"Theories of U.S. Economic Policy"

Economic policy refers to the actions that governments take in order to influence the economy. This usually involves controlling interest rates, regulating businesses, income redistribution, and various other monetary controls. Due to the global connectedness of financial markets, such policies must consider events on the international stage. Global financial institutions, such as the International Monetary Fund and the World Bank, work with countries to foster monetary cooperation, financial stability, and sustainable economic growth.

Under Article 1, Section 8 of the U.S. Constitution, the federal government and the states are given the concurrent powers to enact taxing and spending policies for the "general welfare" of the country. The Founding Fathers believed it critical to include this clause. Under the Articles of Confederation (the first written constitution of the U.S.) the central government had no authority to lay and collect taxes and was forced to rely on donations from individual states. This policy wreaked havoc on the fiscal system and brought the new nation to the brink of economic collapse.

Over time, the courts have interpreted the tax and spend clause to be very broad; however, beliefs about how this power should be utilized has been intensely debated by U.S. policymakers for years. Differences of opinion on this issue are usually based on competing philosophies about how much government should be involved in regulating the economy. The onset of the 2008 financial crisis, subsequent recession, and stubbornly high unemployment rates have only served to intensify the ongoing debate over U.S. economic policy.

Four macroeconomic theories of performance, structure, and behavior of markets have dominated U.S. governmental policies. The country's varying degrees of successes and failures with each of these policies underscores the complicated and volatile nature of economic supply and demand.

- *Laissez-faire economics* is the belief that economic markets should operate entirely free of government intervention in order to operate most effectively and efficiently. The term, sometimes referred to as "let it be economics," hit its zenith in the U.S in the late 1800s during widespread industrialization. American businesses were able to operate virtually unencumbered from government; however, by the early 20th century this policy resulted in shrinking competition as competing companies began to merge. President Theodore Roosevelt fought to "bust" unlawful monopolies and increase government regulation, especially in the booming railroad and oil industries. In addition, numerous laws were passed to regulate child labor, create safer working conditions, and institute price controls.

  After the U.S. stock market crash in 1929, many blamed the unfettered capitalism of the 1920s; however, the causes were more complex. President Herbert Hoover attempted to stave off the depression with a number of governmental interventions that only exacerbated the problem (contrary to the historical view that he was a strong *laissez-faire* proponent). After Franklin D. Roosevelt was elected president in 1932 and established his “New Deal” policies, government intervention became the centerpiece of American economic policy.

- *Keynesian economics* is based upon the school of thought developed by John Maynard Keynes, a 20^{th} century British economist. Keynes’ central belief was that, in order to keep people employed, governments need to run up deficits during economic downturns through increased spending and tax breaks. Conversely, during prosperous times, governments should cut spending and institute tax hikes to curb inflation. The theory supposes a strategic interventionist role for government in order to smooth out the bumps in market cycles.

  Keynesian theory was put to the test during the 1930s—the height of the Great Depression. President Franklin D. Roosevelt embraced the idea only after other policies failed to stimulate the economy. In one of his notable “fireside chats,” he explained to the American public that it was up to the government to “create an economic upturn” and make additions to the “purchasing power of the nation.” Precipitated by U.S. entry into World War II, Roosevelt increased deficit spending, which had the effect of lowering unemployment and increasing demand for war time labor.

  For the next quarter century, Keynesian economics became the centerpiece of U.S. fiscal policy. The economy boomed until the late 1970s, when inflation and an energy crisis shook the American public’s confidence in the Carter Administration’s ability to effectively address the problems. When Ronald Reagan became president in 1981, Keynesian economics fell out of favor.

- *Monetarism* theory emphasizes that one of the most important roles of government is to control the amount of money in circulation. Monetarism gained strength during the 1970s as the country grappled with unprecedented inflation coupled with the supply “shocks” of increasing oil prices. Economists argued that Keynesian theory could not address the economic variations within a given system, such as changing rates of inflation, which are most often caused by increases or decreases in the money supply. In 1979, the Federal Reserve (the central banking system of the United States) announced that it would adopt a monetarism policy to stabilize the economy. The result was a deep recession in the early 1980s, although the policy did help to lower inflation. Monetarism was then abandoned in favor of a return to Keynesian policy.

- *Supply-side economics* argues that economic growth can best be achieved by lowering barriers to production. More specifically, supply-side economic theory rests on the notion that lowering tax rates and reducing business regulation allows for more flexibility, resulting in a greater supply of goods and services at lower prices. This theory developed as a direct response to Keynesian policy’s perceived failure to stabilize Western economies. However, its critics were quick to label it “trickle-down economics,” arguing that tax breaks and deregulation have a very limited effect, if at all, on the broader population.

The most notable proponent of supply-side theory was Ronald Reagan; indeed, he made this theory the cornerstone of his economic policy known as “Reaganomics.” Upon assumption of the presidency in 1981, Reagan pursued an aggressive policy of reducing the growth of government spending (particularly on social programs), lowering income and capital gains taxes, increasing defense spending, tightening the money supply, and reducing government regulation. This economic approach was a marked departure from previous administrations.

The policies had mixed effects. The economy during the 1980s experienced significant turbulence despite generally favorable economic conditions. Interest rates, inflation, and unemployment fell significantly during this time; however, these were coupled with rising income disparities and a ballooning federal deficit. The success of Reaganomics continues to be debated by economists and policymakers alike.