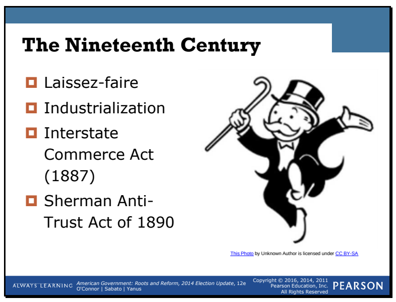
Slide 1

What role does the government play in stimulating the economy? Congressional Budget Office Director Douglas Elmendorf testifies that projected tax hikes and spending cuts for 2013 could put the United States back into recession.

Slide 2



Prior to industrialization, the federal government adhered to a simple form of laissez-faire when it came to economic policy. At the time, people believed the government should meddle as little as possible in the economy, and should restrict itself to maintaining general order.

That changed when industrialization brought increased accidents and disease, and huge corporations exploited workers and the economy. Industrialization worsened the effects of the natural business cycle of growth followed by recession.

The first time the government stepped in to regulate on a large scale involved the railroads. The Interstate Commerce Act, passed in 1887, required railroads to be "just and reasonable." This was followed by the Sherman Anti-Trust Act of 1890, which prohibited price-fixing, bid-rigging and monopolies.

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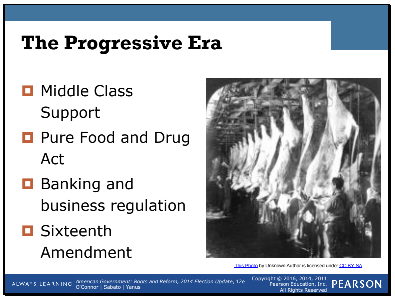

The Progressive movement, which drew support from the middle class, sought to reform the political, economic and social systems in the United States. For example, the Pure Food and Drug Act and the Meat Inspection Act were passed in 1906. They represented the beginning of consumer protections.

Regulation of the financial and business sectors soon followed. Congress passed the Federal Reserve Act in 1913 to regulate the national banking system and provide for more flexibility in the money supply. Flexibility was needed to meet commercial needs and prevent financial panic attacks.

But regulation costs money, and by 1913 Congress was searching for ways to raise revenue. The Sixteenth Amendment was passed in 1913 to allow for collection of the federal personal income tax.

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As you may recall, the American economy grew at a rapid rate until the stock market crash. During the Great Depression, the federal government added layers of regulation to the economy. Some of the financial reforms included the Glass-Steagall Act, which created the Federal Deposit Insurance Corporation, or FDIC, which guaranteed deposits.

Other financial regulations included the Securities Act and the Securities Exchange Act, which set up the independent Securities Exchange Commission and required that prospective investors be accurately informed before investing.

In the agricultural industry, the government provided additional regulation through the Agricultural Adjustment Act, which granted subsidies to farmers. Also during this time, the National Labor Relations Act, also known as the Wagner Act, sought to regulate industry by guaranteeing workers the right to unionize. The government also expanded regulations in the communications, civil aviation and trucking industries.

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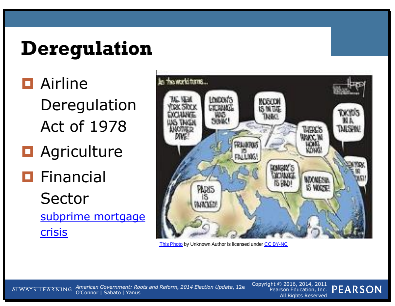

After decades of increasing regulations, political leaders began calling for deregulation of industries. Deregulation involves reducing government control in favor of market-based competition.

One of the first industries to undergo deregulation was the airline industry. The Airline Deregulation Act of 1978 eliminated all economic regulations of the industry. But deregulation actually reduced the number of carriers and competition, which was not what people had expected.

Despite this, Congress also sought to deregulate agriculture and limit farm subsidies in 1996. But in 2002 those subsidies were put back in place.

Deregulation of the financial and banking sectors in the 1990s played a major role in the subprime mortgage crisis that began in 2007.

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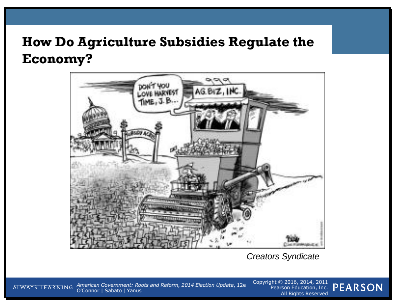

Subsidies are government funds paid to farmers to grow—or not grow—particular crops. They have come under fire in recent years because they disproportionately benefit the wealthiest farmers.

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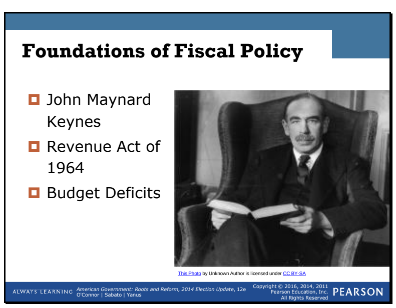

In the 1930s, British economist John Maynard Keynes suggested that governments could prevent the worst of recession by stimulating overall demand, even if it meant running a temporary deficit. This was a major departure from the laissez-faire thinking that had dominated economic policy up to this point.

Keynesian economists argued that increasing demand would increase employment and stimulate a cycle of economic growth. But in America, conservatives objected to running up deficits, even to boost the economy. A compromised was reached in the form of the Revenue Act of 1964, which increased demand by cutting personal and corporate taxes rather than by increasing government spending.

In fact, the legislation did expand the economy and even led to just 4 percent unemployment. But the deficit did increase, and grew even larger when President Ronald Reagan cut taxes even more. Economists warn that budget deficits may be fine in the short term, but in the long run can lead to harmful inflation.

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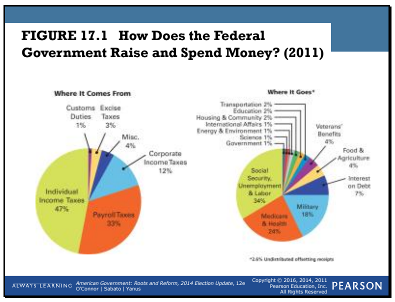

The federal government budget outlines how taxpayer revenues are raised and spent, summarizing the priorities of federal government policy making.

Source: *United States Budget, Fiscal Year 2011, www.gpoaccess.gov.*

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It may be too soon to call the economic slowdown that began in 2008 history. But when it began, government responded in true Keynesian fashion: it created demand. First came the $168 billion stimulus package that included tax rebates that the government hoped middle class people would use to spend money and boost the economy. But that wasn't enough, especially with the subprime mortgage industry in crisis.

Another $700 billion went to bailout that industry, and the Troubled Assets

Relief Program, or TARP, sought to buy up the assets that had led to the crisis. Even that wasn't enough; although TARP had helped stabilize the banks, individuals were still hurting.

In 2009, Congress passed the $787 billion American Recovery and Reinvestment Act, which authorized spending on a variety of tax cuts and public works programs to stimulate the economy and create jobs. But many of those gains were negated by cuts in government spending at the state and local levels.

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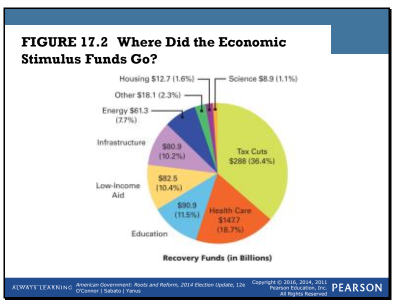

The American Recovery and Reinvestment Act allocated almost $800 billion to aid in the economic recovery. The largest proportion of these funds—more than one-third—went to tax cuts.

Source: *U.S. Government, www.recovery.gov.*

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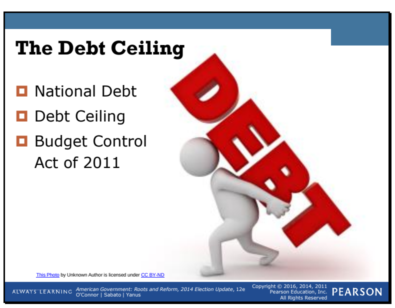

Debate over the debt ceiling raged in 2011. Congress had merely increased it as needed over the years. But the cumulative effect of Bush-era tax cuts, wars in Iraq and Afghanistan, and various bailout packages had led to a national debt that reached $14.2 trillion in 2011. That was the limit of the debt ceiling, which is similar to a credit card limit except Congress can vote to raise the ceiling as needed to pay for Medicare obligations or make interest payments on the debt.

In 2011, conservatives in Congress refused to raise the ceiling without significant cuts in spending. Government reached a standstill, until compromise was reached in the form of the Budget Control Act of 2011. This authorized a series of debt ceiling increases, but also required extensive spending cuts in 2013 that Congress acted to stop late on New Year's Eve, after partisan gridlock had stalled compromise for weeks.
Today, the federal budget is funded for the next few weeks and the U.S. Federal Debt is nearing $21 trillion.

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Our fiscal policy doesn't affect us alone. Increasing globalization means that the fiscal policies of one country can affect others. We have seen increasing globalization in recent years in the form of greater movement of goods, services and capital across borders, and this has led to greater variety of goods for consumers, lower costs and increased standards of living in developing countries.

Increased globalization also carries risks. As we saw in 2012 with Greece and Spain, economic downturn in one country can significantly affect countries that are connected through globalization. One way to measure this increasing interdependence is through regional share of gross domestic product, or GDP. In 2012, the United States, the European Union and Asia each represented about 25 percent of the world's GDP. In contrast, Latin America and the Middle East each held another 3 to 7 percent.

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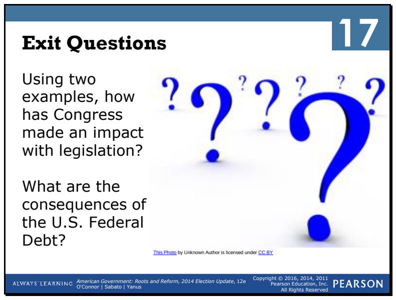
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Exit Questions
Using two examples, how has Congress made an impact with legislation?
What are the consequences of the U.S. Federal Debt?
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