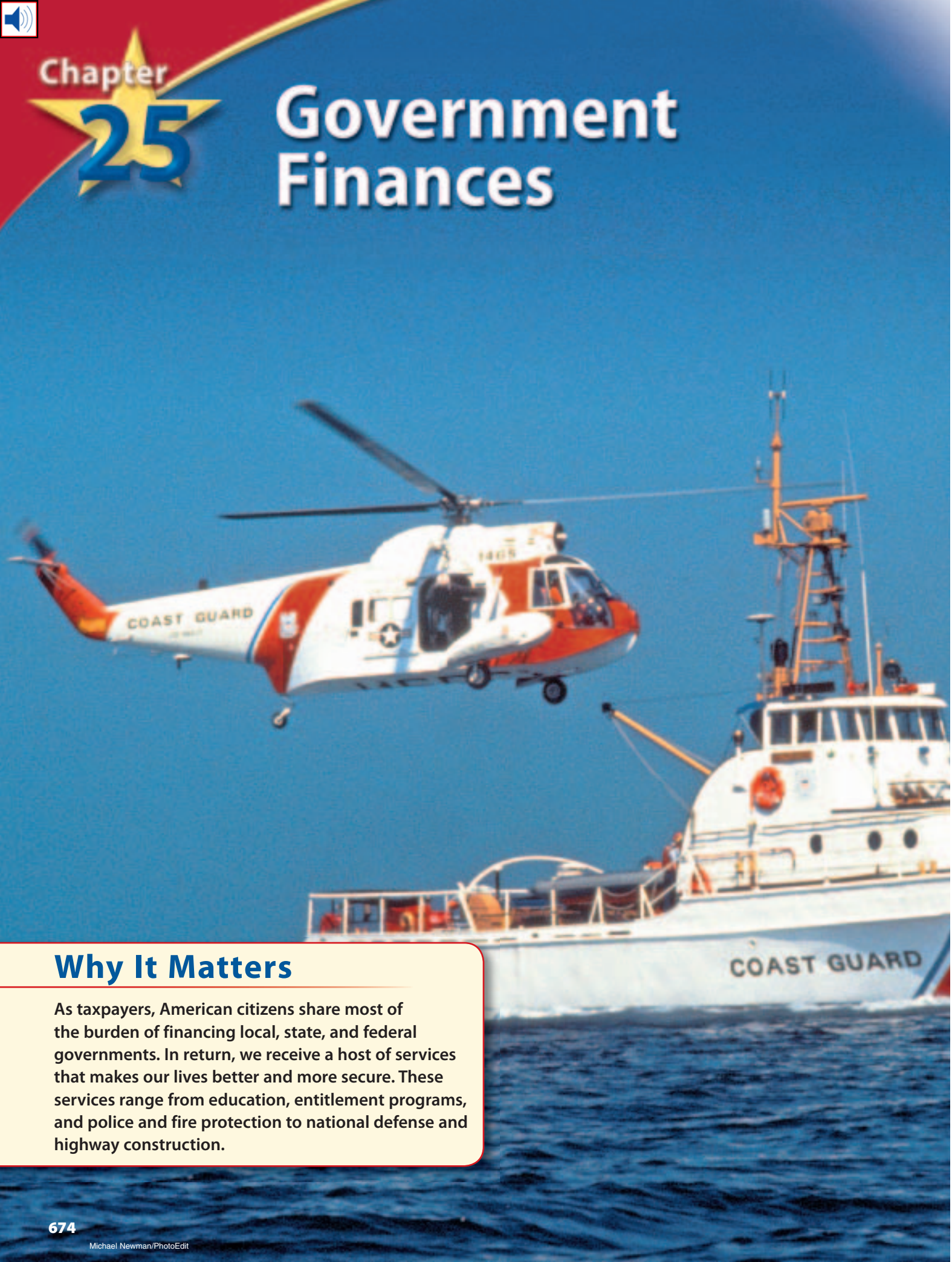
Chapter 25

Government Finances



Why It Matters

As taxpayers, American citizens share most of the burden of financing local, state, and federal governments. In return, we receive a host of services that makes our lives better and more secure. These services range from education, entitlement programs, and police and fire protection to national defense and highway construction.

Michael Newman/PhotoEdit

BIG Ideas

Section 1: The Federal Government

Under our federal system, the executive, legislative, and judicial branches share the responsibility of governing the nation. The president and Congress work together to create the budget—a blueprint for raising and spending the nation's money.

Section 2: State and Local Governments

Political and economic institutions evolve to help individuals and groups accomplish their goals. State and local governments have their own revenue sources and decide how to spend the money they take in.

Section 3: Managing the Economy

Political and economic institutions evolve to help individuals and groups accomplish their goals. Governments use various tools to manage the economy.

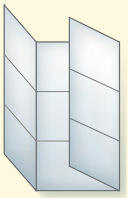
Coast Guard helicopter on patrol with Guard cutter

FOLDABLES™ Study Organizer

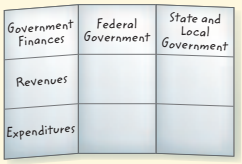
Comparing Information Foldable Make the following Foldable to help you compare the revenues and expenditures of the different levels of government.

Step 1 Fold a sheet of paper into thirds from top to bottom.

Step 2 Open the paper and refold it into thirds from side to side.



Step 3 Unfold the paper and draw lines along the folds.



Reading and Writing
As you read the chapter, use your Foldable chart to compare how money is administered among the federal, state, and local governments.

Section 1

The Federal Government

Guide to Reading

Big Idea

Under our federal system, the executive, legislative, and judicial branches share the responsibility of governing the nation.

Content Vocabulary

- budget *(p. 677)*
- mandatory spending *(p. 677)*
- discretionary spending *(p. 677)*
- appropriations bill *(p. 677)*
- Social Security *(p. 678)*
- Medicare *(p. 678)*

Academic Vocabulary

- enormous *(p. 677)*

Reading Strategy

Representing Create a diagram like the one below to identify the three largest federal expenditures and the three largest sources of federal revenue.

Expenditures	Revenues
1. Social Security	1.
2.	2.
3.	3.

Interactive Graphic Organizer

NORTH CAROLINA STANDARDS
Civics and Economics

2.08 Examine taxation and other revenue sources at the national level of government.
8.08 Evaluate the investment decisions made by individuals, businesses, and the government.
9.07 Analyze the short- and long-term effects of fiscal and monetary policy on the United States economy.

Real World Economics Will the money be there when you retire? Social Security, the federal program designed to provide economic security for people once they retire, is often the subject of protest. Today, many younger generations of Americans are afraid they will pay into the system but never reap the benefits. That is because the Social Security system's long-term financial stability is in question, although economists have offered possible solutions.

▼ **Protesters rally against changing Social Security**

Manuel Balce Ceneta/AP Images

Preparing the Budget

Main Idea **The federal budget, created by the president and Congress, is the government's blueprint for raising and spending money.**

Economics & You Does your family spend money on things it must have then spend what is left over on things it wants but does not really need? Read to find out how your family is like the government.

Did you know that purchases made in 2005 by the federal government account for more than 7 percent of our gross domestic product (GDP)? This is an **enormous,** or very large, amount of money. Each year, the president and Congress work together to create a **budget.** This budget is a blueprint of how the government will raise and spend money.

The government's budget year differs from a calendar year. The government uses a fiscal year (FY), a 12-month period that may or may not match the calendar year. The federal government's budget year begins October 1 and ends on September 30 of the following year and must be renewed at that time.

The Budget Process

By the first Monday in February, the president proposes a budget to Congress outlining how the government should spend its money. The president then formally sends the proposed budget to Congress along with an annual budget message.

Congress then passes a budget resolution. This document totals revenues and spending for the year and sets targets for how much will be spent in various categories. Spending is divided into two types: mandatory and discretionary.

Spending that does not need annual approval is called **mandatory spending.** Examples are Social Security benefit checks and interest payments on the government debt, which must be paid every year.

Discretionary spending is government expenditures that must be approved each year. These include things such as money for the Coast Guard, highway construction, and defense. Discretionary spending makes up only about one-third of the federal budget.

Appropriations Bills Another step remains before the government can actually spend any money: Congress must pass **appropriations bills.** These are laws that approve spending for a particular activity. Appropriations bills always begin in the House of Representatives. The Senate then works with the House to pass all appropriations bills by October 1, the beginning of the fiscal year. Appropriations bills must be approved by both houses and either signed into law or vetoed by the president.

Reading Check **Explaining** How does a fiscal year differ from a calendar year?

Budget of the U.S. Government The federal government publishes a collection of documents that contains the president's budget message and other budget-related publications. ***Identifying*** **What is the first step in the federal budget process?**

Kevin Lamarque/Reuters

Revenues and Expenditures

Main Idea **The federal budget has two main parts—revenues and expenditures.**

Economics & You Do you sometimes have trouble matching what you earn to what you spend? Read to find out why the government faces the same challenge.

The federal budget contains two main parts—revenues and expenditures. The main sources of federal revenues are shown in the graph on page 679.

Revenues

Nearly half of the federal government's revenue comes from the income tax paid by individual Americans. Each year, every worker files a tax return, or a report that calculates the tax a worker must pay on his or her income. Corporations also pay income tax on profits they earn.

The second-largest source of federal income is payroll taxes, which are deducted from a worker's paycheck to fund **Social Security** and **Medicare.** Social Security provides money to people who are retired or disabled. Medicare pays some health care costs of elderly people.

Other taxes are also sources of revenue. Consumers pay an excise tax when they purchase goods such as gasoline, tobacco, and telephone services. When wealthy people die, the federal government collects estate taxes on the wealth passed on to their heirs. The government charges a tax on certain gifts. Miscellaneous sources such as entry fees to national parks also add to federal revenues.

Forms of Taxation

Taxes can be classified according to the effect they have on those who are taxed. In the United States today, these classifications include progressive, regressive, and proportional taxes.

Taxation Whenever we buy gasoline, we not only must pay for the gasoline, but also federal and state taxes on the gasoline. ***Identifying*** **What form of taxation is the tax on gasoline?**

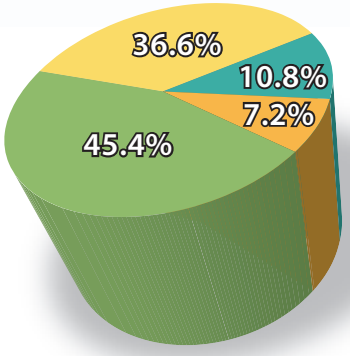
Progressive Tax With a *progressive* tax, like our federal income tax, the tax rate (the proportion of earnings taken in taxes) increases as income increases. Therefore, the higher the income, the larger the percentage of income is paid as taxes.

Regressive Tax The opposite of a progressive tax is a *regressive* tax: the percentage you pay goes down as you make more money. One example of regressive taxes is the gasoline tax. Poorer families spend a larger proportion of their income on gasoline. Therefore, the sales tax they pay on gasoline takes up a larger proportion of their total income than a wealthier family pays.

Spencer Grant/PhotoEdit

The Federal Budget, FY 2007

Revenues



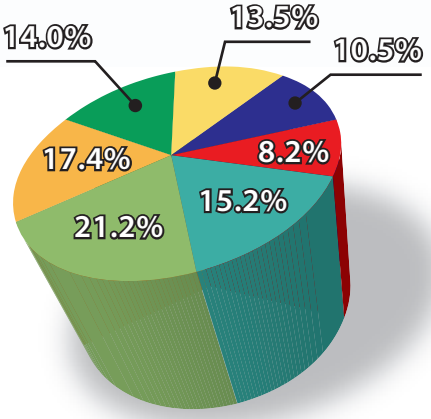
Individual income tax
Payroll tax
Corporate profits tax
Other

FY 2007

Receipts	$2,416
Expenditure	− $2,770
(Deficit)	− $354

(in billions of dollars)

Expenditures



Social Security
National defense
Income security
Medicare
Health
Interest on debt
Other

Source: *Economic Report of the President*, 2006.

Analyzing Graphs

1. **Identifying** What is the largest expenditure in the budget?
2. **Explaining** Does the 2007 budget show a surplus or a deficit? Explain.

Proportional Tax A *proportional* tax takes the same percentage of income from everyone, regardless of how much he or she earns. If there is a tax of 10 percent on all income and you earn $1,000, you pay $100 in taxes; if you earn $10,000, you pay $1,000 in taxes, and so on.

Federal Expenditures The graphs above show where the federal government planned to spend its money in 2007. Social Security was the largest single spending category. Because the number of older people in the population is growing, this expense is expected to grow in the future.

Medicare costs are also likely to rise as the population continues to age. Income security includes retirement benefits for some government workers and others, along with payments to poorer Americans for housing and child nutrition. Health costs include payments for medical research and Medicaid, which pays for health care for people with low incomes.

Defense National defense is the second-largest category of federal expenditures. The original FY 2007 budget set defense spending at more than 17 cents of every federal dollar spent. During times of conflict or war, spending for national defense is increased. Because of the war on terrorism, the 17 percent represents an increase over the percentage of defense spending before September 11, 2001.

Interest on Debt and Other Expenditures A portion of the federal budget each year goes toward paying interest on the money the government has borrowed. The amount depends on how much money has been borrowed and the interest rates of that debt. The federal government also spends on programs from education to highways to natural resources. These categories account for billions of dollars of spending.

How the Budget Process Has Changed

When the federal government began its operation under the Constitution, it had few expenditures. As the government took on new functions, federal expenditures increased greatly. President George Washington was able to put all the figures for the national government's expenditures for one year on one large sheet of paper. Today the federal budget consists of more than 1,000 pages of small type.

Changing Roles During much of American history, presidents traditionally played a limited role in researching and drawing up the budget. Various federal agencies usually sent their budget requests directly to the secretary of the treasury, who passed them on to Congress.

The Budget and Accounting Act of 1921 changed this procedure in an effort to streamline the process. As a result of this law, the president is responsible for directing the preparation of the budget and making the major decisions about national budget priorities. The law requires the president to propose to Congress the budget for the entire federal government, each fiscal year. This budget must be delivered within 15 days after Congress convenes each January.

Reading Check **Explaining** Why are Medicare and Social Security costs expected to rise?

Section 1 Review

Vocabulary

1. **Define** the following terms and use them in sentences related to federal budgeting: *budget, mandatory spending, discretionary spending, appropriations bill, Social Security, Medicare.*

Main Ideas

2. **Identifying** What is an example of mandatory government spending?
3. **Contrasting** How does a progressive tax differ from a proportional tax?
4. **Evaluating** If the government needed to increase government revenue, which kind of tax do you think it should increase? Why?

Critical Thinking

5. **BIG Ideas** In a graphic organizer like the one below, show how the president and Congress cooperate to create the federal budget.

1	President sends budget to Congress
2	
3	
4	

Interactive Graphic Organizer

6. **Analyzing Visuals** Study the 2007 federal budget on page 679. What two major categories are represented? What percentage of expenditures was budgeted for health?

Citizenship Activity

7. **Persuasive Writing** Write a newspaper editorial supporting a position for or against this statement: The federal government should be required to balance its budget each year.

Civics ONLINE

Study Central™ To review this section, go to glencoe.com.

Spotlight VIDEOS

Section 2

State and Local Governments

Guide to Reading

Big Idea

Political and economic institutions evolve to help individuals and groups accomplish their goals.

Content Vocabulary

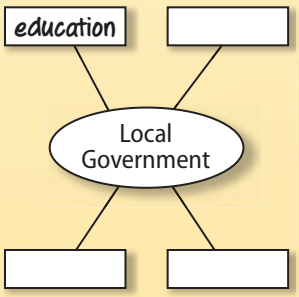
- intergovernmental revenue *(p. 682)*
- sales tax *(p. 682)*
- property tax *(p. 682)*
- entitlement program *(p. 684)*
- subsidize *(p. 684)*

Academic Vocabulary

- revenue *(p. 682)*
- utilize *(p. 684)*
- resource *(p. 684)*

Reading Strategy

Categorizing As you read, complete a graphic organizer like the one below to show the four major expenditures of local government.



Interactive Graphic Organizer

NORTH CAROLINA STANDARDS
Civics and Economics

3.08 Examine taxation and other revenue sources at the state and local level.
3.09 Describe the services provided by state and local government agencies and how funding is provided.
5.05 Explain how local government agencies balance interest and resolve conflicts.

Real World Economics Have you shopped on a "sales tax holiday"? It has been initiated in many states as a day when consumers do not have to pay any sales tax to the state. The sales tax holiday allows shoppers to save as much as 10 percent by eliminating the sales tax on certain products—school supplies, clothing, computers, and other items—for as many as 10 days at a time. In New York City, where the events of September 11th, 2001, caused economic devastation, store owners have looked to the sales tax holiday to help them rebound from difficult times.

Store manager arranges stock for Alabama's sales tax holiday

Jamie Martin/AP Images

Revenues

Main Idea **State and local governments have their own revenue sources.**

Economics & You Sales taxes raise the price of things you buy. Read to find out why this source of revenue is important to cities and states.

State and local governments have their own budget approval processes, **revenues,** and expenditures. The major sources of revenue for each are described below.

State Governments

The most important sources of state government revenues, shown in the graph on page 683, are **intergovernmental revenues.** This revenue is money that one level of government receives from another level. For states, most of this revenue comes from the federal government. The federal government gives states money for welfare, highway construction, hospitals, and other needs.

Sales Tax Next in importance is the state **sales tax.** A sales tax is a general tax levied on consumer purchases of nearly all products. The tax is a percentage of the purchase price, which is added to the final price the consumer pays. The merchant regularly turns over the taxes to the proper state government agency. Five states do not have sales taxes. Rates in the other states range from 2.9 percent to 7.25 percent.

Contributions A third source of state revenue is the contributions that states and state government workers make to their retirement plans. This money is invested until it is needed to pay retirement benefits.

Civics ONLINE

Student Web Activity Visit glencoe.com and complete the Chapter 25 Web Activity.

Income Tax The last major category of revenue is state income taxes. As with sales tax rates, state income tax rates vary a great deal. Some states tax a percentage of the federal income tax. A few states charge a single rate to all taxpayers. In the other states, the rate goes up as income goes up. Seven states have no state income tax.

Local Governments

Intergovernmental revenues are even more important for many local governments than they are for states. The states provide most of this money.

Property Tax The second-largest source of local revenue is local **property taxes.** These are taxes that people pay on the land and houses they own. Property taxes are collected on real property and personal property. Real property includes lands and buildings. Personal property consists of portable objects—things that can be moved—such as stocks and bonds, jewelry, and furniture. Most local governments now tax only real property.

Other Sources Local governments have other revenue sources as well. These include revenue from water and utility systems, sales taxes, local income taxes, and fines and fees.

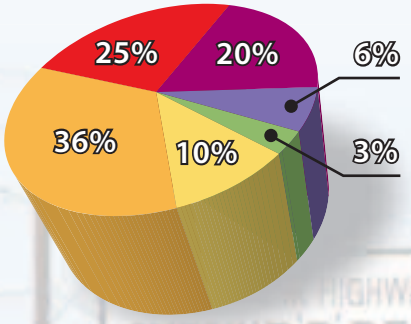
Many states allow their local governments to impose a local sales tax. Merchants collect these taxes right along with the state sales tax, at the point of sale. As indicated on the graphs on page 683, sales taxes are the fourth most important source of local government revenues. Another source of revenue is the local income tax, a tax on personal income. Fines for traffic and other violations and fees for permits and special services also provide income for local governments. Special assessments are fees that property owners must pay for local services. For example, a city may impose a special assessment when it improves a sidewalk.

Reading Check **Contrasting** How do real property and personal property taxes differ?

State and Local Governments

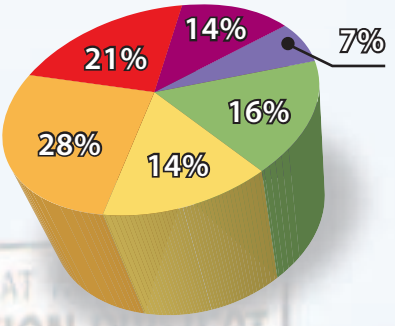
Graphs In Motion
See StudentWorks™ Plus or glencoe.com.

Local Government Revenue



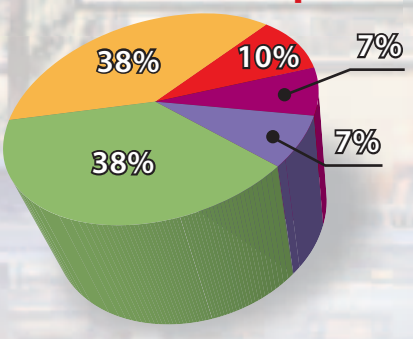
- Intergovernmental revenue[1]
- Property tax
- Charges and miscellaneous general revenue
- Sales tax
- Other taxes
- Other

State Government Revenue



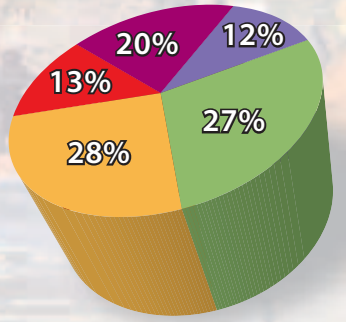
- Intergovernmental revenue[1]
- Sales tax
- Individual income tax
- Other taxes
- Charges and miscellaneous general revenue
- Other

Local Government Expenditure



- Education services
- Utility expenditure
- Hospitals and health
- Police and fire protection
- Other

State Government Expenditure



- Intergovernmental expenditure[1]
- Education services
- Public welfare
- Insurance trust expenditure
- Other

Analyzing Graphs

1. **Calculating** What are the three largest spending categories for local government? For state government?
2. **Comparing** Which level of government has the main responsibility for financing education?

[1]Intergovernmental revenue is revenue distributed by one level of government to another.

Source: U.S. Census Bureau; *Statistical Abstract of the United States,* 2006.

Tony Freeman / PhotoEdit

Expenditures

Main Idea **State and local governments use the revenues they take in to fund many different expenditures.**

Civics & You What do you think is the most important service your local government provides? Why?

State and local governments **utilize,** or make use of, their revenues to fund various expenditures. These expenditures are shown in the lower graph on page 683.

State Governments

Public welfare, or human services, is the name we give to government expenditures that maintain basic health and living conditions for people who have insufficient **resources,** or money, of their own. Most of these expenditures cover **entitlement programs,** such as health, nutritional, or income payments to people who meet established eligibility requirements.

Another category of state spending is colleges and universities. States **subsidize,** or pay part of the cost of, their citizens' college education. Without this subsidy, college students at state schools would have to pay higher tuition and other fees.

Although the federal government pays for building much of the interstate highway system, states are required to maintain those and additional highways. Other categories that take up smaller percentages of expenditures include employee retirement, hospitals and health facilities, and corrections institutions.

Local Governments

Local governments also provide services that they pay for with their revenues. Among the services that local governments provide are education, police and fire protection, and water, sewage, and sanitation services.

William Thomas Cain/Getty Images

Government Services A street sweeper cleans the streets as residents of Trenton, New Jersey, clean up after the Delaware River overflowed its banks in July 2006. Different levels of government must work together to deal with emergencies. ***Identifying*** **Which branch of government has primary responsibility for maintaining highways?**

Education A large share of local tax revenues in many states goes to pay for public schools. Some states pay a large percentage of local public school costs, but local school districts generally provide a large share of the money and make the key decisions regarding operation of the public schools.

Police and Fire Protection Police and fire protection also make up a large part of local budgets. Fire protection is a local function that varies with the size of the community. In small towns, volunteers usually staff the fire department. In large cities, professional, full-time fire departments provide fire protection.

Water Supply Local governments make the vital decisions regarding water service. Smaller communities may contract with privately-owned companies to supply water. The threat of pollution has prompted some local governments to create special water districts. In case of a water shortage, such districts or local governments may try to limit the amount of water used.

Sewage and Sanitation Local governments are responsible for sewage disposal. Proper sewage treatment is vital to the conservation of useful water supplies. Many local governments maintain sewage treatment plants.

In the past, most trash and garbage was buried. Because of environmental concerns, these landfills are no longer the simple solution to sanitation. Some local governments use garbage-processing plants to dispose of a community's solid wastes.

Reading Check **Identifying** What level of government makes most of the key decisions regarding operation of the public schools?

Section 2 Review

Vocabulary

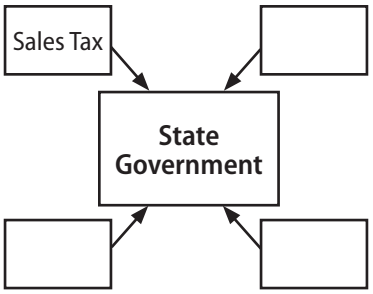
1. **Write** sentences related to state and local governments using the following terms: *intergovernmental revenue, sales tax, property tax, entitlement program, subsidize.*

Main Ideas

2. **Identifying** What are the largest sources of revenue for state and local governments?
3. **Describing** What is the effect of state subsidies on the cost of public colleges and universities?

Critical Thinking

4. **Evaluating** If you needed to raise local government revenues, which source of revenue would you target for an increase? Explain.
5. **BIG Ideas** In a graphic organizer like the one below, explain how a state government gets its revenue.



Interactive Graphic Organizer

6. **Analyzing Visuals** Study the two graphs that appear on page 683. Are police and fire protection the responsibility of state or local government?

Citizenship Activity

7. **Expository Writing** Write a newspaper article that includes your own experiences with local government. Focus on one of these issues: police or fire protection, sewer or water services, trash disposal, or education.

Civics ONLINE

Study Central™ To review this section, go to glencoe.com.

Financial Literacy

How Do You Calculate Unit Prices?

Trying to compare the prices of different amounts of a product—one pound of Product A versus one-half pound of Product B—can be confusing. To get the most for your money, it is important to compare the price, amount, and quality of similar products. Unit pricing can help. The unit price tells you the costs per "unit" (such as per ounce, per pound, per sheet) to buy the product.

Your supermarket offers three sizes of the same cereal.

Cereal	Cereal	Cereal
32 oz.	20 oz.	14 oz.
$5.76	**$3.40**	**$2.52**

To compute the unit price—the price per ounce, in this case—you need to divide the price of each item by its weight. Here is the formula:

$$\text{Unit price} = \frac{\text{Price}}{\text{Weight}}$$

Which one is the best buy?

$5.76 divided by 32 ounces = 18¢
$3.40 divided by 20 ounces = 17¢
$2.52 divided by 14 ounces = 18¢

In this case, the 20-ounce box offers the best price at 17 cents per ounce.

Analyzing Economics

1. **Calculating** Figure the unit price and compare accuracy to the unit price sticker. For example, which is the better buy: a 16-oz. loaf of bread at $.96 or a 25-oz. loaf at $1.20?
2. **Explaining** Can you think of a situation in which you would *not* buy a product at the most economical price? Explain your reasons.

Spotlight VIDEOS

Section 3

Managing the Economy

Guide to Reading

Big Idea

Political and economic institutions evolve to help individuals and groups accomplish their goals.

Content Vocabulary

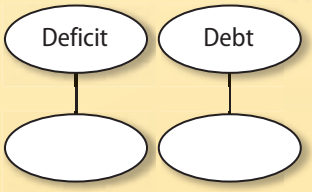
- surplus *(p. 688)*
- deficit *(p. 688)*
- bond *(p. 688)*
- debt *(p. 688)*
- balanced budget *(p. 688)*
- automatic stabilizer *(p. 692)*

Academic Vocabulary

- precise *(p. 688)*
- ideological *(p. 691)*

Reading Strategy

Explaining As you read, complete a graphic organizer like the one below to explain the differences between a federal deficit and the federal debt.

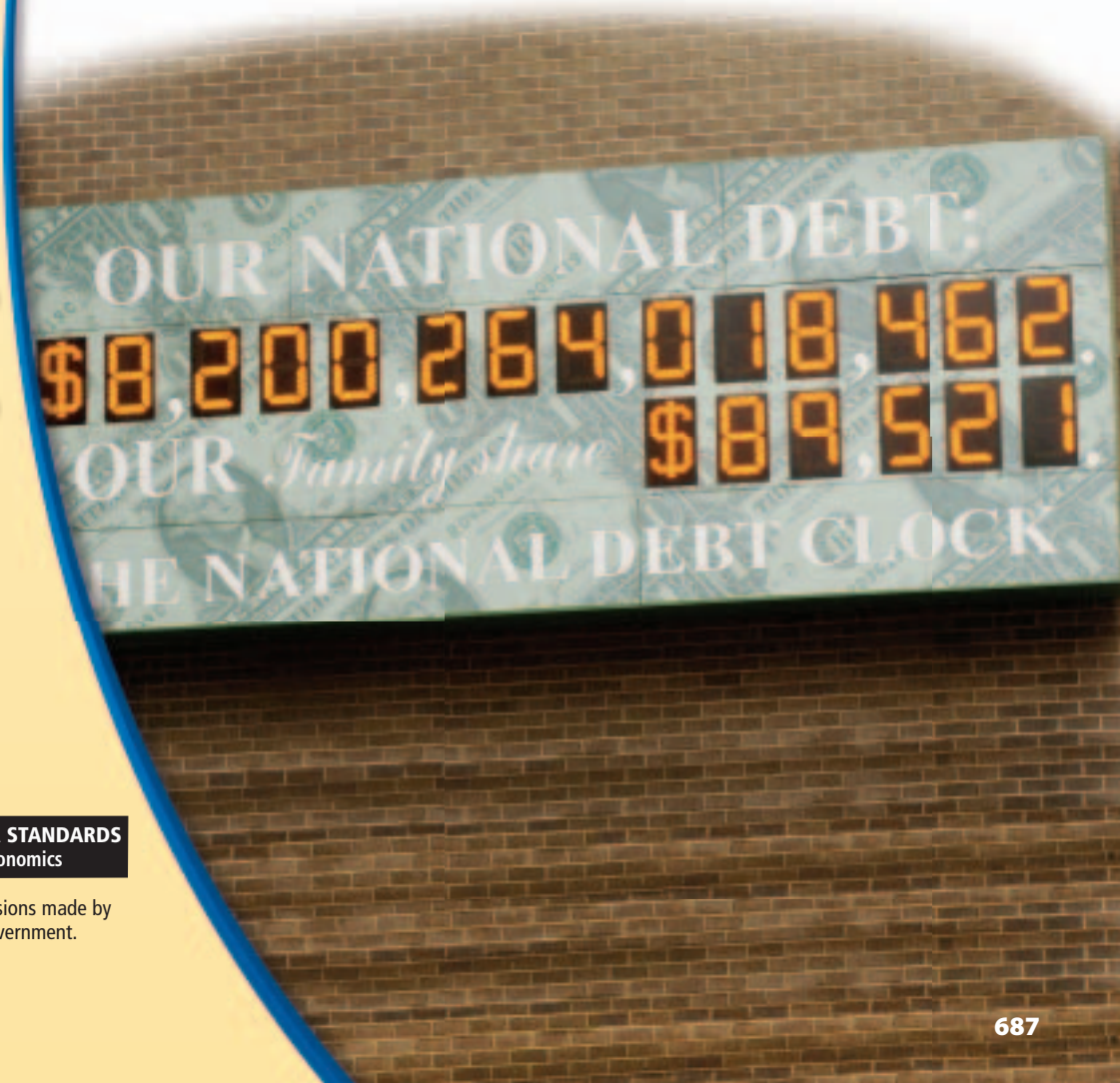


Interactive Graphic Organizer

NORTH CAROLINA STANDARDS
Civics and Economics

8.08 Evaluate the investment decisions made by individuals, businesses, and the government.

Real World Economics This clock is the same in all time zones. The National Debt Clock, created by New York City historian Seymour Durst, acts as a wake-up call to citizens in the United States, making them aware of how much the nation has economically overextended itself—how much money it owes. Today, the national debt is approaching the $10 trillion mark, an amount so enormous most people cannot understand it. The clock spells it out.



▼ **National Debt Clock in midtown Manhattan, New York City**

Stan Honda/AFP/Getty Images

Surpluses and Deficits

Main Idea **Governmental budgeting can result in either a surplus, a deficit, or a balanced budget.**

Economics & You Do you find it easy to estimate how much money you will need over a week or a month? Read to find out why estimating is a challenge for most governments.

Governmental budgeting can be difficult. A budget, after all, is built on forecasts, which are not always **precise,** or exact. If tax revenues are lower than expected, the budget is in trouble. The same is true if expenses are higher than anticipated because of some emergency. In this section, you will learn what happens when the government spends more—or collects more—than it planned. You will also see what steps governments can take to try to influence the economy in certain ways.

When a government spends less than it collects in revenues, it enjoys a **surplus.** A government runs a **deficit** when it spends more than it collects in revenues. Review the proposed federal budget from Section 1 on page 679. As you can see, the federal government planned to end the fiscal year with a deficit of $354 billion. Look at graph A on page 690. You will see that the federal government had deficits for almost all the years shown on the graph.

From the Deficit to the Debt

When the federal government runs a deficit, it must borrow money so it can pay its bills. This borrowing is similar to an individual overspending his or her income and using credit. The government borrows money by selling **bonds.** A bond is a contract to repay the borrowed money with interest at a specific time in the future. When you buy United States savings bonds, you are also lending funds to the federal government. State and local governments can borrow by selling bonds to finance some of their activities. All the money that has been borrowed over the years and has not yet been paid back is the government's **debt,** also known as the national debt.

When a government runs deficits, its total debt goes up. On the other hand, surpluses can be used to cut the debt. Suppose, for example, that the U.S. government had a deficit of $100 billion in one year, followed by a deficit of $75 billion the next. If the country had no earlier debt, it would have a total debt of $175 billion after two years. Suppose it then had a surplus of $50 billion in the third year. That money could be used to reduce the debt to $125 billion.

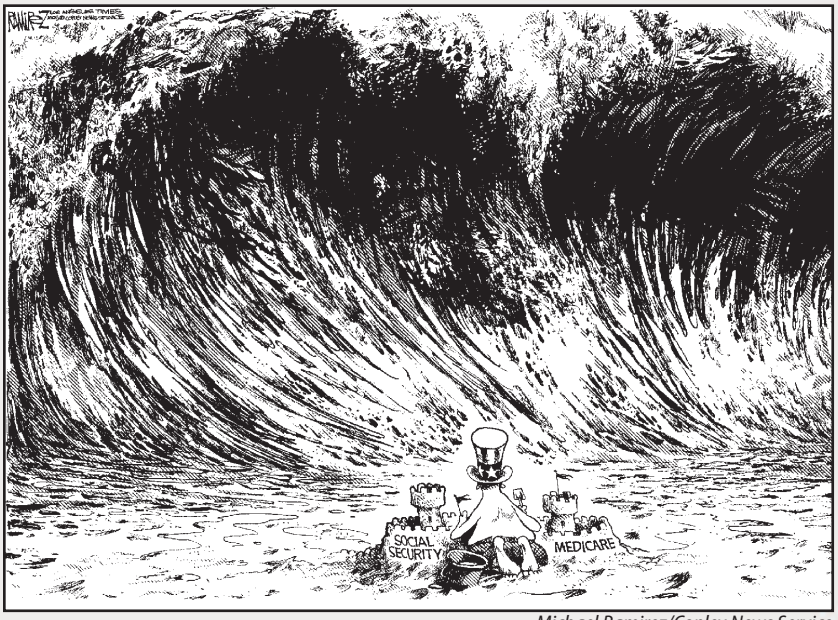
How Big Is the Debt? The national debt has grown almost continuously since 1900, when the debt was $1.3 billion. By 1940 it was $50.7 billion. Huge budget deficits in the early 1990s and early 2000s have pushed the national debt held by the public to approximately $4.9 trillion by October 2006. This equals about $16,365 for every man, woman, and child in America.

A Balanced Budget

The government achieves a **balanced budget** when spending equals revenues. The federal government is not required by law to have a balanced budget, but 48 states and many local governments are. In these cases, governments must cut spending when revenues go down.

During bad economic times, revenues often go down. Yet those are the times when states need to spend more on entitlements. This can make the budgeting process situation difficult. Many state and local governments are prohibited from borrowing to pay operating expenses. For that reason, they try to maintain an emergency fund balance—a government savings account from which deficits can be paid.

TIME Political Cartoons



Michael Ramirez/Copley News Service

America's major entitlement programs are the subject of this cartoon by Michael Ramirez.

1. **How are Social Security and Medicare represented?**
2. **What does the wave stand for?**
3. **What do you think the cartoonist's outlook is for the future of Social Security and Medicare?**

Impact of the National Debt

When the government spends more than it collects in tax revenues, it has to borrow the difference. You have learned that deficits lead to debt. But what does debt lead to?

Even though we owe most of the national debt to ourselves—through the purchase of bonds—the debt can affect the economy in several ways.

Paying Interest The national debt's most direct impact on the federal budget is the amount of tax money needed each year to finance past borrowing. Every year the interest on the national debt must be paid. U.S. taxpayers shoulder the responsibility of paying the interest. In fiscal year 2006, interest on the publicly held debt amounted to $218 billion. This total is roughly equal to one-quarter of all personal income tax revenue collected for 2006, and is a larger amount than the federal share of the payments for Medicaid.

The larger the national debt, the larger the interest payments, and, therefore, the more taxes needed to pay them. When people pay more taxes to the government, they have less money to spend on their own needs.

Interest Rate Additionally, when the federal government borrows money, it leaves less for citizens and private business to borrow. According to the law of supply and demand, an increase in the government's demand for credit will push up the price of credit—the interest rate. A Federal Reserve study in 2003 concluded that for every percentage point increase in the deficit as a share of GDP, long-term interest rates will rise by one-quarter percent. For example, you purchase an automobile for $20,000. Based on a four-year loan at 8 percent interest, your cumulative payments total $23,436.48, of which $3,436.48 is interest. If the interest rate is 9 percent, you pay an additional $453.21 in interest over the life of the loan.

Reading Check **Explaining** How does the federal government get money when it runs a budget deficit?

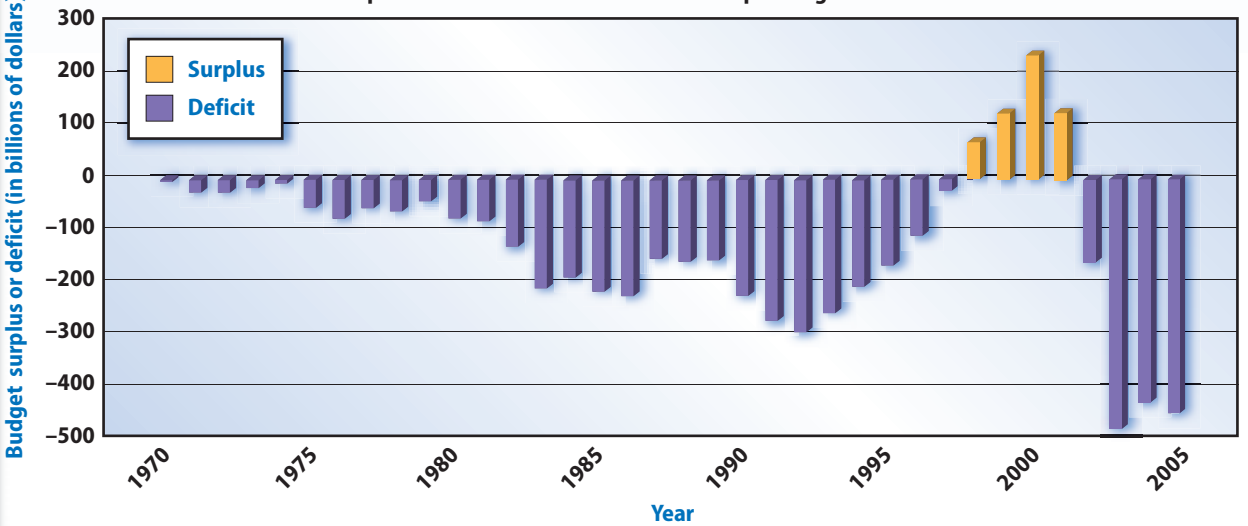
Michael Ramirez/Copley News Service

The Deficits and the Debt

Graphs In MOtion
See StudentWorks™ Plus or glencoe.com.

Federal Budget Surpluses and Deficits

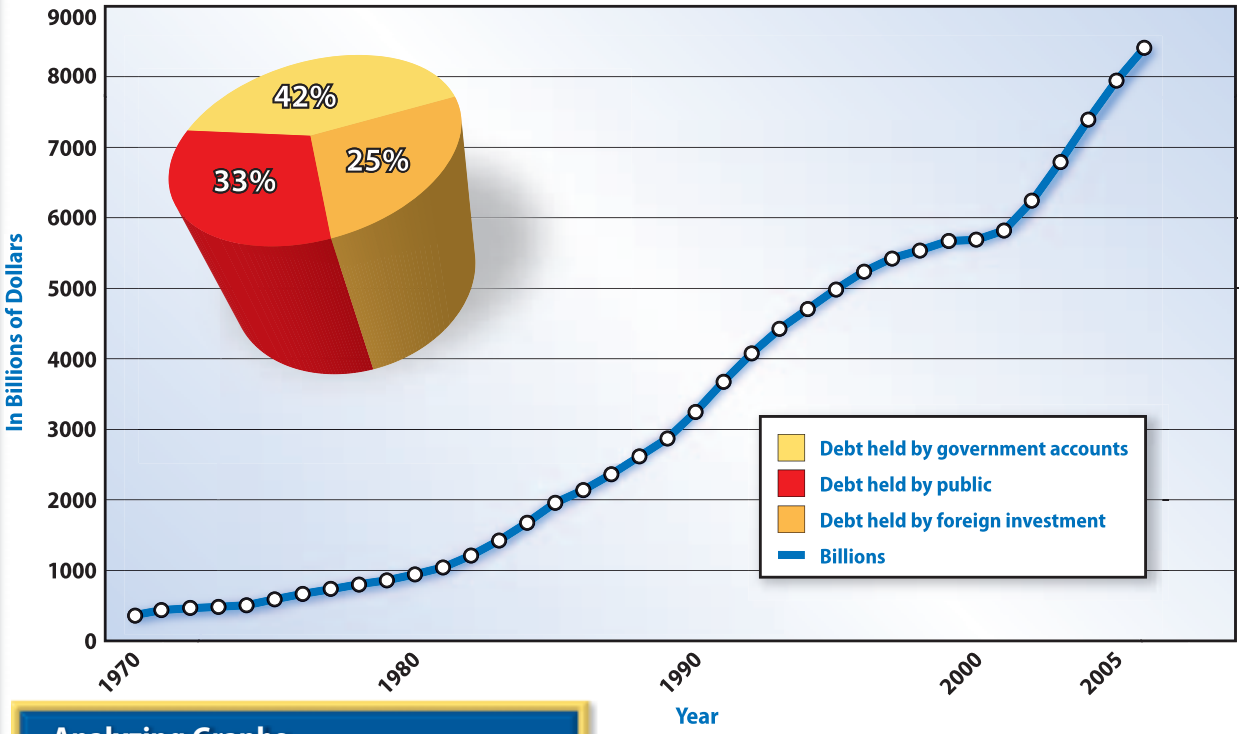
A surplus occurs when government revenues exceed government expenditures. A deficit occurs if annual spending exceeds revenues.



Source: U.S. Office of Management and Budget; U.S. Treasury Department.

The National Debt

When the government spends more than it collects in tax revenues, it has to borrow the difference. The national debt is the total sum of funds the federal government has borrowed over the years and has not yet paid back.



Source: U.S. Office of Management and Budget; U.S. Treasury Department.

Analyzing Graphs

1. **Analyzing** During what years did the federal budget show a surplus?
2. **Summarizing** Describe the changes in the national debt during each of the decades shown on the graph.

Fiscal Policy

Main Idea **The tool of fiscal policy can help governments control the economy.**

Economics & You Do you need to talk your friends into doing something they already want to do? Of course not! Read how this idea applies to fiscal policy.

The role of government in the nation's economy extends beyond its activities as a regulator of specific industries. The government also manages the pace of economic activity. As you learned in Chapter 23, the federal government can try to use taxes and spending to help the economy grow. This practice is known as fiscal policy.

In theory, the government can stimulate the economy during a recession by increasing spending and cutting taxes. When the economy begins to grow again, less stimulus is needed. In those times, the government can reduce spending and increase taxes.

Fiscal Policy in Practice

Nonetheless, these decisions are difficult to make. Many people want lower taxes regardless of the state of the economy. Many people also want government services, so the federal government has a difficult time cutting spending even when the economy is strong.

Does Fiscal Policy Work? Some lawmakers oppose increased spending or tax cuts on **ideological** grounds, or sets of beliefs they hold. Even when leaders agree that a stimulus is needed, they often argue over where and how to spend the money.

Moreover, government action does not always have the desired effect. Sometimes it takes a long time for political leaders to agree on a plan to stimulate the economy. By then, many months may have passed, and the economic situation may have changed.

TIME Teens in Action

Katie Anderton

The homeless shelter Bethesda House in Schenectady, New York, has found the perfect volunteer in Katie Anderton. This 16-year-old from the same city says, "A lot of people my age are afraid of anyone different from them, but I don't see differences—I see people."

QUESTION: What is Bethesda House?

ANSWER: It's the lead agency serving the homeless in Schenectady. They're trying to end homelessness and make our community a welcoming place for everyone to live.

Q: What does it do to help?

A: Everything! Bethesda House has things like hot meals, showers, and a laundry. There's a medical clinic for people with no health insurance and case managers to assist people to find affordable housing. The agency also helps to educate the community about homelessness, to advocate for fairness in jobs, salaries, and health insurance.

Q: Wow! How many people does it assist?

A: Almost 8,000 different people come to Bethesda House each year. More than 60,000 meals are served. Over 500 homeless people are placed in emergency shelters and 85 percent of them are helped to move into permanent housing.

Making a Difference — CITIZENSHIP

Explaining What is the purpose of Bethesda House?

(t b)Fred Ricard

Automatic Stabilizers

It is difficult for the federal government to use fiscal policy to effectively stabilize the economy. However, the economy has a number of **automatic stabilizers.** These are programs that begin working to stimulate the economy as soon as they are needed. The main advantage of these programs is that they are already in place and do not need further government action to begin.

Unemployment Benefits Unemployment insurance programs are one example of automatic stabilizers. When people lose their jobs—as may happen in a recession—they collect unemployment payments. These payments are not very large. Still, they do give people some help until they can find a new job—or until the economy improves and they are hired back by their former employers.

Income Tax The fact that the federal income tax is progressive is another stabilizer. Remember that a progressive tax is based on a taxpayer's ability to pay. The higher a person's taxable income, the higher the tax rate. Progressive tax rates are lower at lower income levels. When people lose their jobs, their income goes down, pushing them into a lower tax bracket. The lower bracket helps ease the impact of the cut in income.

When the economy recovers, the opposite happens. People make more money and, therefore, need and receive less help from entitlements. Generally, automatic stabilizers go into effect much more rapidly than discretionary fiscal policies—policies that governments *choose* to implement.

Reading Check **Explaining** Why is fiscal policy difficult to implement?

Section 3 Review

Vocabulary

1. **Define** the following terms and use them in sentences related to governmental management of the economy: *surplus, deficit, bond, debt, balanced budget, automatic stabilizer.*

Main Ideas

2. **Explaining** What two situations can cause a budget deficit?
3. **Describing** What is the main advantage of an automatic stabilizer?

Critical Thinking

4. **Concluding** Do you think the federal government should be required, like most state governments, to balance the budget every year? Explain.
5. **BIG Ideas** In a graphic organizer like the one below, explain the effect of a government budget deficit.

Cause: Government spends more than it collects in revenues.	→	Effect:

6. **Analyzing Visuals** Look at the graphs on page 690 that show the deficit and the debt. Describe the deficit in the 1970s compared to that of the 1990s.

Interactive Graphic Organizer

Citizenship Activity

7. **Persuasive Writing** Write a paragraph that supports a position on the following statement: In a free-market system like ours, it should never be the government's job to stimulate the economy.

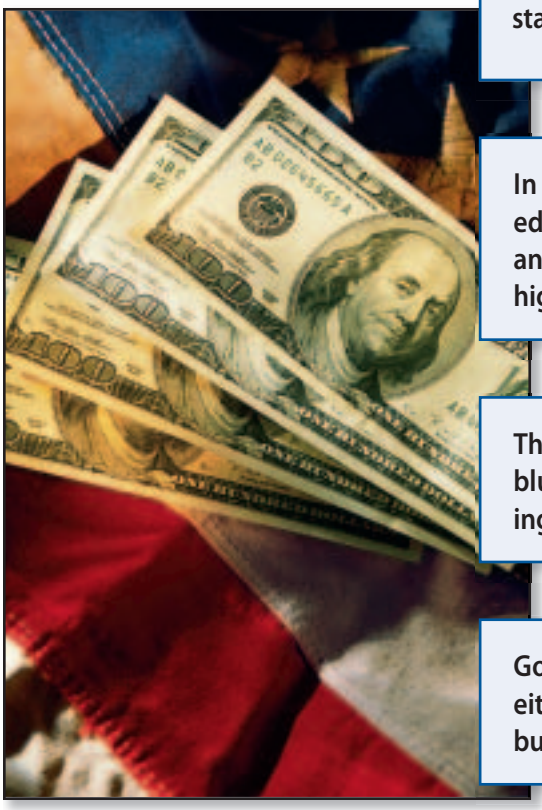
Civics ONLINE

Study Central™ To review this section, go to glencoe.com.

Chapter 25

Visual Summary

American taxpayers finance most local, state, and federal governments.



Government prints money

In return, they receive services such as education, entitlement programs, police and fire protection, national defense, and highway construction.

The published U.S. budget

The federal budget is the government's blueprint for raising revenues and spending money—its expenditures.

Governmental budgeting can result in either a surplus, a deficit, or a balanced budget.

Taxes pay for city services

State and local governments also have revenues and expenditures.

The price of gasoline includes an excise tax

Fiscal policy is a tool that can help governments control the economy.

Chapter 25

North Carolina End-of-Course Test Civics and Economics Practice

TEST-TAKING TIP

When reading a question, note words that tell you that your answer is to be in the negative, such as *Which of these is NOT. . . or All of these EXCEPT. . . .*

Reviewing Vocabulary

Directions: Choose the word(s) that best completes the sentence.

1. Each year the president and Congress have to agree on a plan for spending called a _____.

A revenue
B progressive tax
C budget
D regressive tax

2. _____ provides government money to people who are retired or disabled.

A Social Security
B Medicare
C Appropriations bills
D Proportional taxes

3. A(n) _____ is usually levied on consumer purchases of almost all products.

A property tax
B entitlement
C education tax
D sales tax

4. The government borrows money by selling _____.

A deficits
B bonds
C entitlement programs
D appropriations

Reviewing Main Ideas

Directions: Choose the best answer for each question.

Section 1 *(pp. 676–680)*

5. The federal income tax is a progressive tax, which means the _____.

A tax rate increases as income increases
B tax rate decreases as income increases
C tax rate decreases as income decreases
D tax rate and income are not related

6. A portion of the federal budget each year pays for the interest on _____.

A money lent to Great Britain
B money collected in taxes
C money spent on scientific research
D money borrowed by the government

Section 2 *(pp. 681–685)*

7. The largest source of revenues for local governments are _____.

A property taxes
B intergovernmental revenues
C local income taxes
D fines and fees

8. Which of the following is funding that state governments are NOT responsible for?

A welfare and health programs
B universities and colleges
C interstate highway maintenance
D water supplies and sewers

Section 3 *(pp. 687–692)*

9. Managing the nation's fiscal policy _____.

A requires the president and Congress to work together
B is left entirely to Congress
C is voted on by the people of Washington, D.C.
D must be approved by the Supreme Court

10. The best financial situation for the United States is to have _____.

A deficits exceed surpluses
B surpluses exceed deficits
C deficits exceed revenues
D deficits and surpluses to be equal

Critical Thinking

Directions: Choose the best answer for each question.

11. What trend can be seen when looking at the size of the national debt over decades?

A It gets smaller every year and could be paid of in ten years.

B It is a very small part of the federal budget.

C It grows larger every year and will be difficult to pay off.

D It developed because the government had a revenue surplus every year.

12. What trend is expected with Medicare costs in the future?

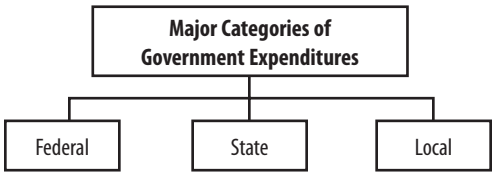
A The costs will go up steadily.

B The costs will go down dramatically.

C The costs will remain stable with little change.

D The government will do away with the Medicare program.

Base your answer to question 13 on the diagram below and your knowledge of Chapter 25.



13. Expenditures for Social Security and national defense best fit under which level of government?

A Federal

B State

C Local

D Federal and State

Document-Based Questions

Merton Miller was a well-respected American economist and teacher who lived from 1923–2000.

> *. . . if you take money out of your left pocket and put it in you right pocket, you're no richer.*
>
> —Merton Miller

14. How do you think Miller feels about the government investing its money to make it grow?

A He would disagree with investing.

B He thinks saving is the best way to manage funds.

C He would be in favor of investing funds.

D He doesn't believe in income taxes for investing.

15. What do you think Miller believed the government's role in managing its money should be?

A The government should stay out of money management.

B The government is doing a good job of balancing the budget.

C The government has to make their funds increase for the country to prosper.

D The government should ask individual citizens to manage its money.

Informational Writing

16. Some people believe more power over spending money should be given to the states rather in the federal government controlling it. What do you think? Write a Pro/Con list for giving the states more power over spending. Conclude with a paragraph about what your list shows.

STOP

CivicsONLINE

For additional test practice, use Self-Check Quizzes—Chapter 25 on glencoe.com.

Need Extra Help?

If you missed question. . .	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Go to page. . .	677	678	682	688	678	680	682	684	691	688	690	680	680	678	678	684

TIME REPORTS

The Federal Deficit

As government spending grows and tax revenues shrink, the United States racks up record-breaking debt

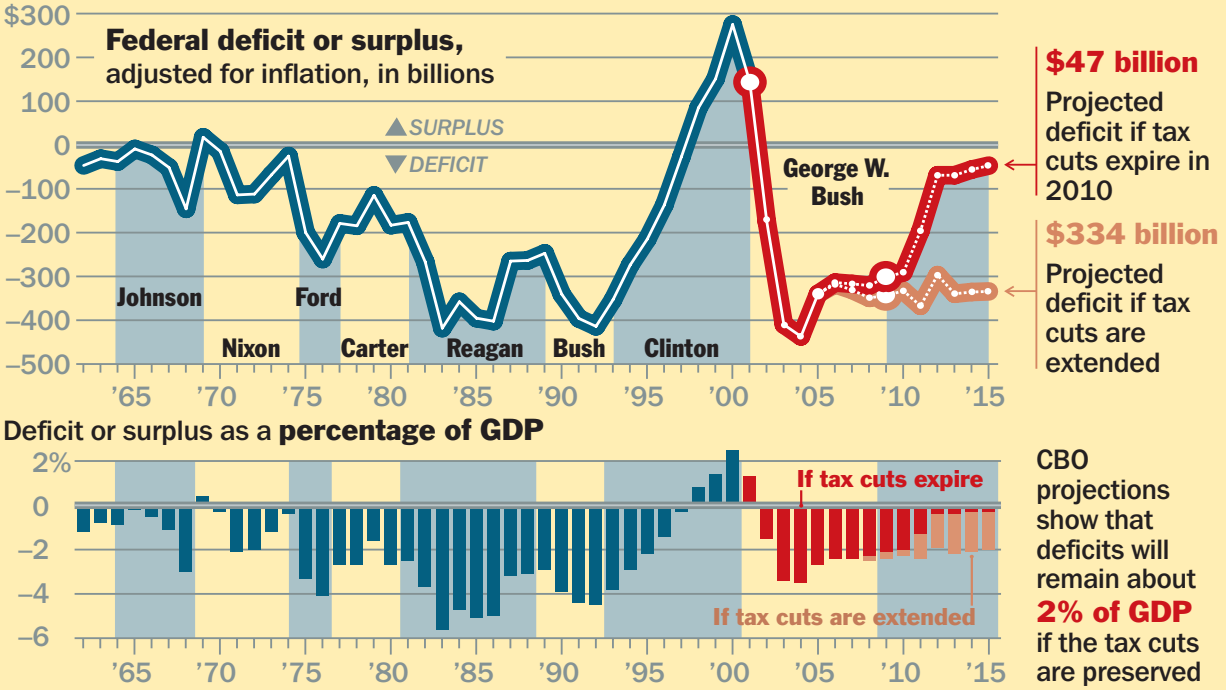
AFP/Getty Images

ADDING IT UP This electronic clock, located in New York City, shows the total U.S. government debt as of August 2006 (top) and the estimated share for each American family (bottom). The *national debt* is the total amount of money that the government owes; the *deficit* is the yearly amount by which spending exceeds revenue. The clock does not have enough digits to show the debt when it reaches the $10 trillion mark, which is expected to occur by 2008.

Back in 2000, when Bill Clinton was completing his second term as President, the United States had a budget surplus of $236 billion—meaning that the federal government took in 236 billion more dollars than it spent that year. Under President George W. Bush, the surplus has become an annual deficit of $400 billion. About a quarter of what the government has spent since Bush entered the White House has been borrowed.

In Bush's defense, Josh Bolten—who served as Director of the Office of Management and Budget before becoming White House Chief of Staff—points to the economy the President inherited. "We had this burst bubble. Revenues just disappeared, and this was all before the President's tax cuts." But when Bush came into office, the nonpartisan Congressional Budget Office (CBO) was projecting surpluses for years to come, until Bush's tax cuts went into effect. CBO estimates show that if Bush's tax cuts are made permanent—as he is advocating—deficits will persist for at least 10 years.

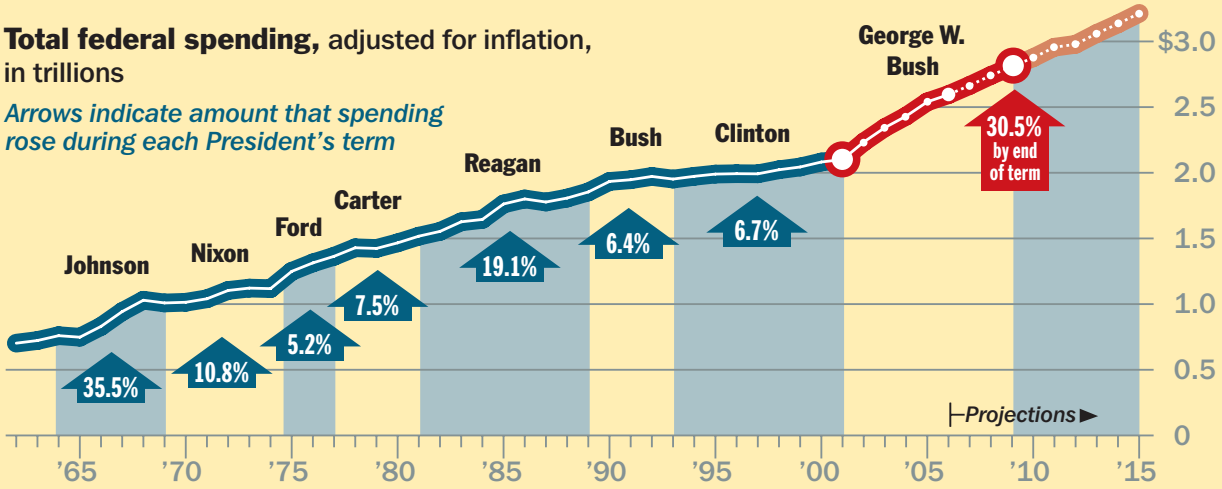
The deficit has exploded under Bush ...



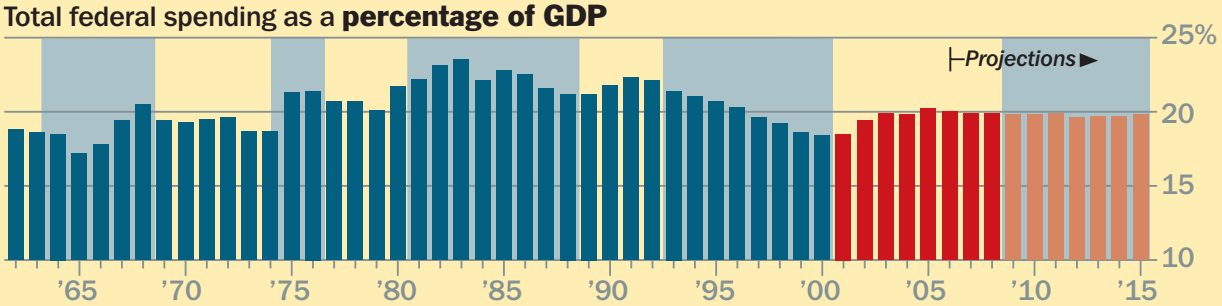
... and spending has increased rapidly ...

Total federal spending, adjusted for inflation, in trillions

Arrows indicate amount that spending rose during each President's term

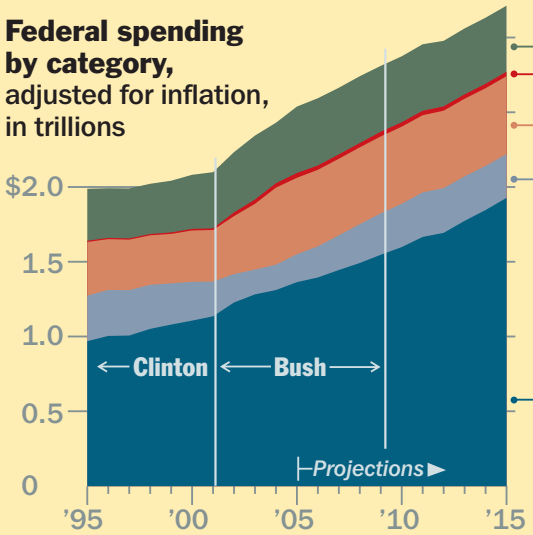


Total federal spending as a **percentage of GDP**



... across the entire government

Federal spending by category, adjusted for inflation, in trillions



	Change since 2001	Projected change, 2001-08	Projected change, 2001-15
All other discretionary spending	18%	19%	18%
Other homeland-security spending	195%	167%	174%
Defense spending	48%	49%	51%
Interest on the debt	20%	12%	26%
Mandatory spending*	20%	31%	70%

*Programs such as Social Security, Medicare, Medicaid, veterans' benefits, unemployment, food stamps

Sources: Congressional Budget Office, Bureau of Labor Statistics, Center on Budget and Policy Priorities. All inflation-adjusted figures are 2006 dollars

Analyzing Primary Sources

Government and the Economy

Reading Focus

In the nation's early years, most political leaders were reluctant to involve the federal government too heavily in the economic sector. They accepted the idea of laissez-faire, a doctrine opposing government interference. While consumers and producers make most economic decisions, government activities have a powerful effect on the U.S. economy.

Read to Discover

As you read, think about the following:

- Why did the Framers believe it was necessary that the Constitution include the commerce clause?
- How much influence should the government have over the economy?

Reader's Dictionary

Bill of Attainder: a law that punishes a person accused of a crime without a trial or a fair hearing in court

ex post facto law: a law that would allow a person to be punished for an action that was not against the law when it was committed

The Constitution and the Economy

Some provisions in the U.S. Constitution protect private property rights and the freedom to take part in commercial activities free of arbitrary restrictions.

Commerce Clause Article I, Section 8, states that Congress shall have the power "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes; . . ."

Coinage Clause Article I, Section 8, states that Congress shall have the power "To coin Money, regulate the value thereof, . . ." and "To provide for the Punishment of counterfeiting the Securities and current Coin of the United States; . . ." Article I, Section 10, gives Congress this power exclusively by stating that "No State shall . . . coin Money; . . ."

Copyright Clause Article I, Section 8, states that Congress shall have the power "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writing and Discoveries; . . ."

Contract Clauses Article I, Section 9, states that "**No Bill of Attainder** or **ex post facto Law** shall be passed . . ." by Congress. Article I, Section 10, states that "No state shall . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligations of Contracts, . . ."

Export Clauses Article I, Section 9, states that "No Tax or Duty shall be laid on Articles exported from any State . . .", and Article I, Section 10, states that "No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, . . ."

Searches and Seizures Amendment IV states that "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, . . ."

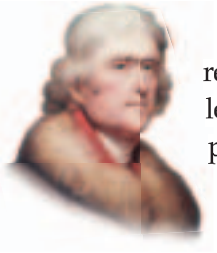
Due Process Amendment V states that "No person shall . . . be deprived of life, liberty, or property, without due process of the law; . . ." and Amendment XIV, Section 1, states, "nor shall any State deprive any person of life, liberty, or property, without due process of law; . . ."

Reserved Rights and Powers Amendment IX states that "The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people." And Amendment X states, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Photographs as Primary Sources A new $1 coin was introduced in 2007. The Unit States Mint will mint and issue four presidential $1 coins per year. Why do you think the coin features the presidents?

Role of Government

Two presidents provide their views on the role of government in the economy.



[A] wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government.

—Thomas Jefferson, First Inaugural Address, March 4, 1801

Government ought to have the right and will have the right, after surveying and planning for an industry to prevent, with the assistance of the overwhelming majority of that industry, unfair practice and to enforce this agreement by the authority of government. The so-called anti-trust laws were intended to prevent the creation of monopolies and to forbid unreasonable profits to those monopolies. That purpose of the anti-trust laws must be continued, but these laws were never intended to encourage the kind of unfair competition that results in long hours, starvation wages and overproduction.

—President Franklin D. Roosevelt, Fireside chat, Sunday, May 7, 1933

DBQ Document-Based Questions

1. **Explaining** What restrictions does the U.S. Constitution place on state and local taxing powers?
2. **Describing** Which excerpt supports a laissez-faire position regarding government and the economy? Explain.
3. **Evaluating and Connecting** Originally the Framers of the Constitution wanted to ensure that Congress could not involve itself in the states' internal affairs. Yet, the necessary and proper clause has been expanded so that Congress now has some control over virtually all economic activities, even within each state's borders. Do you think this is a fair exercise of congressional power? Give reasons for your answer.