews these requests and makes recommendations to the President.
  - President reviews OMB recommendations and then submits a budget to Congress.
- **Presidential action**
  - President signs or vetoes entire taxing and spending bills – no line item veto
  - Congress can override a veto with 2/3 vote in both houses
- **Congress** (Constitution grants Congress the power of the purse)
  - Congressional Budget Office (CBO) provides an independent analysis of the President's budget -- a check on OMB
  - Roles of Budget, Ways and Means, Finance, and Appropriations Committees
  - Input and lobbying from agencies
  - Majority vote needed in both houses
  - Government Accountability Office (GAO) is a congressional watchdog agency that ensures money is spent as prescribed by law
- **Political influences**
  - Political party differences
  - Interest group/PAC influence
  - Iron triangles
  - Public opinion

ECONOMIC PERFORMANCE FACTORS

- The following can be used to assess the health of the American economy:
  - Inflation
    - Refers to a general increase in the price of goods and services in an economy over time
    - In the U.S., the rate of inflation generally remains from 2 to 3 percent per year
    - High rates of inflation can undermine economic stability and growth
  - Unemployment
    - Occurs when people seeking work are unable to find it
    - In the U.S., the rate of unemployment has generally hovered from 4 to 7 percent
    - Rates above 8 percent may indicate underlying economic problems

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FISCAL POLICY

FISCAL POLICY - DEFINITION

- Fiscal policy affects the economy by making changes in government's methods of raising money and spending it
- Policy that describes the impact of the federal budget (including taxes, spending, and borrowing) on the economy

TOOLS AND IMPACT OF FISCAL POLICY

- Governments try to stimulate the economy to prevent a recession/depression
  - Government can lower taxes >> stimulates the economy by encouraging consumer spending or by encouraging investment
  - Government can increase its own spending, which offsets declines in consumer demand >> Keynesian economic policy
- Economy is growing too quickly and economists fear inflation may increase >> government can attempt to cool the economy down by increasing taxes or by reducing its own spending

WHERE THE MONEY COMES FROM (SOURCES OF FEDERAL REVENUE)

- Individual income taxes (progressive tax)
  - The individual income tax is the federal government's largest source of revenue
- Payroll taxes (regressive tax)
  - Pay for social insurance (Social Security and Medicare)
  - Fastest-rising source of federal revenue
- Corporate income taxes
  - The corporate income tax is set at 35 percent of net corporate income profits; however, corporations find many ways of reducing their taxable income, often to zero.
- Social security taxes
  - The second largest source of federal revenue is the Social Security tax.
- Excise taxes
  - Taxes on the consumption of liquor, tobacco, gasoline, telephones, air travel, and other so-called luxury items
- Other
  - Estate and gift taxes
  - Tariffs - taxes on imports
- Borrowing
  - Budget deficit - borrow money
  - Selling Treasury notes and savings bonds
    - Adds to national debt

WHERE THE MONEY GOES (SOURCES OF FEDERAL EXPENDITURES)

- Nearly half of federal spending in 2012 went to required benefit payments for individuals (Social Security, Medicare, Medicaid, etc.)
- 2/3 of all spending was mandatory/nondiscretionary/uncontrollable
- National Defense: 21%. Discretionary/controllable.
- Interest Payments: 9%. Nondiscretionary/mandatory.
- Nondefense discretionary (grants to states and local governments): 16%.

ENTITLEMENTS

- "Uncontrollables": federal money that is
  - provided to those who meet eligibility requirements and
  - is automatically spent each year without congressional review.
- Some have a built in COLA, also without annual review. This in turn creates additional budget pressures.
- Examples: Social Security, Medicare, federal pensions
- These account for about 2/3 of the federal budget, which causes difficulties of balancing the budget.
- Attempts to change/reduce/alter extremely difficult >> many voters who support these programs (especially old people)

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MONETARY POLICY

MONETARY POLICY – DEFINITION

- Monetary policy is the government's control of the money supply
- The government can control how much or how little is in circulation

THE FED (THE FEDERAL RESERVE BOARD)

The powerful arm of government that controls the money supply is the Federal Reserve System, which is headed by the Federal Reserve Board. The board is designed to operate with a great deal of independence from government control. One important way that the "Fed" controls the money supply is by adjusting interest rates - high rates discourage borrowing money, and low ones encourage it.

The Federal Reserve Board's seven members are appointed by the president and are approved by the Senate for 14-year, nonrenewable terms, and the president may not remove them from office before their terms are up. The chair is elected by the board for four years, and may be reelected. The Board heads the Federal Reserve System, which was created by Congress in 1913 to regulate the lending practices of banks. It consists of 12 regional banks, which in turn supervise a total of about 5,000 banks across the United States.

- Established by Congress in 1913 to help govern the nation's monetary policy through an independent and apolitical process
- Overseen by a seven-member Board of Governors
  - Members of the board are appointed by the president and confirmed by the Senate to 14-year terms and cannot be removed
  - The length of their terms intended to insulate the Fed from political pressures from both the president and the Congress.
- The Fed's primary role is to regulate the nation's money supply. Priority is placed on limiting the rate of inflation and preventing recessions.
- The Federal Open Market Committee makes the policies. A few ways the FOMC controls monetary policy:
  - Open-market operations
    - Refers to the efforts by the central bank to buy or sell government bonds
    - This is the most common form of monetary policy and is generally used to try to control short-term interest rates
    - By selling bonds, the Fed effectively removes money from circulation, slowing the economy
    - By purchasing bonds, the Fed effectively expands the money supply, encouraging economic activity
  - Reserve ratios
    - The Federal Reserve establishes the minimum cash reserves any bank must hold.
    - By increasing the ratio, the Fed can effectively reduce the amount of money in circulation, slowing the economy down.
    - By contrast, reducing the requirement increases the amount of money in circulation, generally leading to an expansion of economic activity.
  - Federal funds rates
    - Interest rate at which banks trade balances held at the Federal Reserve
    - This rate is an important benchmark, as many other interest rates, including credit card rates and home mortgage rates, are often based on the federal funds rate
    - Increasing the federal funds rate thus makes borrowing more expensive, slowing economic activity
    - Lowering the federal funds rate makes borrowing cheaper, increasing economic activity
  - Discount rate
    - Cost banks pay to borrow money from the Federal Reserve Bank
    - By reducing the discount rate, the Fed makes it more attractive for banks to borrow money, effectively increasing the amount of money in circulation and encouraging economic activity
    - By contrast, increasing the discount rate generally slows the economy down

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MANAGING THE ECONOMY

DEFICIT-SPENDING

- Budget deficit: incurred when govt. expenditures exceed income during a one year period
- National (public) debt: amount owed by fed. govt. -- accumulation of past budget deficits
- Reagan
  - Huge budget deficits during the 1980's (>$200 billion per year) ---> national debt tripled from $1 trillion to $3 trillion during the 1980's. Tax cuts and increases in defense spending were among the main causes.
- Bush 41
  - In 1990, Congress and Bush 41 agreed on a pay-as-you-go ("paygo") proposal that would allow Congress to increase spending ONLY if that increase was offset by higher taxes and/or spending cuts elsewhere. The "paygo" agreement, however, expired in 2002. Its expiration helps to explain the rising deficits since then.
- Clinton
  - Government shutdown in mid-90s as a result of budgetary politics
  - Reduction of deficits under Clinton and development of SURPLUSES ---> political differences over what to do with these surpluses: Republicans favored tax cuts, Democrats wanted to apply the surpluses to the Social Security System to bolster it.
- Bush 43
  - Tax cut in 2001 ($1.36 trillion) + recession + terrorist attacks of 9/11 + wars in Afghanistan and Iraq + end of "paygo" ended budget surpluses ---> resumption of record-high budget deficits
  - Economic crisis of 2008-09 once again led to soaring budget deficits and therefore a soaring national debt.
- Obama
  - Current national debt (2014): >$18 trillion.
  - Failure of Congress to pass the Balanced Budget Amendment.

DEVELOPMENTS IN ECONOMIC POLICY

- Great Depression of 1930's let to even greater regulation of economy by Congress: Unemployment rate of 25%, bank failures, and deflation demanded aggressive actions.
- Keynesian Economics
  - During Depression, New Deal was influenced by of British economist John Maynard Keynes.
  - Keynes suggested that government could manipulate the economic health of the economy through its level of spending.
    - In hard times, govt. should increase spending (even if it means running large deficits) to stimulate economic health.
    - In inflationary "boom" times, govt. should decrease spending to "cool down" the economy.
  - Difficulty posed by Keynesian Economics: Once govt. spending rises, it is politically difficult to cut it (consider the fights in recent years over entitlement reform). This helps to explain why we have such high budget deficits.
- Supply-Side Economics
  - Definition: Cuts in taxes will produce business investment that will compensate for the loss of money due to the lower tax rates. Tax rates will be lower, but business will boom, unemployment will go down, incomes will go up, and more money will come into the Treasury.
  - Most associated with the Reagan Administration (1981-1989).
  - Unfortunately, the Reagan tax cuts were not accompanied by spending cuts, so the national debt tripled from $1 trillion to $3 trillion.
  - Tax cuts under Bush 43 have prompted concern that they have contributed to a rising national debt.
- The push for a Balanced Budget Amendment
  - High deficits have led some to believe that Congress needs to be "tied down" to a constitutional amendment that would require that spending not exceed income.
  - 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.
  - Opponents say that such an amendment would be "tinkering" with the Constitution: it would decrease needed flexibility in times of crisis, and Congress would figure out a way of evading the amendment anyway.
  - This amendment was proposed in the Senate, but was voted down by the House in 1992.
  - The line-item veto could have precluded the need for such an amendment. Wasteful spending could be deleted with a "stroke of the pen." Declared unconstitutional.

TRADE POLICY

- Increasing trade deficits (where imports exceed exports) caused by:
  - Expanding economy in China
  - Rising oil prices from our overseas suppliers
- Trade deficits have led to calls for protectionism
- Off-shoring >> loss of American jobs
- However, there has been more of a push for free trade rather than for tariffs (NAFTA)

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SOCIAL POLICY

GOVERNMENT SUBSIDIES

- Governmental financial support. Main types of subsidies:
  - Cash: Aid to Families with Dependent Children (AFDC), payments to farmers ("agricultural subsidies") to keep crop prices and farms incomes high.
  - Tax Incentives: Home mortgage interest payments are tax deductible, oil companies receive tax credits for exploration and production, tariffs that protect domestic industries.
  - Credit Subsidies: Veterans' Administration provides lower-than-normal interest rates for veteran home loans, student loans.
  - Benefit-In-Kind Subsidies: non-cash benefits (food stamps, Medicaid, Medicare).

THE POLITICS OF SUBSIDIES

- Most Americans complain about subsidies: however, most of them also receive them in one form or another.
- Once subsidies are established, they are extremely difficult to eliminate.
  - "Iron triangles" or issue networks develop and work quite hard to keep the subsidies.
  - Some subsidies even become "sacred cows."
  - Woe to the member of congress who votes against these!
  - Think about Social Security in this regard.
- Another reason subsidies are hard to eliminate is that they are often difficult to "see."
  - The dairy industry, for example, receives heavy subsidies for milk production, yet few people are aware of this.
  - Supermarkets don't exactly state how much of the price of milk comes from subsidies.
- The federal govt. today provides loans and cash payments to farmers ("crop support payments"), and in some cases pays farmers to not grow crops to prevent surpluses.
  - Criticisms of these subsidies: Though these are supposed to help farmers, much (30%) of these subsidies go to huge "agribusiness" firms, leading to charges of "corporate welfare."
  - Consumers end up paying higher prices for food, yet so much of the subsidies go not to the small farmers, but instead agribusiness.

SOCIAL WELFARE SUBSIDIES

- Major social welfare programs:
  - Programs that have ***no means test*** – one does not have to prove that he lacks the means in order to qualify for benefits – one does not have to have a low level of income to qualify for these benefits.
    - Social Security: for elderly, survivors, and disabled. Even upper income people qualify for benefits if they fall into one of the three categories.
    - Medicare: Federal medical coverage for the elderly.
    - Unemployment Insurance: Payments to the unemployed.
  - ***Means test*** programs
    - Aid to Families with Dependent Children (AFDC): Payments to poor families with children.
    - The program that most people are talking about when they discuss the "welfare system."
    - Supplemental Security Income (SSI): Cash payments to disabled people whose income is below a certain amount.
    - Food Stamps: Coupons given to the poor to buy food.
    - Medicaid: Federal medical coverage for the poor on AFDC and SSI.

RECENT DEVELOPMENTS IN SOCIAL WELFARE POLICY

- Entitlements (Social Security - which started in 1935) threaten to produce massive budget deficits in the future.
  - Some have called for reforms for Social Security
    - Increasing the age of recipients for 65 to 67 or 70
    - Adopting means testing for recipients
- GOP (Grand Old Party - Republicans) Contract with America (1990s) stressed the role of federalism
  - Returning power back to the states by ending the federal entitlement status of various welfare programs (AFDC), and replacing that with a system of block grants to the states.
  - This would enable states to become "laboratories" and free them up to experiment with what works best for their own particular situations. GOP argues that states know what is best for them.
- Welfare is a huge political issue for the two parties:
  - Republicans have linked the current "welfare mess" to various social pathologies: a higher illegitimacy rate, a higher rate of single-parent families, higher crime rate, drug problems, etc. They have stressed welfare reform and have claimed that the Democrats have blocked their efforts at reform.
  - Given this political climate, even Democrats have stressed the importance of welfare reform. President Clinton promised to "end welfare as we know it," and signed a huge welfare reform bill in 1996 that was passed by the Republican Congress.
  - Some of the bill's highlights:
    - Ends the federal entitlement status of various welfare programs. More state authority. Note the impact of federalism.
    - Limits welfare payments to no more than five years.
    - Welfare recipients must work within two years of applying for benefits.
    - Requires food stamp recipients to work.
    - Prohibits aliens (legal or illegal) from receiving various welfare benefits.
    - Requires teen mothers to live with parents and attend school to receive welfare benefits.

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FOREIGN POLICY

WHO MAKES FOREIGN POLICY?
Many people and organizations within government have a hand in setting United States foreign policy. The main objective of foreign policy is to use diplomacy - conferences, meetings, and agreements - to solve international problems. They try to keep problems from developing into conflicts that require military settlements.

KEY FOREIGN POLICY PLAYERS

- Foreign policy is shared responsibility of the President and Congress. Checks and Balances applies:
  - War – Congress declares, but President is commander-in-chief
  - Treaties – President makes them, but Senate ratifies
  - Appointments – President makes them, but Senate approves them
- Despite shared responsibilities; the President is primarily responsible for foreign policy and has extensive support within the executive branch:
  - Secretary of State: Responsible for foreign affairs
  - State Department: Responsible for day-to-day management of foreign policy
  - Other Cabinet officials: Since foreign policy affects domestic policy, other Cabinet officials (Commerce, Treasury, Defense, Agriculture) also have inputs
  - National Security Council (NSC)
    - Coordinates policies that affect national security
    - Members include Pres., V.P., State, Defense, CIA Director, National Security Adviser, and others.
    - National Security Adviser has emerged as a key player who sometimes has more influence than the Secretary of State
      - → Presidents tend to rely more upon the NSA because he is literally "closer" to the President (office in the White House) and his loyalties are not divided between the President and a Cabinet Department (as with the Secretary of State)
  - Department of Homeland Security: Responsible for coordination of domestic law enforcement and intelligence agencies to thwart terrorism
  - CIA (Central Intelligence Agency)
    - Functions: Gather and evaluate intelligence and information about other nations.
    - Created in 1947 to monitor the Soviet threat. Fall of communism since 80's has led the agency to branch out into other areas, e.g., international drug trafficking, terrorism, nuclear proliferation.
    - Agency's covert operations have led to some concern about govt. secrecy in a democracy. Can these two co-exist?
    - This concern has led to the creation of intelligence oversight committees in both the House and Senate.

MILITARY (DEFENSE) POLICY
Until 1947 the Cabinet-level official most directly responsible for military policy was called the Secretary of War. The name changed to "Secretary of Defense," and the department that this official heads has more federal employees than any other in the government. The Department of Defense is headquartered in the Pentagon, where about 25,000 military and civilian personnel work. The Secretary of Defense is always a civilian, and he supervises three large military departments - Army, Navy, and Air Force.

Under the Constitution, the President is commander-in-chief of the armed forces, and he has used that authority to order American military forces into combat on many occasions. During peacetime, his most important military powers are those he exercises through the Secretary of Defense in managing the Department of Defense. The President and Secretary of Defense make important decisions regarding the military budget and distribution of funds among the military services.

The most important military advisory body to the Secretary of Defense is the Joint Chiefs of Staff. Its five members are the chiefs of staff of the three military departments, the commandant of the Marines, and a chair. All of the service chiefs are appointed by the president and must be confirmed by the Senate. Only the Secretary of Defense, however, sits on the president's cabinet and on the National Security Council.