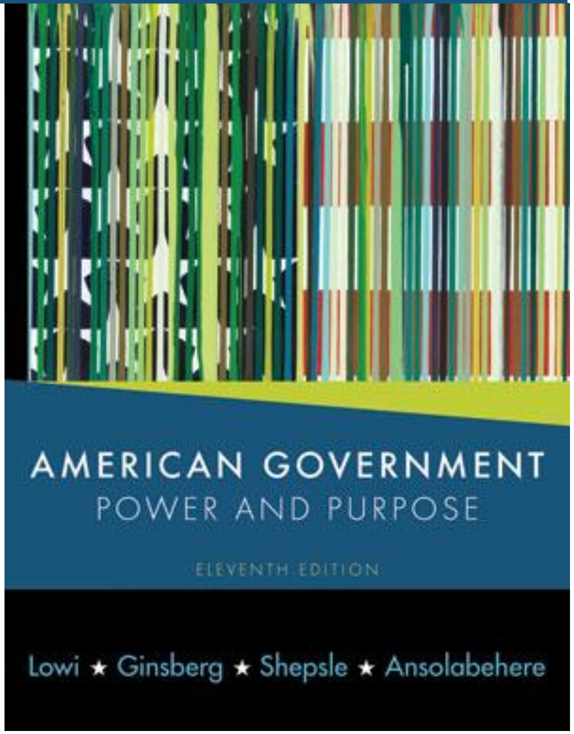
14 Economic Policy

AMERICAN GOVERNMENT

POWER AND PURPOSE

Lowi ◆ Ginsberg ◆ Shepsle ◆ Ansolabehere



Public Policy Defined

Public policies are authoritative government statements backed by rewards and punishments.

Examples of public policies include:

- Acts of Congress;
- Executive orders;
- Court rulings.

Bureaucracies, too, shape policy as they implement it.

It is through implementation that the punishments or rewards of a given policy are made concrete and tangible to citizens.

Policy → Speed Limit 40 mph

If the government makes the authoritative decision that there should be a 40-mile-an-hour speed limit, officials post signs alerting motorists to the policy.

Policies without enforcement are not policies at all.

The government will need to make the policy more tangible by enforcing the new speed limit with police officers, who will provide a ticket (a disincentive) to those who fail to obey the newly posted speed limit.

If motorists become aware that a new policy is “on the books” but know that the police do not enforce it, they are less likely to obey the policy.

Types of Public Policies

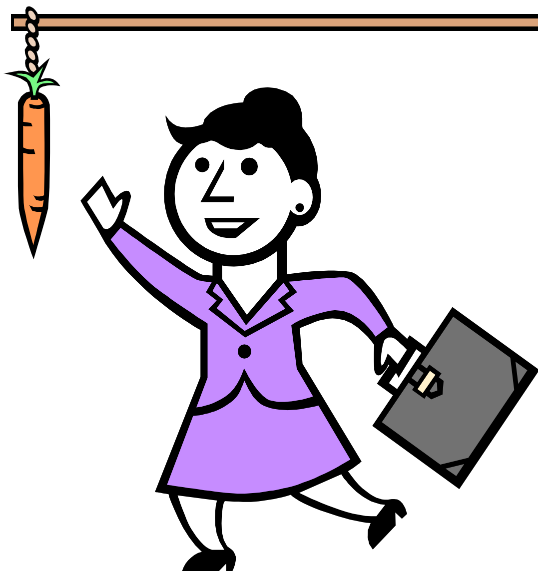
The Rationality Principle: All political behavior has a purpose.

The Institution Principle: *Institutions structure politics.*

Public policies can be understood as efforts to shape individual actors' goals and behavior by making rules that provide incentives for behaviors deemed positive and disincentives for behaviors deemed negative.

There are three types of public policies to consider:

- **Promotional policies** promote desirable behavior;
- **Regulatory policies** discourage undesirable behavior;
- **Redistributive or macroeconomic policies** seek to change individual behaviors by altering the overall economic context in which people act.



Promotional policies provide incentives—or “carrots”—for private actors to engage in behaviors the government deems desirable.

Examples of promotional techniques include licenses, grants, and government contracts.

Regulatory policies provide punishments—“sticks”—to increase the costs to private actors engaging in those undesirable behaviors.

<u>Regulatory techniques include</u>:

- Criminal and civil law;
- Administrative regulation (e.g., Environmental Protection Agency, Occupational Safety and Health Administration);
- “Sin” or excise taxes.

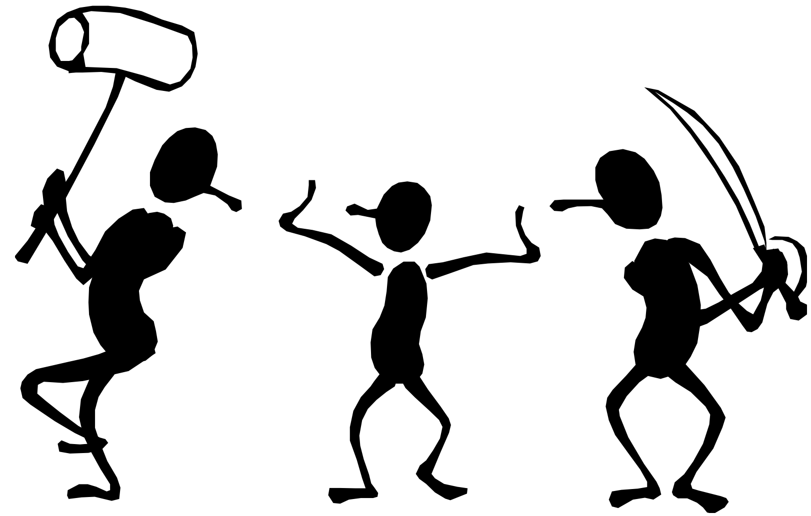
Macroeconomic and redistributive policies often are aimed at redistributing the resources of a society.

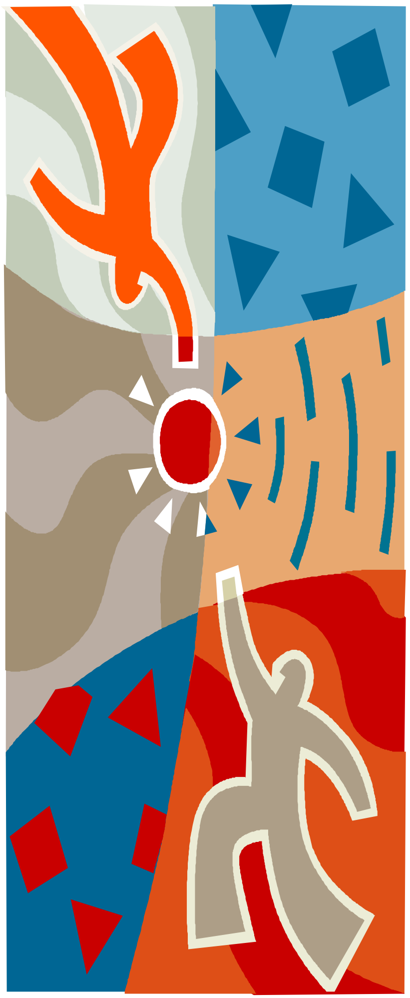
The progressive income tax—whereby the more an individual makes in income, the higher the percentage of income tax he or she pays—is a central component to most redistributive policies.

Policy Conflict

Politics often involves the mediation of societal conflicts over public policies.

The patterns of policy conflicts vary in terms of both their intensity and their scope.





In many cases, policy conflict is muted as political elites strike deals to get what they want in exchange for supporting other elites' preferences.

In some cases elites simply refuse to stand in the way of other elites. Political Scientist E. E. Schattschneider called this implicit cooperation "mutual non-interference."

In other cases the deals are more explicit. We call these relationships "logrolls."

In *The Power Elite*, sociologist C. Wright Mills argued that elites in business, politics, and the military dominate American government and society.

In these instances, policy conflicts are widespread and tend to divide the “haves” and the “have-nots” in society.

A third type of policy conflict involves relatively narrow, though often intense, conflicts between special interest groups.

In this view, which draws on the group theory of pluralism, different actors self-select into different policy conflicts and produce different governing coalitions for different policies.

Are policy conflicts logrolls, where nobody fights; large societal conflicts of the haves versus the have-nots; or pluralist battles between selected interest groups?

According to Theodore Lowi, the answer depends on the policy at hand and what it proposes to do.

Lowi's Law: Political actors become active on a policy (either in favor or against it) or do not become active based on their perception of whether (and how) they will be affected by it.

1. Those who believe they will be affected are more likely to become active on the policy, while those who do not perceive that they will be affected will remain dormant.

2. By the same token, those who will be affected positively will be in favor of the policy, while those who think they will be harmed by the policy are likely to oppose it.

Each of the policy areas likely provokes different types of conflict:

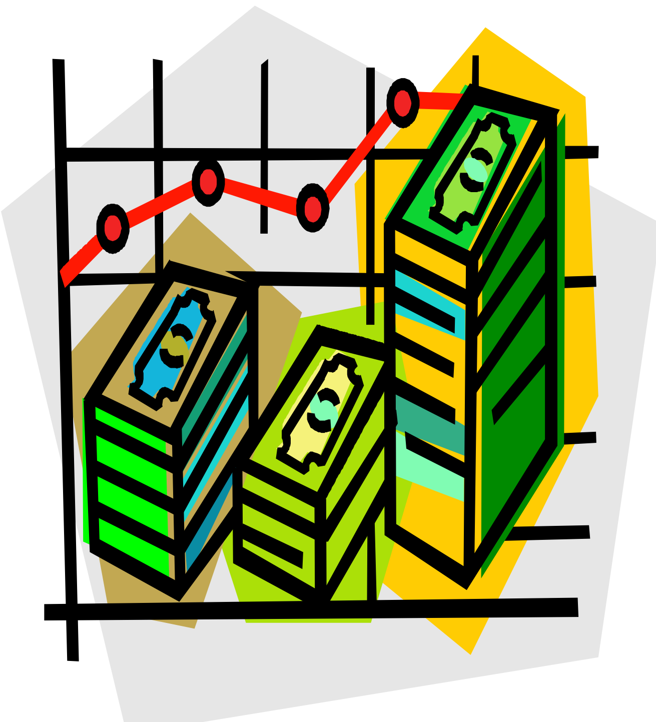
Promotional policies, because they highlight policy “winners” but few people perceive that they are “losers,” generally provoke little or no conflict.

As such, promotional policies tend to follow the “mutual non-interference” or “logroll” politics characterized by elite deals in order to mute conflict.

Regulatory policies generally affect a relatively small number of individuals and groups (but can affect them in important and often negative ways), so they tend to be dominated by the intense but narrow conflicts characterized by pluralism.

Redistributive policies excite widespread conflict between large groups such as those between the "haves" and the "have nots" because almost everyone perceives that they are affected (either positively or negatively).

How Does Government Make a Market Economy Possible?



Though many think of markets as the natural order of things and take a capitalist economy for granted, our market economy is a **political economy** established, fostered, and otherwise affected by government policies.

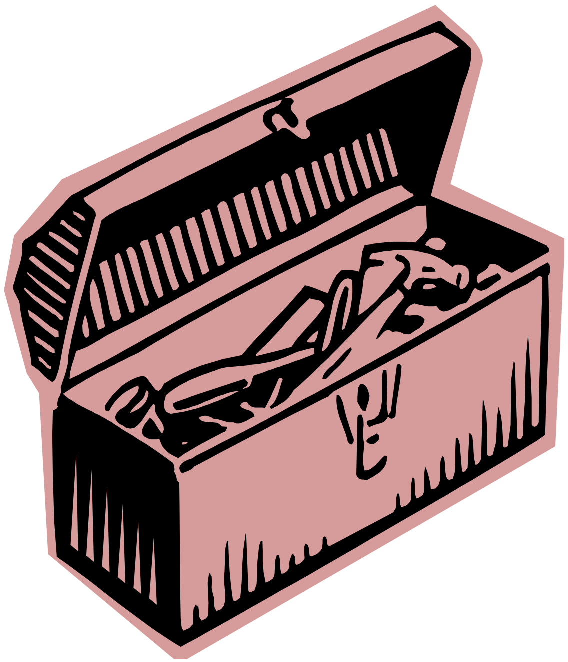
At the most basic level, government involvement makes it possible for the economy to function by:

- Establishing law and order;
- Defining rules of property;
- Enforcing contracts;
- Governing rules of exchange.

Other Effects of Government Involvement

- Setting market standards;
- Providing public goods;
- Creating a labor force;
- Ameliorating externalities;
- Promoting competition and countering tendencies toward monopoly.

What Are the Tools of Economic Policy?



American economic policy is the result of many different economic institutions and policy tools that direct, shape, and fine-tune the economy.

The tools of **promotional policies**—that is, tools by which the government tries to "incentivize" behavior—include licenses, subsidies, and government contracts.

- **Subsidies** are government grants of cash or something else of value to encourage or promote activities desired by the government;
- Similarly, through its **contracting power**, the government can set conditions on companies, also encouraging predetermined behaviors.

The government also employs **regulatory tools** designed to discourage behaviors the government deems undesirable.

- The government has instituted **antitrust policies** to discourage monopolistic practices and other threats to market competition;
- The government also employs **administrative regulations** that impose restrictions and penalties on private actors to discourage other undesirable behaviors, like pollution or indecency.

Monetary policies are the government's efforts to regulate the economy through the manipulation of the supply of money and credit.

The **Federal Reserve System** of twelve Reserve Banks regulates member banks to affect the supply of money and credit in order to fight inflation and deflation in the American economy.

The Federal Reserve affects monetary policy through:

- the **interest rates** it offers member banks;
- setting the **reserve requirement** of how much cash banks are required to hold at any given time;
- **open-market operations** (the buying and selling government securities);
- setting the **federal funds rate**, an interest rate that banks charge each other.

Fiscal policies include the government's uses of taxing and spending to affect the economy.

Although fiscal policies are used to affect economic growth, they can also be used for the purposes of redistributing wealth in society.

What are the sources of federal revenues and how do these reflect political choices?

Progressive taxation is taxation that hits upper-income brackets more heavily.

Regressive taxation is taxation that hits lower-income brackets more heavily.

Federal Revenues by Type of Tax as Percentage of Total Receipts, 1960–2008

Year	Individual Income Tax	Corporation Income Tax	Social Insurance and Retirement Receipts	Excise Taxes	Other
1960	44.0	23.2	15.9	12.6	4.2
1970	46.9	17.1	23.0	8.1	4.9
1980	47.2	12.5	30.5	4.7	5.1
1990	45.2	9.1	36.8	3.4	5.4
2000	49.6	10.2	32.2	3.4	4.5
2004	43.0	10.1	39.0	3.7	4.2
2005	43.0	12.9	36.9	3.4	3.8
2006	43.4	14.7	34.8	3.1	4.1
2007	45.3	14.4	33.9	2.5	3.9
2008 (est)	48.4	13.7	36.1	2.7	–0.9

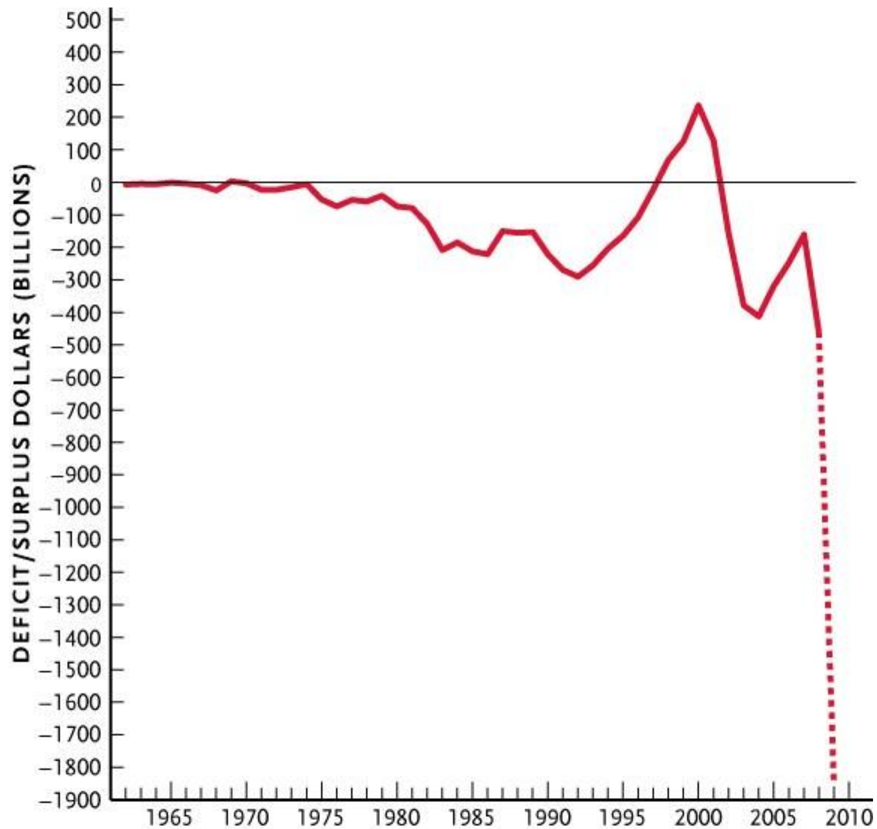
SOURCE: Office of Management and Budget, www.whitehouse.gov/omb/budget/fy2009/pdf/hist.pdf (accessed 4/13/09).

The government's spending and budgeting decisions also have a large impact on the economy.

The government can address priorities by directing resources toward a certain sector or problem.

The government's **budget deficit** can affect long-term growth and interest rates.

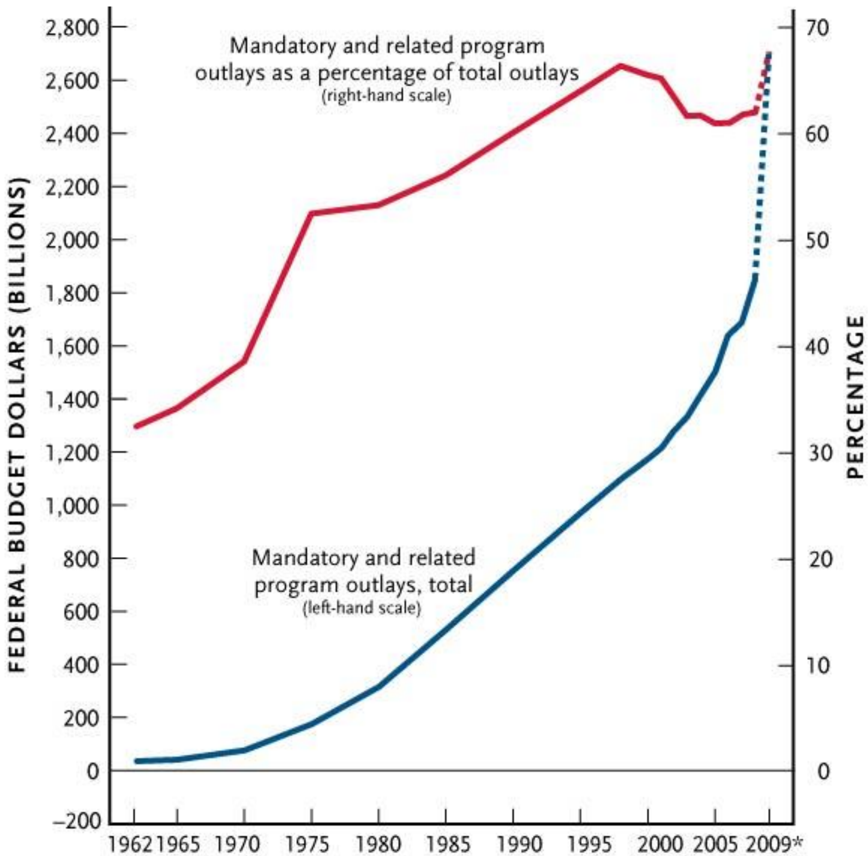
U.S. Budget Deficits and Surpluses, 1962–2009*



A large portion of federal spending is made up of "uncontrollable" or **mandatory spending** like Social Security and Medicare.

These costs limit policy makers' abilities to direct resources to other priorities and keep the budget in balance as the portion of the budget that is **discretionary** declines.

Uncontrollables as a Percentage of Total Federal Budget, 1962–2009



Political Conflict and Economic Policy

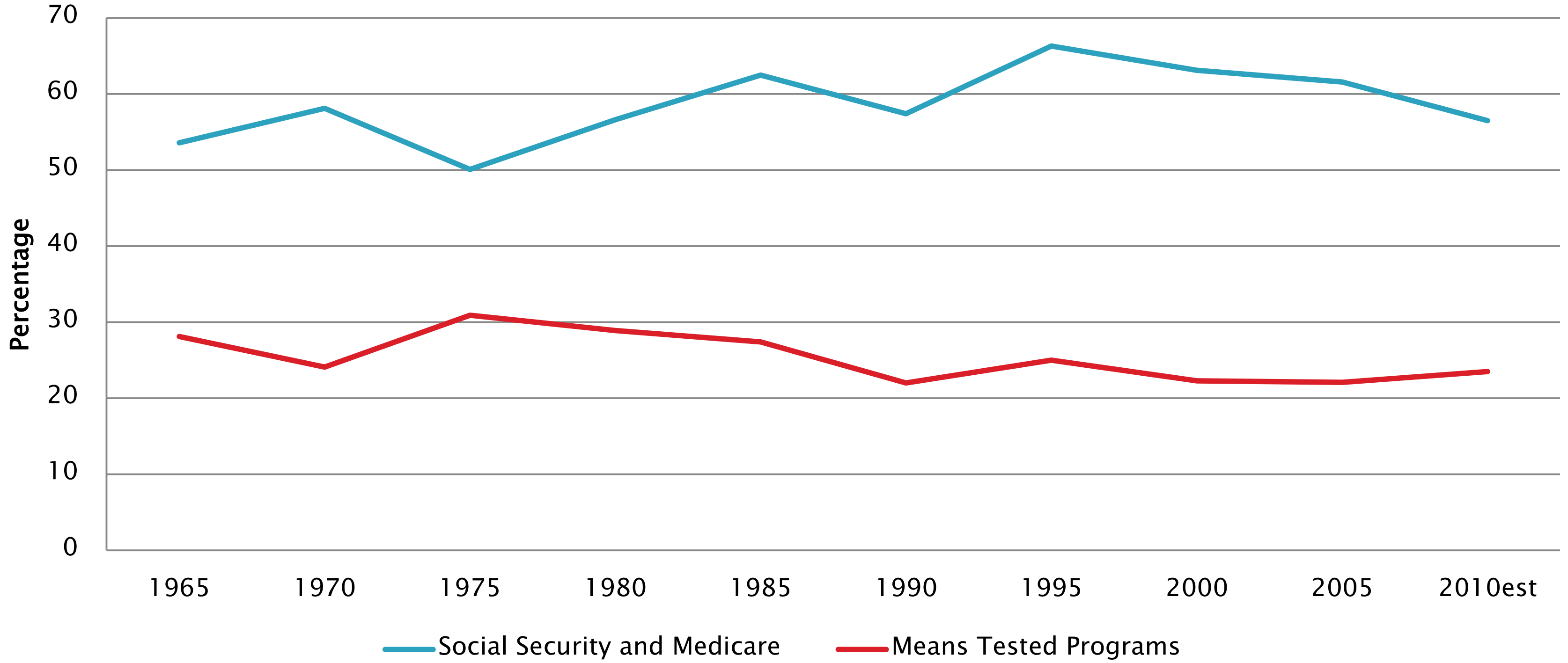
Different economic policies engender different levels of political conflict.

Consider the great deal of conflict over welfare policy, for example.

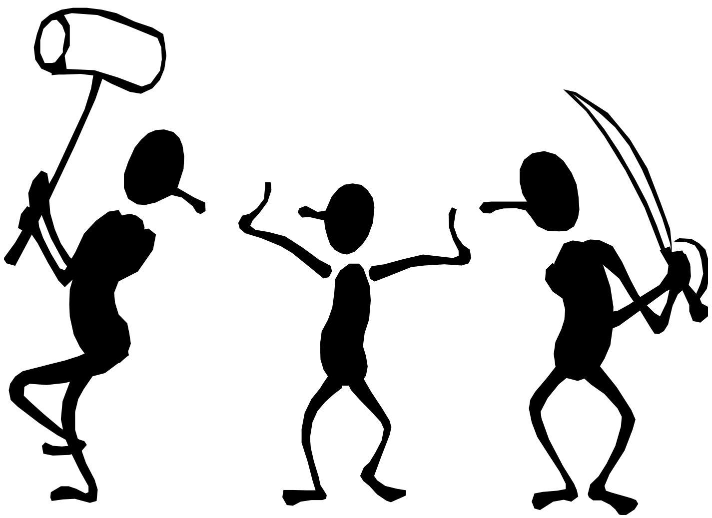
Recall **Lowi's Law**: political actors become active on a policy (either in favor or against it) or do not become active based on their perception of whether (and how) they will be affected by it.

What actors perceive themselves to be "winners" and "losers" when it comes to policies like welfare and Social Security?

Spending on Social Insurance Programs (Social Security and Medicare) and Means-Tested Welfare Programs as a Percentage of All Mandatory Spending, 1965–2010



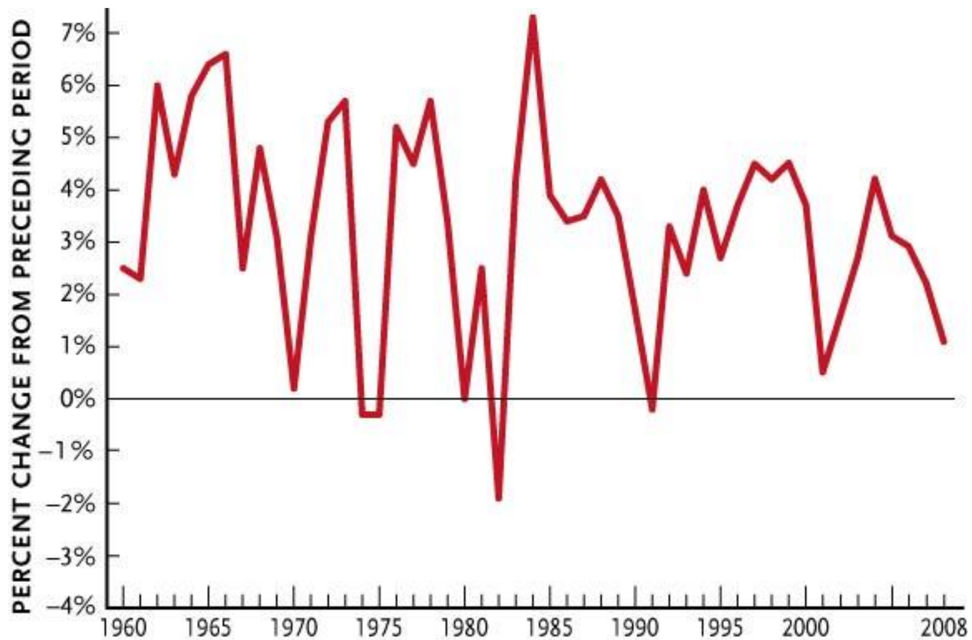
Source: U.S. Office of Management and Budget, Table 8.5, "Outlays for Mandatory and Related Programs: 1962–2014" *Historical Tables, Budget of the U.S. Government, Fiscal Year 2010* (Washington, DC: U.S. Government Printing Office, 2009), http://www.gpoaccess.gov/usbudget/fy10/hist.html, accessed October 4, 2009. "Means-tested programs" are defined as all "income security programs."



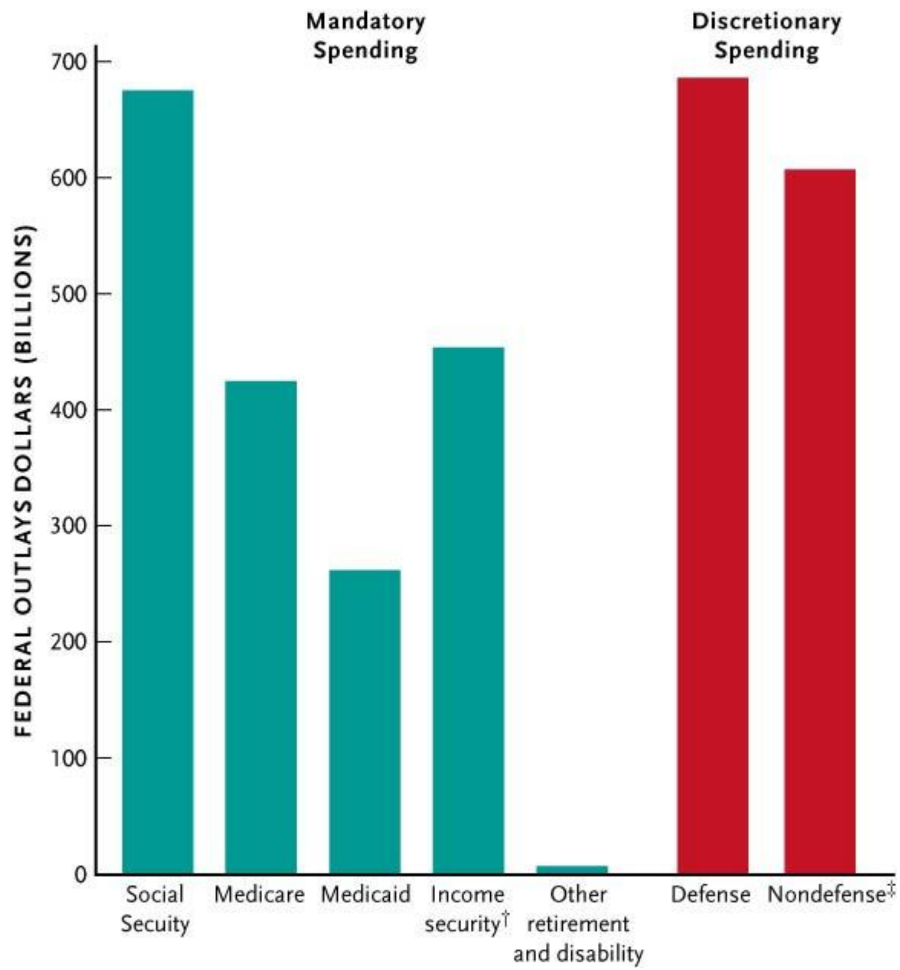
Although the bulk of federal government spending is toward non-means tested social insurance programs rather than welfare and other means-tested programs, the latter are disproportionately conflictual, while Social Security and Medicare tend to be very popular programs.

Additional Art for Chapter 14

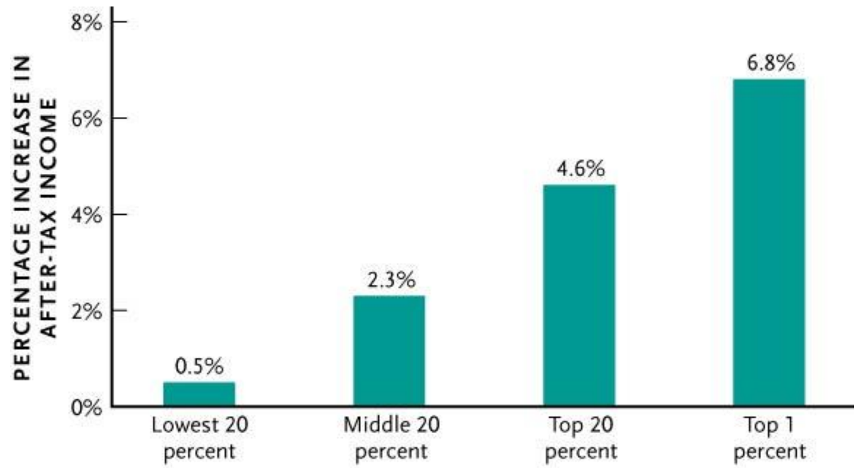
Changes in Real Gross Domestic Product, 1960–2008

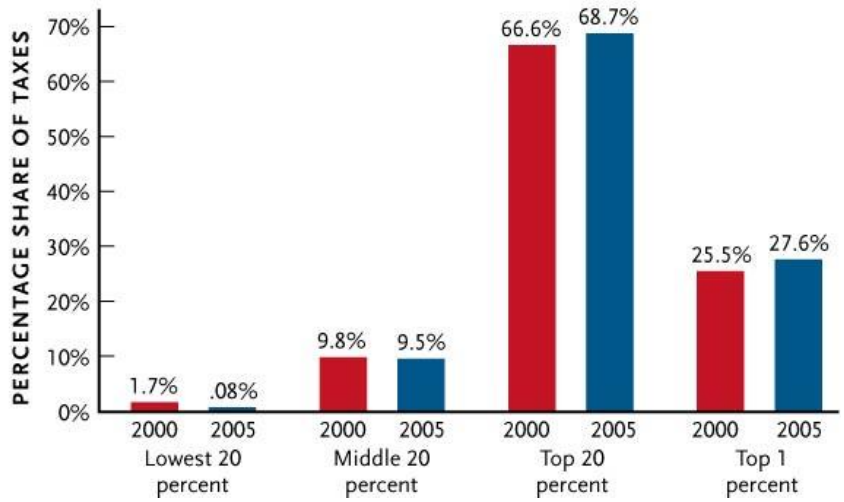


Budget Outlays of The Federal Government by Function, 2009*

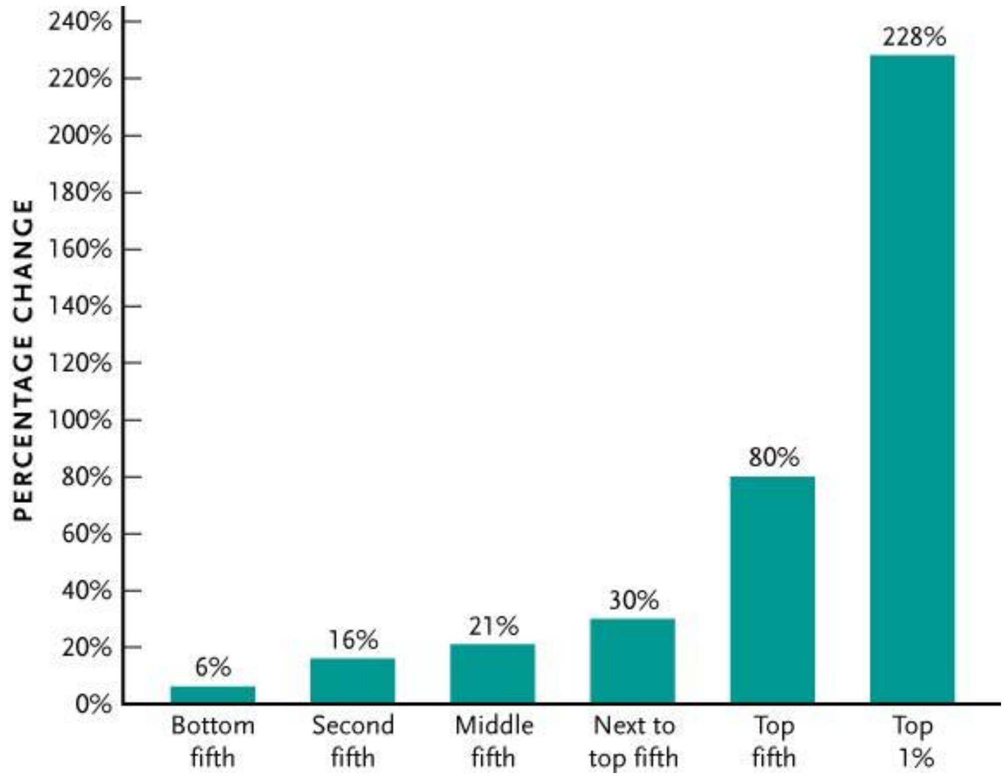


Two Perspectives on Tax Cuts





Change in Average After-tax Income, 1979–2005



ANALYZING THE EVIDENCE

The Income Gap

Examined carefully, data often raise more questions than they answer. When viewing a table or figure, especially in the context of policy debates, it is usually prudent to make a list of the questions raised by the data presented rather than simply accepting the interpretation offered by the analyst presenting the data. Take, for example, the so-called income gap that has become a major issue in contemporary American politics. As indicated by the table below, in the last several years the difference or "gap" between the share of America's income going to the richest and poorest segments of the population has been increasing. Many Democrats blame Republican tax cuts for making the rich richer and the poor poorer and assert that major changes in tax policy are needed to restore a measure of equality to American society.

THE PROPORTION OF MONEY INCOME GOING TO EACH FIFTH OF THE POPULATION

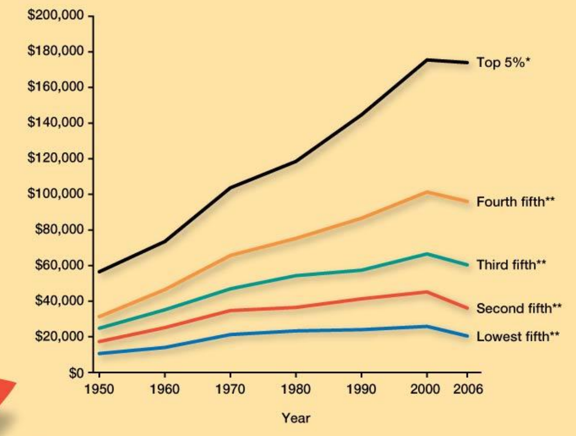
Family Income Bracket	1929 (%)	1934 (%)	1944 (%)	1950 (%)	1960 (%)	1970 (%)	1980 (%)	1990 (%)	2006 (%)
Lowest fifth	5.4	5.9	4.9	4.5	4.8	4.1	4.3	3.9	3.4
Second fifth	10.1	11.5	10.9	12.0	12.2	10.8	10.3	9.6	8.6
Third fifth	14.4	15.5	16.2	17.4	17.8	17.4	16.9	15.9	14.5
Fourth fifth	18.8	20.4	22.2	23.5	24.0	24.5	24.9	24.0	22.9
Highest fifth	51.3	49.7	45.8	42.6	41.3	43.3	43.7	46.6	50.5
Gap between lowest and highest fifths	45.9	43.8	40.9	38.1	36.5	39.2	39.4	42.7	47.1

Note: Figures are not strictly comparable because of difference in calculating procedures.

Source: Data for 1929–50, Allan Rosenbaum, "State Government, Political Power, and Public Policy: The Case of Illinois" (Ph.D. diss., University of Chicago, 1974), chaps. 10–11, used by permission; for 1960–2006, *Statistical Abstract of the U.S.*, 2009, Table 675.

These data may indicate an emergent social problem in the United States, but at least two questions must be answered before we can draw any meaningful conclusions from them and before we can make policy recommendations. First, the data deal with differences among income groups but they do not show the absolute income of any group. It is possible that all income groups are better off today than they were in prior years. If everyone is better off, perhaps we do not want to change our tax policies, even if they tend to increase income inequality. This possibility is at least partially borne out by census data: Between 1980 and 2004, the average incomes of every income group increased—though the incomes of the wealthiest Americans increased more sharply than those of any others.

INCOME IN CONSTANT (2006) DOLLARS



*Average income.
**Income at upper limit of each fifth.
Source: *Statistical Abstract of the United States*, 2009. Table 675.

A second consideration is that the data showing a growing income gap deal with aggregates, not individuals. We cannot know from the data presented whether families are generally locked into a particular income quartile or are likely to move from year to year. If the latter, then the apparent increase in inequality shown in the first table is at least mitigated by social mobility. In recent years, for example, the percentage of black families in the lowest income group has decreased more sharply than the percentage of white families in that group. At the same time, the percentage of black families in the highest income group has increased more substantially than their white counterparts, suggesting that there is social mobility across the income groups.[1] Thus, in considering the income gap, we may want to consider whether policies designed to reduce inequality might interfere with social mobility.

[1] *Statistical Abstract of the United States*, 2007. Table 676.

This concludes the presentation slides for Chapter 14: Economic Policy

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