6

The Economy

Goal: *Unit Six provides a definition of the economy, and an overview of three types of economies reflecting different degrees of government regulation. It also distinguishes between short business cycles and long-term economic crises that affect the economic hardship experienced by individuals, families, and households. Practitioners using this economic lens will be better equipped to guide and support clients through both challenging and prosperous economic times.*

A. What is the Economy?

The economy refers to the system of production, distribution, exchange, and consumption that a society uses to transform natural resources, labor, capital (factors of production), into useful goods and services (the act of production) and to distribute or allocate the products to useful ends for consumption. Virtually all economies accomplish these tasks. Economic decision makers consider three basic economic questions. What to produce? How to produce it? For whom should it be produced? The answers to these questions and who decides, depends on how leaders in business and government define the nature of the relationship between the government and the market economy. When we look around the world we see that nations answer these questions and organize their economies in one of the following three ways.[1]

B. Types of Economies

1. **Free Market Economy.**[2] The free market economy refers to an economic system

where the government allows for the interaction of supply, demand and other regular market dynamics to determine what to produce, where to produce, what prices to set, and how to allocate scarce resources between alternative uses. A true free market or laissez-faire (let it be) economy has little or no government planning, regulation or other influences.

Free markets were common in the 1700s and early 1800s. This was prior to the rise of large corporations and economic markets dominated by one (monopoly) or a few (oligopoly) sellers. Few economies exist in such a pure form in the modern world as societies rely on governments to regulate market forces in varying degrees rather than allow total self-regulation. The question of how much the government should regulate business and other parts of the economy has always been a topic of considerable public debate, but the debate intensified in recent years as negative views of the government took hold.

2. Mixed Economy.[3] A mixed economy refers to an economic system in which both the government and private enterprise play important roles with regard to production, consumption, investment, and savings. That is where both the government and private enterprise address what output is produced, how it is produced, and for whom it is produced. Most Western industrial nations, including the United States, have a mixed economy. Mixed economies rely more heavily on government intervention than do free market economies but have less reliance on government regulation than in a planned economy. Mixed economies involve market mechanisms but also government-operated institutions and controls.

In a typical mixed economy, the government may operate the postal service, rail lines, libraries, and in many cases, the health care service. Even in industries that are not owned or run by the government, the government plays a central role through activities including raising taxes and issuing regulations. Minimum wages, fair labor standards, Social Security, anti-trust laws, banking regulations, the Tax Code, as well as consumer and environmental protection are examples of government involvement in the market economy in the United States.

In mixed economies, governments also address issues beyond the reach of market forces, including the provision of social welfare benefits to people who cannot find a job or earn enough in the market and activities that cannot yield a profit but may benefit society. Examples are a lighthouse in the harbor or the paving and maintenance of roads and bridges.

3. Planned or Command Economy.[4] A command or centrally planned economy refers to an economic system where a central government authority makes decisions about allocation of resources, production, distribution, and consumption rather than allowing market forces to play a major role. A planned economy may consist of state-owned enterprises, private enterprises directed by the state, or a combination of both. Central planners determine the assortment of goods to be produced, allocate raw materials, fix quotas, and set prices.

Most socialist and communist countries have tried to implement parts of a command economy. Capitalist countries may also adopt such a system during national emergencies (i.e. wartime) in order to mobilize resources quickly. Beginning in the 1980s and 1990s, many governments presiding over planned economies began to deregulate and move toward mixed economies by increasing the role of the private sector and allowing private enterprise to make more pricing, production, and distribution decisions.

4. The Underground Economy. The underground economy consists of market transactions and productive activity that are unreported, sometimes illegal, and escape the watchful eyes of official record keepers. It is sometimes referred to as the informal, parallel or shadow economy. Many people work only in the shadow economy, because they find it more profitable to do so or because they are barred from the official economy—as is the case for most undocumented immigrants. Off-the-books employment is not taxed and is not calculated into benefits calculations. Some people receiving unemployment, SSI, or Public Assistance might work off the books so their reported income will not rise above the income requirements of the case assistance programs. In this way they supplement their typically low income.

By most estimates, a substantial amount of productive activity takes place in the underground economy for the United States. Of course, these are only estimates because such activity, by definition, goes unreported. Were activity in the underground economy added to official activity in the "overground" economy, then gross domestic product could be boosted by as much as 25 to 50%.[5]

RESOURCE:

"Nannies Under the Table"
From the New York Times

http://economix.blogs.nytimes.com/2010/08/30/nannies-under-the-table/?_r=0

C. The Workings of the Economy.

The economy is dynamic in nature. Its activities fluctuate in response to both short business cycles and longer economic waves. Both economic cycles and waves deeply affect human services practice and social welfare policy. Their turbulence can create widespread economic insecurity and market instability that falls heaviest on the most economically vulnerable individual, families and communities.

1. What is The Business Cycle? The United States and all other modern industrial economies experience regular business cycles, often called economic ups and downs. In some years, most industries are booming and unemployment is low; in other years most industries are operating far below capacity and unemployment is high. Economists refer to periods of economic prosperity as expansions or booms and periods of economic decline as recessions, depressions, contractions or busts. They call the combination of booms and busts the business cycle or the periodic but irregular fluctuations (ebb and flow) of economic activity. Each of these wave-like movements typically contains a complete cycle that lasts from three to five years but could extend to ten years or more.[6]

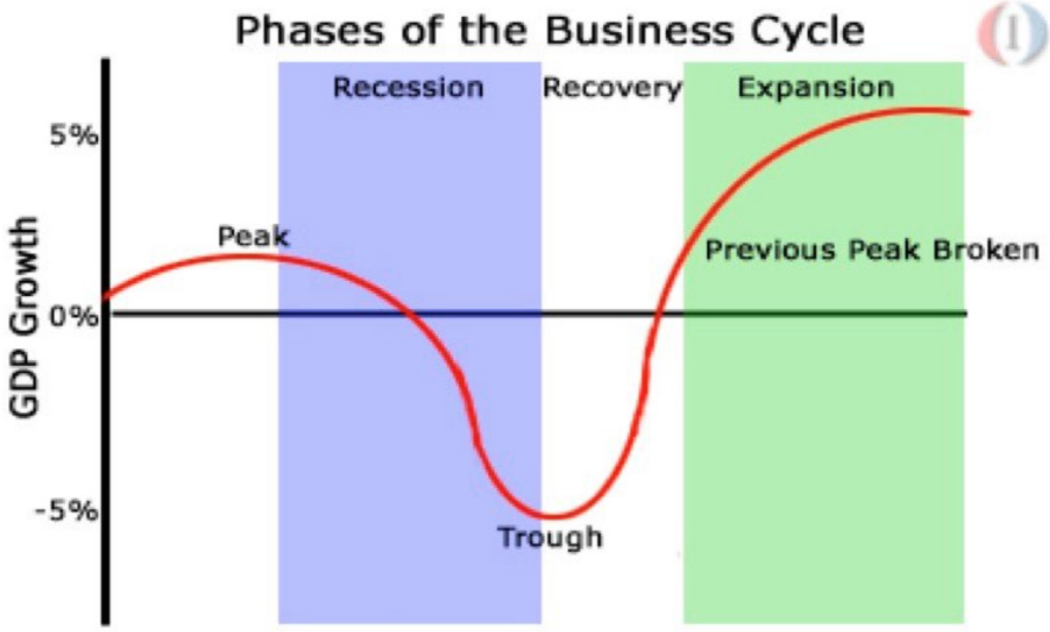

Fig. 6.1 Phases of the Business Cycle

The *peak* of the cycle occurs at the point when the economy is running full-steam. That is, key economic indicators, such as employment, output, and new housing starts reach a high. After experiencing a great deal of growth and success, income and employment begin to decline. In other words, the peak marks the end of the expansion and the beginning of a contraction that leads into a trough, that is, the lowest point of the contraction. This point in the business cycle--when output and employment bottom out--can last a short time, be prolonged, or end rather quickly.

In any case, the point of the trough identifies the end of contraction/recession and the beginning of the recovery or expansion. In the expansion or recovery phase, the economy begins to grow once again, moving away from the low experienced at the trough. Employment, production and income all undergo a period of growth and the overall economic climate improves.[8] These standard downturns stem from ordinary imbalances in the market and are typically resolved with minimal political conflict and little or no structural change.[9]

The Nature of the Business Cycle has Changed

The nature of the business cycle has changed in recent years in ways that affect human service clients, workers, and agencies as well as the broader society. A surge in jobs used to be a reliable sign of the end of a recession — but not any longer. Economists describe four of the most recent economic recoveries (1981, 1990, 2001, 2009) as "jobless recoveries" because employment growth fell far behind economic growth. The 2008 recession was both the longest post-World War II recession and the deepest.[10] That is, the unemployment rate reached historic highs comparable to the early 1980s and the post-recession job growth was unusually weak. People who lose their jobs, homes, and other important economic supports during such economic slumps often turn to human services agencies for help.

2. Measuring the Business Cycle. The National Bureau of Economic Research, an independent research institution, determines the official dates of peaks and troughs in U.S. business cycles.[11] It dates the beginning and end of a business cycle according to when the direction of economic activity changes. Because key economic indicators often change direction at slightly different times, the dating of peaks and troughs necessarily involves a certain amount of subjective judgment. The 20th century had 25 business cycles.[12]

Fig. 6.2 Not a Recession[13]

3. Long Economic Waves and Economic Crises. An economic crisis is defined as an economic collapse that is part of a long economic cycle. According to some economists, long economic waves refer to 30-to-50 year cycles that include about 15 to 25 years of strong economic growth and prosperity followed by 15 to 25 years of economic decline (or slowed economic growth) that often end in a major economic crisis. The resulting crisis reflects the deterioration of the institutional arrangements that had previously supported profitability and productive economic growth (see below).

The resolution of such a crisis typically follows considerable political conflict that eventually forces a reorganization of major social, economic, and political institutions.[14] Such a deep crisis differs from a recession that represents the low point in the ordinary, more frequent and short-lived business cycle discussed earlier.

Fig. 6.3 Main Street vs. Wall Street[15]

4. Background Leading to the Current Economic Crisis. The U.S. has faced two long-term economic crises during the 20th century. The first, the Great Depression, surfaced with the collapse of the economy in the 1930s. The second, less dramatic but equally important, crisis surfaced in the mid-1970s marked by slow economic growth and falling profits. Each crisis resulted in a major reorganization of the nation's economic institutions and sparked very different governmental responses.[16]

The New Deal ushers in restructuring of the economy

The nation's leaders defined the causes of the Great Depression to be failures of the free or laissez-faire market system that had long governed economic activity. For the first time, they actively called upon the federal government for help. After considerable political struggle, Washington responded with the New Deal policies that ushered in a major restructuring of the economy based on redistributing income downwards from the haves to the have-nots and expanding the role of the federal government.

Among other institutional reforms the strategy included: a progressive income tax (i.e. 25 brackets), a tax rate of 94 percent on the top bracket, a high rate of corporate taxation, and the 1935 Social Security Act. The Social Security Act launched the modern welfare state in the United States by transferring social welfare responsibility from the states to the federal government and creating an entitlement program.

The Golden Era of Capitalism

The U.S. invested in social welfare about 50 years after the majority of industrial states.[17] It was followed in the 1960s and 1970s by the War on Poverty and Great Society programs that continued government social investments. From 1935 to 1975 increased revenues and greater administrative capacity allowed the federal government to respond more fully to population growth, the emergence of new needs, and the demands of social movements. The expanded role of the government, including the welfare state, was accompanied by prosperity, steady economic growth, falling poverty, and less inequality. Some call it the "golden era of capitalism."[18]

End of post-war prosperity in the seventies

The second crisis surfaced in the mid-1970s and signaled the end of postwar prosperity and growth. Many national leaders blamed this crisis on "big government" (especially the welfare state), "personal irresponsibility" and the gains of the post-war social movements, especially the labor, civil rights and women's liberation movements. Instead of turning to the government for help as they did in the past, leaders sought to limit the role of the (what they saw as a "bloated") welfare state.[19]

This created growing tension with what others saw as the government responsibility to protect people in need. More specifically, national leaders tried to undo the New Deal and Great Society programs by redistributing income upwards from the have-nots to the haves and downsizing the state. Since then public policy has systematically: cut taxes, dismantled social programs, shifted social welfare responsibility from the federal government back to the states (devolution) and from the government or public sector back to the private market (privatization).

Public policy has also limited the influence of social movements (whose post-war victories, some argue, contributed to economic growth) as well as individual societal well-being.) They add that if social movements regained their strength, they might successfully resist the new austerity plan.

Reaganomics: standard of living in average household falls

The New Right's revival of laissez-faire economics, known as Reaganomics or Supply-Side Economics has driven U.S. economic policy since 1980. The proponents of Reaganomics promised that benefits of their pro-market, anti-government strategy would trickle down to the average person. The resulting tax and spending cuts vastly increased the wealth of individuals and profits of many corporations. Instead of trickling down, the standard of living of the average household fell. Reaganomics also promised the taken together these policies would promote economic growth.

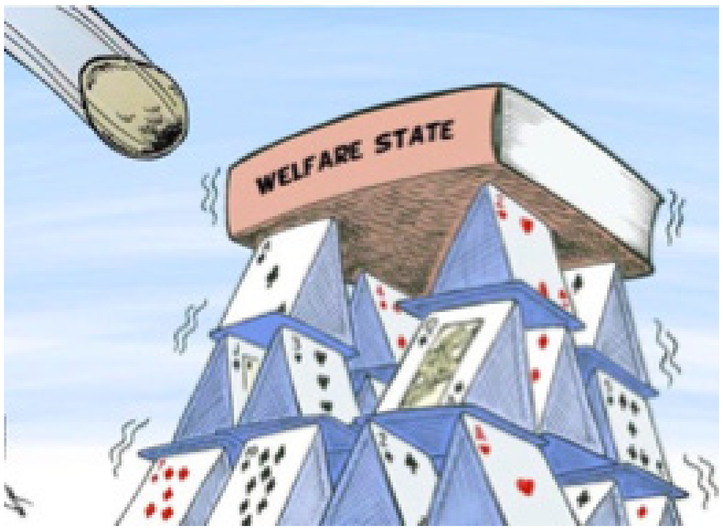

Fig. 6.4 Welfare State in Danger [20]

But the data show that during this period economic growth slowed. From 1947 to 1973 - the big government era - the economy grew by an average of 4% a year. In the era shaped by Reaganomics (aka Neoliberalism) (1979-2013), the annual growth rate dropped to 2.65 percent.[21]

Slowed economic growth has a long-term effect

Over the long haul, the slowed economic growth led to ever-increasing jobless recoveries. These brewing economic problems contributed to the first economic crisis of the 21st century, marked by the burst of the housing bubble, record high unemployment, very low levels of investment, reduced liquidity, and the stock market crash in 2008. Between 2007 and 2009, economic growth slowed even more, measuring minus 1.01%. President Barack Obama's short-term response to this economic calamity included the well known stimulus package – a combination of remedies such as tax cuts, state aid, and support for "shovel-ready" (i.e. construction) projects. He also extended unemployment insurance benefits as part of the deal made with the Republicans that allowed the "Bush tax cuts" to continue until 2012.

Congressional stalemates have stalled most spending during the Obama Presidency. Therefore, the major economic stimulus came from the Federal Reserve Board ("The Fed"). The FED's policies both lowered interest rates and initially bought $85 billion in government bonds. These policies are also known as "monetary easing" or "quantitative easing" (see Monetary Policy below). More recently, as the economic improved, the FED began to reduce the dollar value of bonds purchased, and to lessen its effort to stimulate the economy in other ways. Longer-term solutions to the deep crisis depend on the capacity of the currently deeply divided Congress to find common ground.

For Discussion:

1. How do you see the effects of large economic policies and business cycles on your clients and agencies?

2. How could you use this information to inform a strengths-based conversation with a client about economic hardship like the loss of a job or difficulty paying expenses?

NOTES
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