CHAPTER 16: THE FEDERAL BUDGET AND ECONOMIC POLICIES

IF YOU LEARN ONLY FOUR THINGS IN THIS CHAPTER . . .

1. The creation of the federal budget is one of the central tasks of national government.
2. The Office of Management and Budget creates the basic budget and uses this duty as a way to advance its legislative priorities. Congress counters this power with its own budget agency, the Congressional Budget Office.
3. There are opposing theories of the proper role of government in the economy.
4. The 20th century saw increased expectation that the federal government will moderate business cycles and stabilize the economy.

THE BUDGET PROCESS

The budget process itself is a form of policy making. The federal budget process prioritizes where funds go and what can be done with them. Economic growth has become the measure of how effective the government is at creating a stable infrastructure and atmosphere for improvement.

The federal budget year, called the **fiscal year**, goes from October 1 through September 30. The Office of Management and Budget (OMB), under the executive branch, is responsible for drafting the budget. The Congressional Budget Office (CBO) is the group responsible for analyzing the budget and balancing the OMB's expenditure priorities with those of Congress.

The Senate and House Budget Committees are in charge of issuing the first concurrent budget resolution, which then must be approved by the full House and Senate. After this, congressional committees and subcommittees work on appropriations bills and make any changes to revenue bills needed to make them consistent with the first budget resolution. Next, Congress passes appropriation bills followed by a second, binding budget resolution, both of which are sent to the president for him or her to sign or veto. If both are signed, the budget goes into effect.

The main focus of the budget is on discretionary programs, which Congress can choose to fund. Mandatory programs are already set for funding. Congress sometimes has to authorize borrowing to cover all these. The greatest political controversy regarding economic policy is over what constitutes appropriate types and levels of federal spending. For example, some view **entitlement** programs such as Social Security and Medicare, which are major examples of **mandatory spending**, as being wasteful and unnecessary. Others argue that **discretionary spending**, such as expenditures for the armed forces, must be reduced.

REVENUES AND EXPENDITURES IN 2015 PROPOSED BUDGET

	Approximate %
Revenues and Sources = $2.775 Trillion	
Individual Income Tax Receipts	47
Social Security Taxes and Contributions	34
Corporate Income Tax Receipts	10
Federal Excise Taxes	3
Deposit on Federal Earnings	3
Estate, Gift Tax Receipts	1
Federal Customs, Duties, Tariff Receipts	1
Expenditures and Sources = $3.455 Trillion	
Social Security Payments	23
Security Agencies (Defense, Energy, Homeland Security, Veterans Affairs)	18
Non-Security Agencies	15
Net Interest Payments on the Public Debt	6
Medicare Payments	14
Medicaid Payments	8
All Other Spending on Programs (running the government agencies, transportation funds, energy funds, court funds, etc.)	15

GOVERNMENT DEBT

Massive government **debt** has accumulated in record amounts since the 1980s. About 6 percent of the budget is now devoted annually just to keeping up with the interest payments on the debt.

In recent years, the debate has become even more political as foreign governments, such as Japan and the People's Republic of China, have purchased substantial sums of the bonds that finance the debt.

There are key disagreements about the government's role in the economy. Federal statutes require that the government must try to keep the economy stable and growing, but there is no consensus on how this is best done or even if the government should try.

ECONOMIC POLICY

Monetary Policy

Monetary policy, which controls the money supply mainly through the Federal Reserve System, largely determines the interest rates that banks charge for loans and has the power to speed up or slow down the economy as appropriate. The Federal Reserve Board is responsible for monetary policy, or control of the money supply. The Board's seven members are appointed by the president, and must be confirmed by the Senate, for 14-year terms that cannot be renewed.

Monetarism, which is widely associated with the work of Milton Friedman, is the belief that variations in the money supply have the greatest influence on the economy and that economic stability is best attained by keeping the growth rate of the money supply steady.

Fiscal Policy

Fiscal policy refers to altering levels of taxation and spending to promote economic stability. Two opposing theories have greatly influenced U.S. fiscal policy in recent years.

According to **Keynesian economics**, the government must manage consumer demand for goods and services. In times of economic stagnation, it should increase its level of spending to stimulate consumer demand. Conversely, in inflationary times, it should raise taxes to lessen consumer demand. Franklin Roosevelt and Barack Obama based their economic policies on Keynesian economics.

In opposition to Keynesian theory, **supply-side economics** maintains that the government should focus its economic policies on stimulating the supply, not the demand, of goods and services. This theory maintains that tax cuts, especially those for corporations and the wealthy, will provide more funds for investment in businesses, thus leading to increased levels of employment and economic prosperity for all. Advocates of this approach claim that initial tax cuts will eventually be offset with new tax revenues from the economic growth that will ensue. However, President Reagan and George W. Bush embraced this theory, cutting taxes and some government spending, but the federal debt soared during his administration.

PRESIDENTIAL ECONOMIC PROGRAMS

Program	President	Description
Trust Busting/Progressivism	T. Roosevelt	Early 1900s These efforts were results of the late 1800s Populist votes and growing demands for industrial reforms.
New Deal	F. Roosevelt	1930s Massive help from government programs such as Social Security was needed and became key social efforts.
Fair Deal	H. Truman	Late 1940s Early efforts at civil rights equality began in federal programs such as the military.
New Frontier	J. Kennedy	Early 1960s Civil rights laws were passed. Early forms of affirmative action and environmental programs began. Peace Corps established.
Great Society	L. Johnson	Mid-1960s Vast attempts were made to rebuild inner cities, give jobs, and provide assistance with programs such as Medicaid.
Price Controls New Federalism	R. Nixon	Early 1970s Rapid inflation was met with attempts to stop price increases through mandates. Environmental protections established.
Whip Inflation Now (WIN)	G. Ford	Mid-1970s More federal attempts at stopping rapid price increases were required, but efforts did not help.
Reaganomics/Trickle-Down Supply-Side/Devolution New Federalism	R. Reagan	Early 1980s The goals were to cut federal programs and business regulations. Tax cuts in the name of expansion were central.
Clintonomics	B. Clinton	1990s Devolution of federal government programs to the states. Reduction of the national debt.

FEDERAL MANDATES AND THE BUDGET

Many recent forms of federal assistance have come with "strings attached"—mandated rules that must be followed by states that use the money. Highway funds of the past were controlled by speed limit and drinking age rules. Education funds have recently been connected to testing requirements.

When the federal government passes rules without supporting funds, known as **unfunded mandates**, states can balk at the regulations. Recent suits by local governments over unfunded gun control rules were won by states, and the rules did not have to be followed. When states need the money for important social programs, however, they must follow national guidelines.

CHAPTER 17: DOMESTIC POLICY DEVELOPMENT

IF YOU LEARN ONLY FOUR THINGS IN THIS CHAPTER . . .

1. The public has come to demand domestic programs that address various problems.
2. Many domestic policy priorities are set through financial assistance to states and local governments in the form of grants.
3. The federal government often sets domestic policy priorities based on a comparison between the potential costs and the potential benefits of programs being considered.
4. Domestic policy changes were often brought about by economic developments and demands for civil rights.

INTRODUCTION

In addition to economic policy, there are two other major categories of public policy: domestic policy and foreign policy. **Domestic policy** focuses on issues within the United States, while **foreign policy** concerns U.S. relations with the other nations of the world. National priorities have become more elaborate, and the scope of federal involvement in public policy has grown in recent times. As mentioned in several other contexts, the Great Depression was a key event that changed the way people perceived the role of government. Recent conservative movements have advocated for a decrease in the powers granted to the government during the Depression, but overall public opinion is favorable toward government programs such as Social Security, Medicare, urban renewal, and public transportation. Debates will certainly continue about the effectiveness of government in trying to solve social problems or economic ills, but some reforms, such as the Securities and Exchange Commission (SEC), which regulates the stock market, and the Food and Drug Administration (FDA), which ensures that harmful foods and medicines are not sold to consumers, are supported by most citizens.

KINDS OF POLICIES

Domestic policies fall into three basic categories. The first category encompasses **distributive policies**. Distributive policies are aimed at specific groups and are very selective in nature. Farm and industrial *subsidies* provide billions to those who grow critical food supplies or produce important products. Prescription drug companies, energy providers, and the airline industry all benefit from government subsidy programs. These programs are also popular with political leaders, as they tend to create voter support among the employees of such companies, while also garnering generous campaign contributions from the corporations themselves.

Regulatory policies are aimed at individuals, businesses, and governmental institutions. These policies cover a wide range of activities and services, from advertising to public utilities. The Environmental Protection Agency (EPA) regulates the amount of pollutants that can be released into the air and water. The SEC is a regulatory agency that oversees the stock market as well as other financial exchanges. The SEC was initially created to prevent another depression; however, its modern role also includes investigating corporate corruption, such as the Enron scandal, and fraud, such as Bernie Madoff's Ponzi scheme in 2008.

Redistributive policies are aimed at giving assistance to those who are seen as needing financial assistance. If you plan to apply for financial support for college, you too will likely be the recipient of government-subsidized loans, federal grants, or both. Many of these programs originated during the Great Depression or the Great Society policies in the 1960s (Medicare, food stamps). The most recent additions have been health insurance subsidies the help millions afford medical coverage under the Affordable Care Act (ACA), or Obamacare. Such programs have become a source of controversy in recent years. Public opinion remains divided on whether or not these policies should continue in their present form or if they should be substantially reduced.

GRANT PROGRAMS

The system of federal grants continues to be a source of controversy among conservatives with regard to policy and funding. Congress grants states money for programs that the states control but requires certain federal rules be followed. States sometimes chafe under federal rules but most follow them or lose federal funding. One example of this dynamic is how the federal government regulated highway speed limits, although that power was officially left up to the states. A 1973 law prohibited federal highway grants for states with interstate speed limits set higher than 55 mph. The law was repealed in 1995, but for more than 20 years, the federal government was able to regulate the speed limit on a national level. A more recent example of the effect of federal grant regulation can be seen in our public education system. The **No Child Left Behind** federal education plan emphasizes the accountability of public schools. However, the program has been accused of being an **unfunded mandate**. This means that the government has created stricter federal requirements but has not allotted any federal funding to help schools adhere to these new requirements. The Americans with Disabilities Act, which requires nearly all private businesses to be accessible to disabled citizens but does not assist business owners with the cost of conforming to the act, is another example of an unfunded mandate.

THE BASICS OF POLICY DEVELOPMENT

- **Agenda setting.** Modern-day presidents have often taken the lead in setting the government's legislative agenda and Congress also plays a major role in this process. Congress often listens to public opinion as a cue to what issues should be addressed. Polls and media reports often influence perceptions of what issues appear to be most important.
- **Policy formulation.** Proposed actions require studies of potential costs, logistical concerns, long- and short-term effects on the affected parties, as well as other considerations. To create a clearer picture of the effects of a proposed policy, political leaders look at **cost-benefit analysis** data to compare the probable costs with the projected benefits. If a problem exists but the proposed policy is costly, then the issue might be dropped. These are often the result of OMB and CBO analyses.
- **Policy adoption.** This is the part of the process that receives the most media attention. A proposed policy is submitted as a bill to Congress. It is debated in the committee system and revised until it either dies or passes through Congress to the executive branch.
- **Policy implementation.** Someone must implement any new policy. Depending on the scope of the policy, an agency within the executive branch may be selected. In response to the terrorist attacks of September 11, 2001, a new cabinet department was created to oversee homeland security. Independent government agencies, such as the SEC and the EPA, are more specialized and don't generally implement policies outside of their specific area of focus.
- **Policy evaluation.** The public and the government react to the new policies and programs and then decide whether or not any changes are needed. After the online Federal Market Place for health insurance was introduced in 2013, the public found it worked poorly. The government then went about implementing changes to improve it.

MAJOR DEVELOPMENTS IN DOMESTIC POLICY

Late 1800s: Gilded Age and Populism	The beginnings of policies for workers developed. Major battles occurred over the issue of union rights. European reforms on child labor influenced the United States. The People's (Populist) Party platform of 1892 brought radical calls for policy changes. Examples included legalizing unions, funding for public transportation, civil service reform, a national currency, graduated income taxes, and new banking regulations.
Early 1900s: Progressive Era	The breakup of Standard Oil signaled moves to control monopolistic business practices and trusts. The Panic of 1907 brought calls for banking reforms and led to the creation of the Federal Reserve System. Women were granted suffrage (the right to vote). The collapse of the stock market in 1929 led to calls for financial regulation policy.

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MAJOR DEVELOPMENTS IN DOMESTIC POLICY (con't)

Mid-1930s: The Great Depression, New Deal	The executive branch moved to the forefront of economic policy development. Social Security was adopted as a major social safety net. WWII military spending created a long-term reliance on military jobs, contracts, bases, and industries.
Late 1900s: Cold War Era, Great Society	Government led attempts to reduce poverty, support agricultural production through subsidies, control inflation, and spur economic growth. Medicare and Medicaid programs were established, and discussions were held concerning changes in medical care. Environmental protection programs were created, rights were established for those with disabilities, and the government moved to increase financial support for public schools.
Early 2000s	The environment has remained a major issue with renewable energy and less reliance on foreign oil having come to the forefront. Since 9/11. there has been an increase in domestic digital surveillance. Healthcare reform reemerged as an issue, especially since President Obama took office in January 2009.

MAJOR FORMS OF FEDERAL ASSISTANCE TO STATES AND LOCAL GOVERNMENTS

Grants-in-Aid (Categorical Grants)	Grants are given for specific policy programs.
Block Grants	Community development, law enforcement, and education programs are examples of purposes for specific blocks of money.
Formula Grants	Federal rules indicate who gets the grants and how they apply. If states want to use these funds, they must abide by the rules.
Project Grants	Competitive bids are required, and often some matching funds are required from state and local governments.

CHAPTER 18: FOREIGN POLICY: MILITARY AND ECONOMIC

IF YOU LEARN ONLY FOUR THINGS IN THIS CHAPTER . . .

1. The vast majority of military conflicts involving the United States were conducted without congressional declarations of war. This shows the primacy of the executive in the development of foreign policy.
2. Treaties have often been replaced by executive agreements that do not require Senate approval.
3. The president is able to rely on a large staff and support network when considering foreign policy decisions. Congress does not have this network at its disposal.
4. Not without controversy, the United States remains a leader of key international organizations such as the United Nations, the World Trade Organization, and the International Monetary Fund.

INTRODUCTION

Foreign policy decisions have always been a special power of the executive branch. The need for forceful leadership, speedy decisions, and direct negotiations gives the president control over most interactions with foreign powers. Congress has authority to ratify treaties, confirm ambassadors, and control the budget, but the president's roles as negotiator, receiver of diplomats, and commander-in-chief are paramount. Foreign policy agreements can be unilateral (made by the United States alone), bilateral (made between the United States and another nation), or multilateral (made among the United States and two or more other nations).

The history of power changes in the government often details the history of presidents pushing foreign policy and military initiatives. The vast majority of past military conflicts have occurred because the president ordered the deployment of troops. In only five instances in the past did Congress actually declare war.

WARS DECLARED BY CONGRESS

- 1812: Against the United Kingdom
- 1846: Against Mexico
- 1898: Against Spain
- 1917: Against Germany, Austro-Hungary
- 1941: Against Japan (Germany and Italy declared war on the United States after December 8, 1941.)

MILITARY CONFLICTS WITHOUT FORMAL DECLARATIONS OF WAR

- 1801: Barbary Coast
- 1817: Florida, Spain
- 1845: Mexico: Border fight
- 1861: Civil War
- 1899: Philippines
- 1899: Cuban insurgents
- 1900: China (Boxer Rebellion)
- 1917: Mexico (Pancho Villa)
- 1918: Russian Revolution
- 1950: Korea (until 1953)
- 1954: Guatemala
- 1958: Lebanon
- 1961: Cuba (Bay of Pigs)
- 1962: Vietnam (until 1972)
- 1965: Dominican Republic
- 1970: Cambodia
- 1980: Iran (hostage crisis)
- 1983: Grenada
- 1983: Lebanon
- 1987: Persian Gulf
- 1989: Panama (Noriega)
- 1991: Iraq/Kuwait
- 1992: Somalia

- 1999: Bosnia/Kosovo
- 2001: Afghanistan
- 2003: Iraq

MAJOR FOREIGN POLICY MAKERS

The primary duty of the **State Department** is conducting American foreign policy. It performs this duty by trying to avoid or resolve any situation that could result in the use of American military force. To decrease the need for military force, the State Department negotiates with other nations, provides financial aid, promotes American business interests, and protects American citizens abroad. The president's chief foreign policy adviser is usually the secretary of state. He or she runs the State Department and has undersecretaries to fulfill duties in specific foreign policy areas. The secretary of state spends a significant amount of time meeting and negotiating with foreign leaders.

The **Foreign Service** is a division of the State Department, but its representatives, such as **ambassadors**, represent all government interests and usually coordinate their work with various federal agencies.

Congress created the **National Security Council** (NSC) in 1947 to serve the president in forming foreign and economic policies that promote national security. The national security advisor, who is appointed by the president, often rivals the influence of the secretary of state in the formation of foreign policy. Under Presidents Richard Nixon and Gerald Ford, Henry Kissinger served as both the secretary of state and the national security advisor, but this is rare.

Congress also created the **Central Intelligence Agency** (CIA) in 1947 to gather and analyze information needed to make foreign policy decisions. The CIA director, who is appointed by the president and approved by the Senate, and his or her staff monitor and report on developments around the world.

The **Department of Defense** (DOD) specializes in defense policy. Headquartered in the **Pentagon**, the DOD is comprised of all three branches of the military (Army, Navy, and Air Force), the leaders of which all work under the supervision of the secretary of defense. The **Joint Chiefs of Staff** is a five-member group that advises the president, the national security advisor, and the secretary of defense on military issues. It is made up of the chiefs of staff of all three branches of the military, the commandant of the Marines, and a chairperson, who is a top-ranking military officer appointed to the role by the president.

THE RISE OF "AGREEMENTS" OVER TREATIES

In addition to military powers, the executive branch has diplomatic powers that the legislature does not control. Presidents make executive agreements with foreign leaders that do not require senatorial approval. These agreements are so common in modern times that treaties are less frequently proposed. Recently, treaties aimed at the reduction of nuclear weapons have been met with considerable congressional opposition. Presidential administrations find it much simpler to cut deals at the agreement level and then wait to see if they work. If formal treaties are then needed, they can be negotiated. The collapse of the Soviet Union significantly reduced the need for military alliances coordinated through treaties.

THE IMPORTANCE OF POLICY DECISIONS

Foreign policy decisions are critical and sometimes long lasting. They usually do not involve military actions. Most policies concern programs of financial assistance through grants, loans, or building projects. The United States also works with the major international organizations, such as the United Nations (UN) and the World Trade Organization (WTO), which takes a leading role in promoting free trade. The United States also remains a leading member of the North Atlantic Treaty Organization (NATO), the North American Free Trade Agreement (NAFTA), the World Band, the International Monetary Fund (IMF), and other international associations. In August 2005, President George W. Bush signed the legislation establishing the Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR). In March 2012, after a half decade of negotiations, the United States-South Korea Free Trade Agreement took effect. This removed tariffs from 80 percent of U.S. manufactured goods and two-thirds of farm products to South Korea

UNITED STATES AND INTERNATIONAL TRADE

The United States will probably be increasingly affected by a world of increasing international trade and interlocking political connections. There are serious domestic debates between the two major parties about America's involvement in the UN and the WTO.

Many conservatives dislike the idea that the United States must cooperate with foreign governments. Many liberals dislike the abuses that some international corporations heap on workers and the environment under free trade agreements. This conflict will be difficult to resolve, but the arguments will not stop the continued interconnectedness of world governments and the internationalization of markets.

INTERNATIONAL ORGANIZATIONS AFFECTING FOREIGN POLICY

- **Free trade agreements (FTAs).** The U.S. currently has agreements with 20 countries, including South Korea, that have removed tariffs on most trade between the agreements' countries.
- **European Economic Union (EEU, EU).** Although not a member, the United States is greatly affected by the formation of this large free-trade zone. The creation of the EU requires the United States to deal with a united Europe when making foreign policy decisions that affect trade and defense.
- **G-7 summits.** These are meetings that are held by leaders of the United States, Great Britain, China, Germany, France, Japan, and Canada. The meetings are held to further international cooperation and economic development.
- **International Monetary Fund (IMF).** The United States is a leading member of this organization, which acts like a bank of last resort to save countries from defaulting on loans. This was recently seen in Greece, where the IMF provided loans in order for the country to be able to pay back its original lenders. Controversially, its loans typically require the government to make unpopular economic policies.
- **Multinational Corporations.** Foreign policy is being shaped by increasingly multinational ownership of property, financial instruments, and companies.
- **NAFTA.** The North American Free Trade Agreement was approved during the Clinton administration and created a free-trade agreement that affects the United States, Canada, and Mexico.
- **North Atlantic Treaty Organization (NATO).** Originally organized to protect Western Europe from communist aggression, NATO has changed and expanded greatly since the fall of the Soviet Union. NATO now includes former communist countries of Central and Eastern Europe.
- **United Nations (UN).** The UN attempts to promote world peace and human rights. It has 193 member nations and is headquartered in New York City. The UN includes a number of important components, including UNESCO and UNHCR.
- **World Bank.** This international organization gives loans to developing nations.
- **World Trade Organization (WTO).** Created in the late 1990s, the WTO's main goal is to expand free trade.