Economic Policy

What do you know about the National Debt?

US Debt Clock

Economics - the idea of choice

Is it about numbers and math?

Or values?

We all want economic prosperity, but we disagree with how to get there

What do you know about Economic Policy?

Most voters would like to have all three things:
- Lower Taxes
- Less Debt
- Services we like or need

How do these things conflict?
- People want prosperity, but they also want no tax increases, no govt deficit, and continue/higher govt spending on things they like (education, medical care, environment, retirement benefits)
- If we have more spending on popular programs (like education), we have to pay for it some how. How?
- Higher taxes or more borrowing

So here are some hypotheticals

1. If you want to spend more $$ in medical research
   a. You raise taxes on cigarettes (only a minority smoke them and this would only alienate a minority of voters, meaning that this program would be liked by the majority + **most people are happy and affected positively)**
2. If you want to pay for new education programs or bigger environmental programs…
   a. You raise taxes on affluent voters (high-income people)
   You can find a majority of voters who will support (or at least not oppose very strongly) tax increases on a small group of voters

Why is it so hard for politics to produce wise economic policy?

1) Everyone wants general prosperity (at least I would hope so...)
2) Large majorities (voters) want more govt spending on popular programs and don't think much about the long-term

BUT

The more the govt spends on popular programs, the more money it requires. The more $ the govt takes, the less that is left over for private investment that might produce prosperity.

Vocabulary & Basic Concepts

Monetary vs Fiscal Policy

Monetary Policy:
Policies that involve regulating the supply of money in the economy

Fiscal Policy:
Policies that involve taxing and spending

Principles

	Monetary	**Fiscal**
Involves:	Regulating the money supply	The budget: taxing and spending
Goal:	Control inflation, mitigate downturns, stimulate investment and credit availability, promote economic growth.	Stimulate demand in the economy, control unemployment, promote economic growth.
Terms you'll hear:	Interest rates, discount rate	Tax cuts, spending programs, stimulus

Who dat? The Policy Makers

	Monetary	**Fiscal**
Key Player	**The Federal Reserve System aka THE FED.** **Federal Reserve Board and 12 Regional Reserve Banks**	• Congress • The President (as policy agenda setter) • OMB – remember them? • Dept of the Treasury (IRS)

Policy Tools (Crash Course)

	Monetary	**Fiscal**
Tools		

Other Important Economic Terms

- Economic Theories - next class
- Deficit & surplus & inflation & deflation
- Spending Money
- The Budget
- Reducing Spending
- Levying Taxes

The Deficit (& its opposite, the surplus)

The amount that the government overspends in a budget year

- This amount represents the total amount of money that the federal government had to borrow from citizens and foreign governments in order to meet its spending obligations

- George W. Bush assumed office in 2001 after 4 consecutive years of <u>surplus</u> (**when the govt spends less than it gets in taxes**)

- However, taxes, foreign wars/conflicts, a stock market crash and recession, an economic stimulus package brought back deficits

- **So how big is the deficit?   ~$441 billion** (for FY17 as of Feb)

US govt spending $4.07 trillion > US govt revenue $3.63 trillion

Inflation

- Economy on a case of Red Bull

- Too much money in circulation
- Too much credit going out
- Risky investments, too much demand for money
- Prices rise
- Value of money goes down

- Needs to chill.

Deflation

- Economy is crawling…slowly. Must….have….coffee.

- Too little money in circulation
- Too little credit going out
- Not enough investment, too little demand for money
- Prices fall
- Value of money goes up

- Needs an infusion, or those paddles

Spending Money

Voters want…
1. A Balanced Budget
2. Lower Government spending (they believe the government spends too much and it can easily cut spending if it wanted to)

What's the problem here?

Question: What causes a deficit?

Is it a spending issue?

Or a taxing issue?

Or a priorities issue?

Spending Money: Inconsistent Economic Policies

People want limited government with no deficit, but also good schools, clean air, better health care, less crime

Where do we get this money from?

◦ Probably through increasing taxes
◦ Also through cutting **other spending**

Politicians Promise Two Conflicting Ideas

◦ Vote for me & I'll cut deficit & keep govt spending down!
◦ Vote for me & I'll make certain your favorite program gets more money!

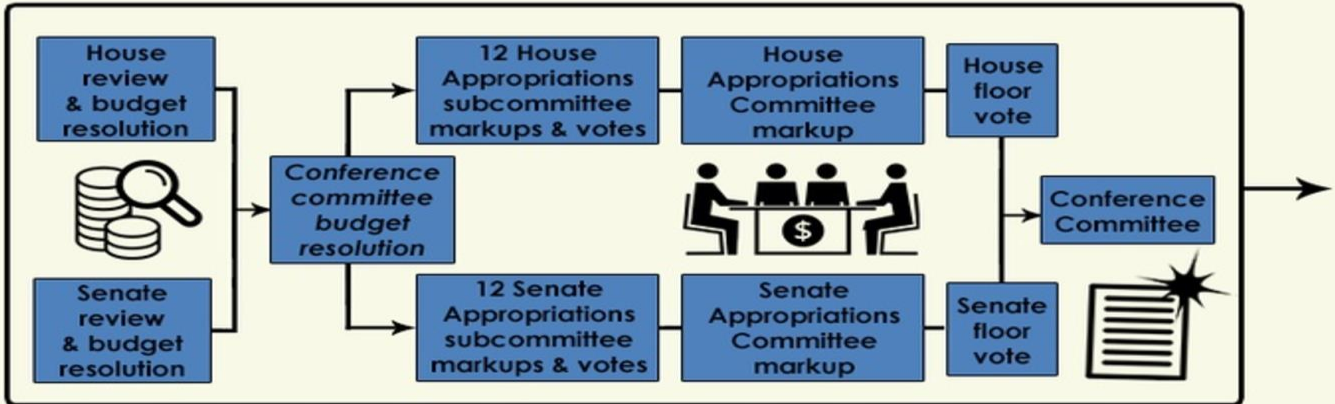Why do we let them do this? (the problem of democracy)
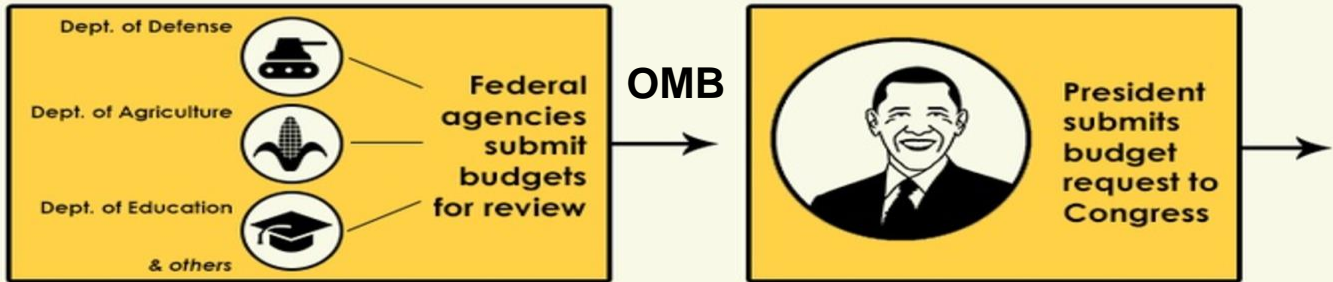
The Budget

The Budget – A plan that lays out how much the government will collect in taxes & spend in revenues, and how those expenditures will be allocated among programs.
- The Fiscal Year: October 1st through September 30th

The Budget is decided based on 2 key things:

1) How much $ the govt is going to spend
2) Allocating/distributing that $ among programs/agencies

The Annual Federal Budget Process

Dept. of Defense
Dept. of Agriculture
Dept. of Education
& others

Federal agencies submit budgets for review

OMB

President submits budget request to Congress

House review & budget resolution

Senate review & budget resolution

Conference committee budget resolution

12 House Appropriations subcommittee markups & votes

House Appropriations Committee markup

House floor vote

12 Senate Appropriations subcommittee markups & votes

Senate Appropriations Committee markup

Senate floor vote

Conference Committee

President vetoes or signs into law

NATIONAL

The Budget - Entitlements (important!)

About ⅔ of what the government spends is **mandatory**

- **Most of this mandatory spending is called Entitlements (AKA "uncontrollable spending")**
- Examples include: <u>Social Security, Medicare</u>, veteran benefits, Food Stamps, Welfare, Medicaid

These entitlements includes money that people are "entitled" to

- They have paid into these funds over time (Social Security)
- Or people qualify for these funds based on individual situation: poverty level, retired from military

These programs don't require Congress to approve their spending levels each year – the spending is automatic…

(although Congress *could* change the rules by changing the law)

The Budget - What happens if govt reduces Entitlement Spending?

- The majority of the American public will be angry
- Remember that economic policy aims to make the **majority happy and pleased with the government**

- Also - elections can be determined based on the economy
  - If the econ is good, incumbents have an advantage
  - If it's bad, you'll be blamed
  - Your opponents will use your economic ideas against you
  - "It's the economy, stupid"
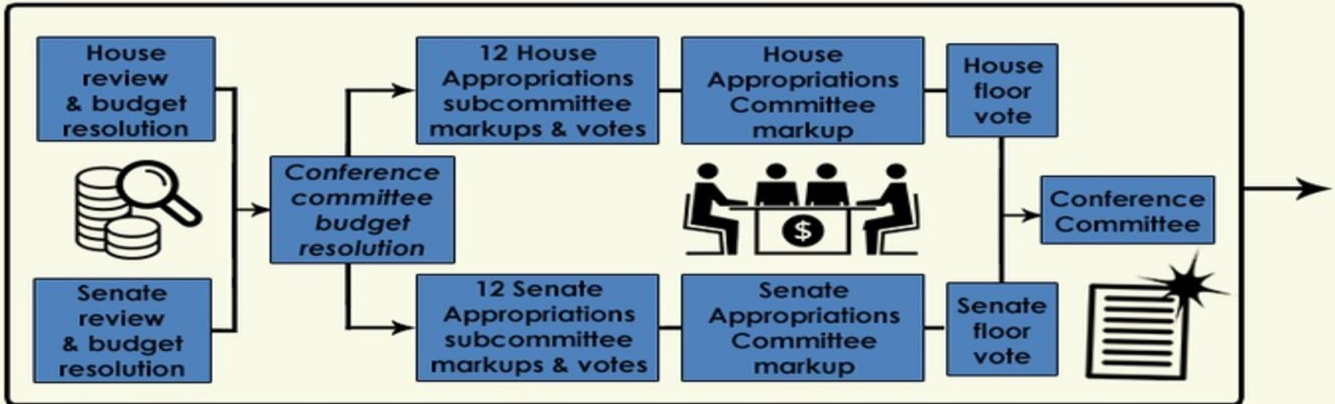
The Budget - What can be altered?
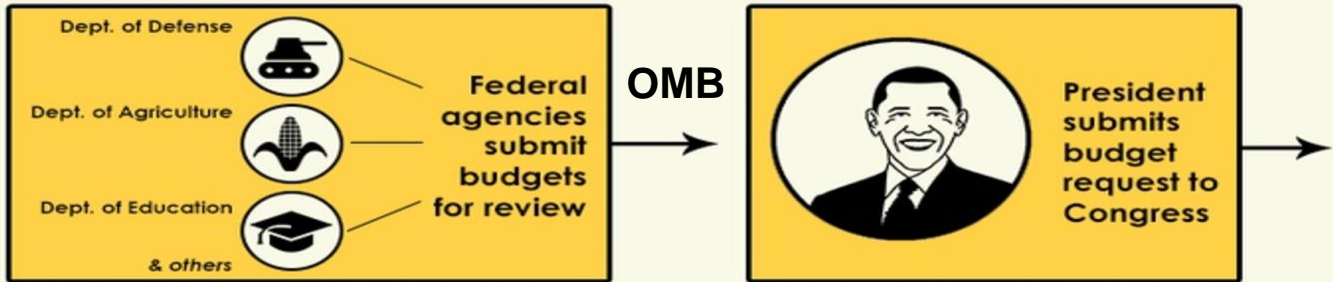
- About ⅓ of the overall funds (remember ⅔ of it are entitlements/mandatory)
- Includes federal agencies like:
    - Defense/Homeland Security
    - Education
    - Agriculture
    - International Relations
- **Will reducing the spending to these programs make a huge/major fix in the deficit? What about the debt?**
    - Probably not... taxes need to be raised.

The Budget - Who is involved?

Mostly Congress. Also, the President, OMB, interest groups, the public, interest groups, lobbyists, interest groups.

1) President/OMB submits budget request to Congress
2) Lawmakers release their budget plans/create a budget resolution (with a total amt)
3) Subcommittees in House/Senate set funding for each program in the budget
4) House/Senate come together to resolve these differences
5) Budget returns to President and becomes law (if signed)

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NATIONAL PRIORITIES

What if they can't agree on a budget?

Option A: Continuing Resolution!

-   Congress just keeps agreeing to continue current spending levels for a few months at a time.

- Way to take a stand, Congress.

Option B: Sequestration!

- If we can't make the difficult decisions, then we'll agree that an automatic set of horrible spending cuts will happen that we'll all hate. Surely that will make us agree on something!

Option C: Government Shutdown!

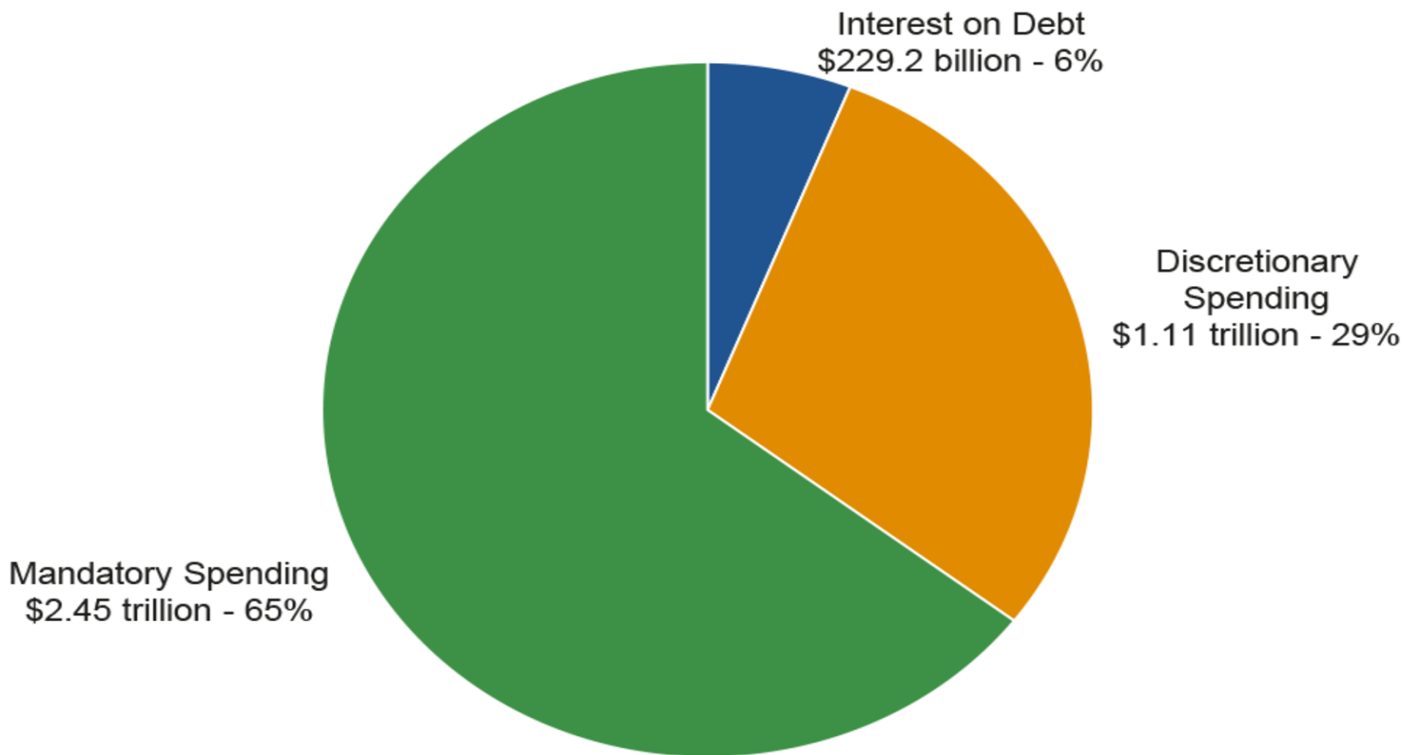-   No budget, no $, no government.   No problem!

Reducing Spending

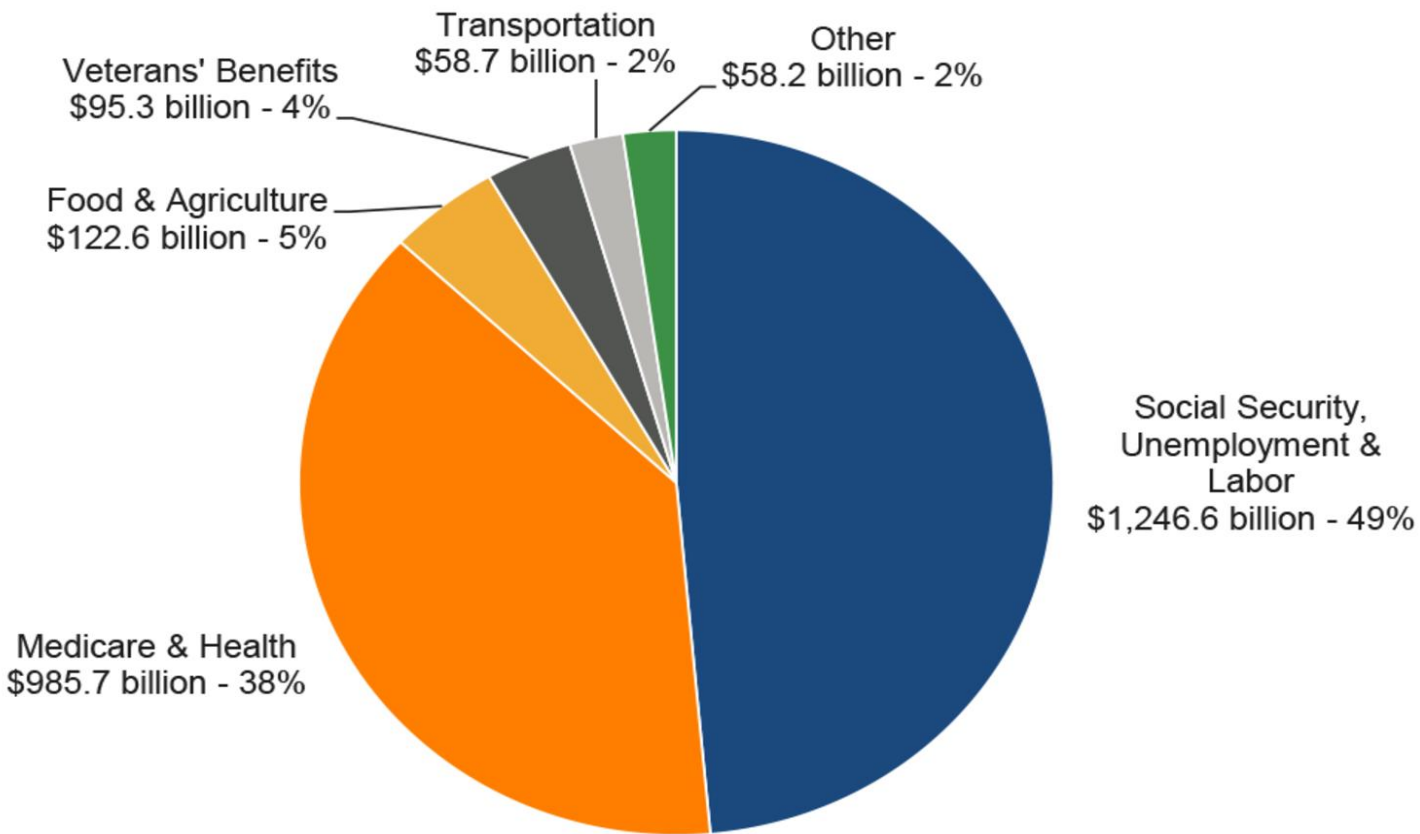Over time, there has been more and more government spending

So there has been increased regulation and an effort to put a cap/limit on this spending

- ◦ 1980s-1990s

FY 2015 Mandatory and Discretionary Spending and Interest on Federal Debt (in 2015 Dollars)

Interest on Debt
$229.2 billion - 6%

Discretionary Spending
$1.11 trillion - 29%

Mandatory Spending
$2.45 trillion - 65%

Total Mandatory Spending 2015: $2.45 Trillion

Transportation
$58.7 billion - 2%

Other
$58.2 billion - 2%

Veterans' Benefits
$95.3 billion - 4%

Food & Agriculture
$122.6 billion - 5%

Social Security,
Unemployment &
Labor
$1,246.6 billion - 49%

Medicare & Health
$985.7 billion - 38%

Discretionary Spending 2015: $1.11 Trillion

Social Security, Unemployment & Labor $29.1 billion - 3%

Science $29.7 billion - 3%

Transportation $26.3 billion - 2%

Food & Agriculture $13.1 billion - 1%

Energy & Environment $39.1 billion - 3%

International Affairs $40.9 billion - 4%

Military $598.5 billion - 54%

Housing & Community $63.2 billion - 6%

Veterans' Benefits $65.3 billion - 6%

Medicare & Health $66 billion - 6%

Education $70 billion - 6%

Government $72.9 billion - 6%

Total Federal Spending 2015: $3.8 Trillion

Housing & Community
$61.5 billion - 2%

International Affairs
$50.2 billion - 1%

Energy & Environment
$44.8 billion - 1%

Science
$29.8 billion - 1%

Transportation
$85 billion - 2%

Education
$102.3 billion - 3%

Food & Agriculture
$135.7 billion - 4%

Veterans' Benefits
$160.6 billion - 4%

Interest on Debt
$229.2 billion - 6%

Military
$609.3 billion - 16%

Social Security,
Unemployment &
Labor
$1,275.7 billion - 33%

Medicare & Health
$1,051.8 billion - 27%

Levying Taxes

Question: What is a "fair" tax?

Brainstorm this question.

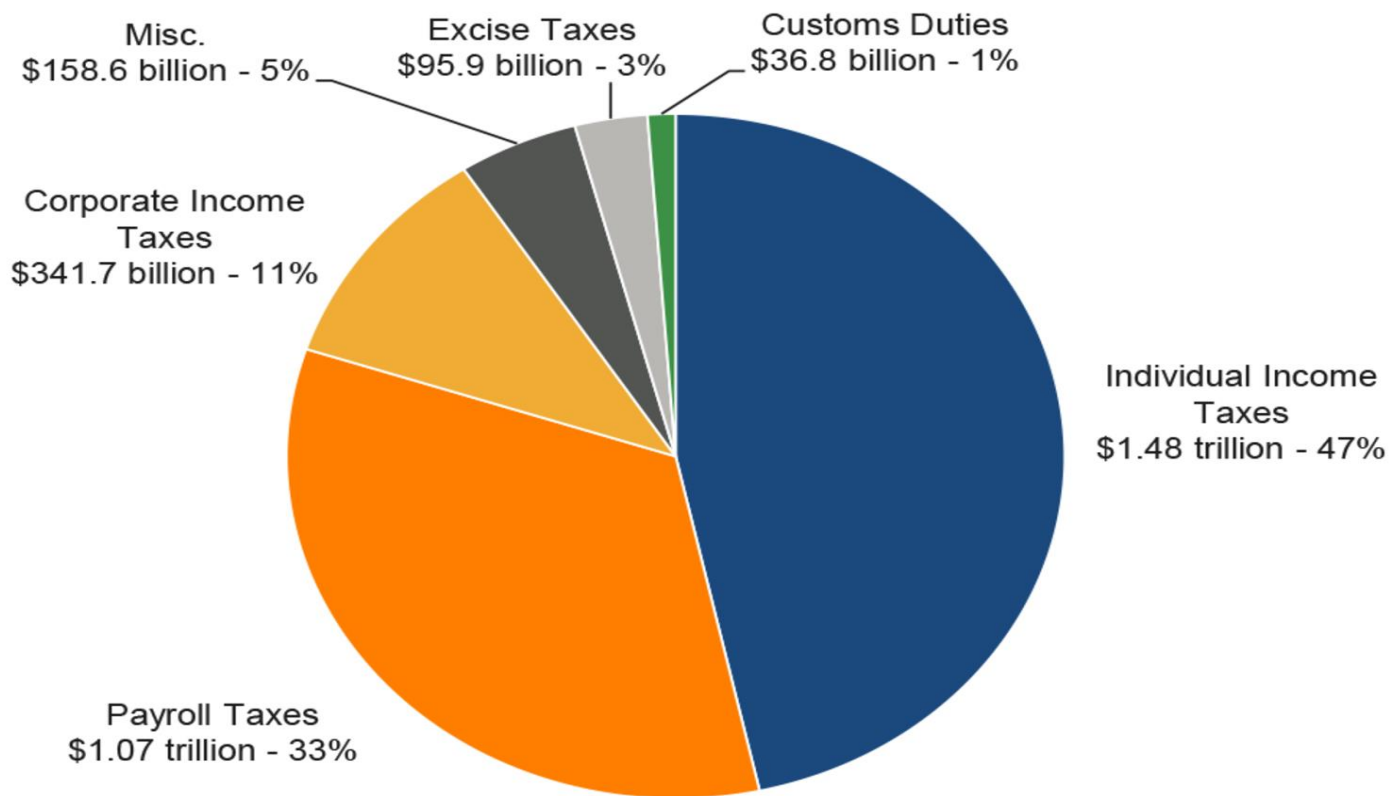# Taxes - What is fair?

"Fair" Taxes should fall under 3 categories
1) Keeps overall tax burden low
2) Requires everyone to pay something
3) Requires the better-off to pay at a higher rate than less-well-off

# Taxes - What is Good?

There are 3 categories for "good" tax laws:
1) Impose modest burdens on the people paying the tax (not too high)
2) Prevent cheating
3) Mildly progressive (higher tax rate for the better-off)

Federal Tax Revenue 2015: $3.18 Trillion

Misc.
$158.6 billion - 5%

Excise Taxes
$95.9 billion - 3%

Customs Duties
$36.8 billion - 1%

Corporate Income
Taxes
$341.7 billion - 11%

Individual Income
Taxes
$1.48 trillion - 47%

Payroll Taxes
$1.07 trillion - 33%

Individual and Corporate Income Taxes as Percent of Total Federal Revenue (1934–2015)
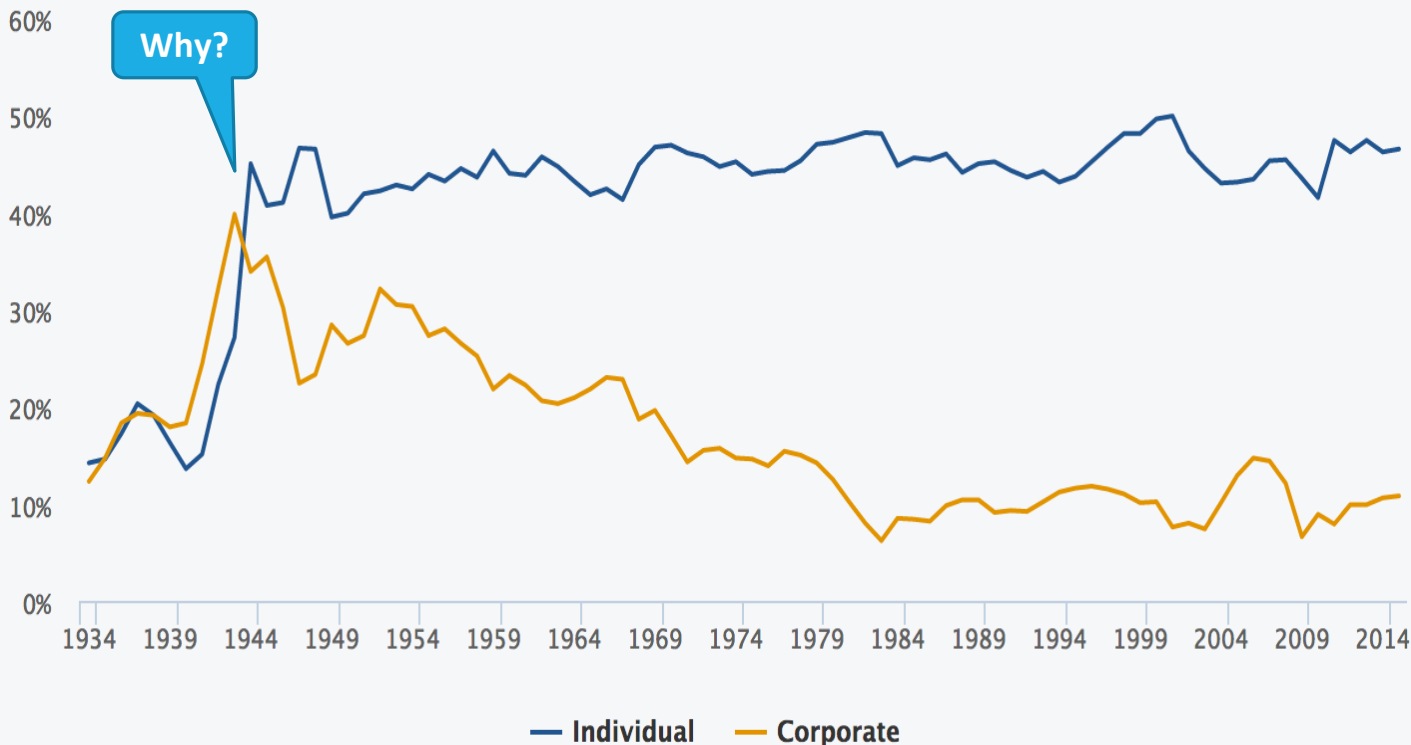
Taxes - Goals Achieved

1) Impose modest burdens → Goal Achieved!

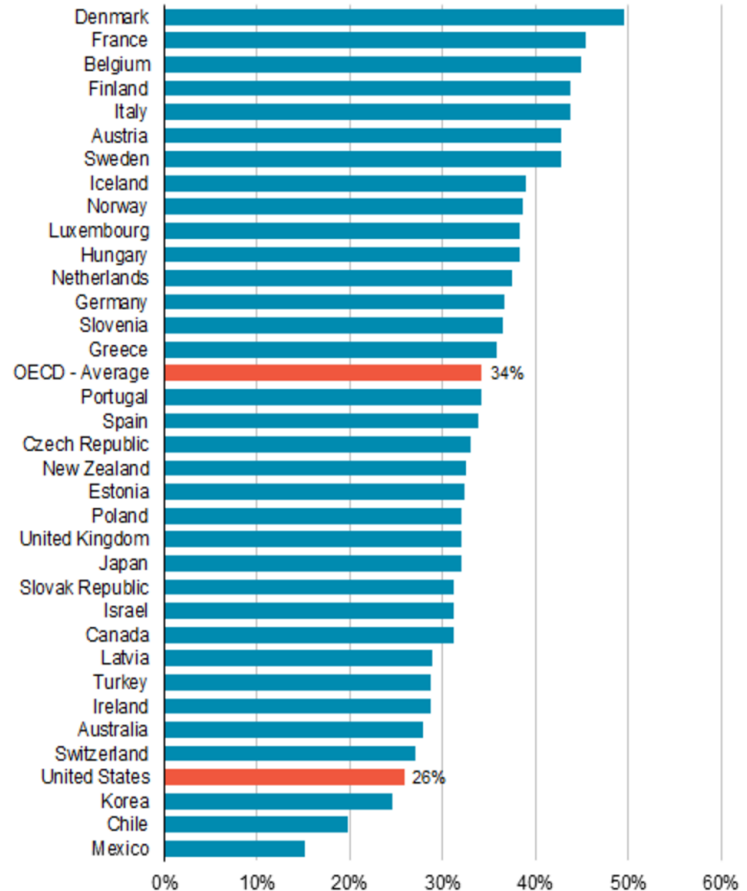- Tax burden in US is lower than most other democratic nations

Link

Why is the US at 26% for tax revenue when the average is 34% for developed countries?

- Those countries (mainly in Europe) provide **extensive government services** that the US does not.
- Ex. health care, college tuition (even through a Master's degree)

Taxes as a Share of Gross Domestic Product
OECD, 2014

TPC

Bar chart of Taxes as a Share of GDP, OECD 2014, showing (top to bottom): Denmark, France, Belgium, Finland, Italy, Austria, Sweden, Iceland, Norway, Luxembourg, Hungary, Netherlands, Germany, Slovenia, Greece, OECD - Average (34%), Portugal, Spain, Czech Republic, New Zealand, Estonia, Poland, United Kingdom, Japan, Slovak Republic, Israel, Canada, Latvia, Turkey, Ireland, Australia, Switzerland, United States (26%), Korea, Chile, Mexico.

Source: OECD Stat Extract.

Taxes - Goals Achieved

2) Prevents cheating - sort of...

- Americans evade their taxes less than the French/Italians (but this is why other nations have higher sales tax)
- How do people avoid paying taxes?
    - Illegally?
    - Legally?

Different Methods of Taxation

<u>Progressive Tax</u>

- Where wealthier citizens pay at higher rate or % of their income.
- US income tax is progressive. 10% of those who earn the most income, pay about 70% of all federal income taxes.   Different tax "brackets".

<u>Regressive Tax</u>

- Where the tax burden falls more heavily on lower-income citizens. The opposite of a progressive tax.
- Examples? ($1 per gallon gas tax – that $15 per tank is a higher % of your measly income than mine)

<u>Flat Tax (or Proportional Tax)</u>

- Everyone pays the same % of their income in taxes, no matter what their income is.
- Ex. Everyone pays 10%.

- http://www.investopedia.com/ask/answers/042415/what-are-differences-between-regressive-proportional-and-progressive-taxes.asp

2016 tax brackets

Tax rate	Single	Head of household
10%	$0 to $9,275	$0 to $13,250
15%	$9,276 to $37,650	$13,251 to $50,400
25%	$37,651 to $91,150	$50,401 to $130,150
28%	$91,151 to $190,150	$130,151 to $210,800
33%	$190,151 to $413,350	$210,801 to $413,350
35%	$413,351 to $415,050	$413,351 to $441,000
39.6%	$415,051 or more	$441,001 or more

Why have taxes been on the rise?

Before 1913 & the 16th Amendment, there was no federal income tax
- ◦ Government mainly got their money from tariffs (tax on imported goods... so they just taxed foreign countries)

Generally, taxes would increase during war and decrease during peace
- ◦ Except during Cold War and Iraq War when Reagan and George W. Bush decreased taxes and increased military spending
- ◦ What's the thinking here?
- ◦ What did this result in?

Highest Marginal Tax Rate 1913-2014

Extra Time/Exit-Ticket

On the back of your warm-up, **draw** a progressive tax, regressive tax, and flat tax (you will have to look up flat tax definition).

- X-Axis: the amount one earns in income
- Y-Axis: the tax rate

Then, explain the differences between the three in writing.

Finally, which one is **fair?** Which one is **good?** Explain your reasoning.

Turn this in when you are done! :)

US Economic Policy Over Time

In your groups, you will be given a topic and you will trace economic policy over time. You can create a chart (like the one here) or write down the major changes within the policy. You will present these to the class. Some of these ideas will overlap.

Income taxes (1913-present)

Corporate taxes (1913-present)

Federal deficit (1913-present)

Federal spending overall (1913-present)

Foreign conflicts vs. isolationist (1913-present)

Presidents & their political party