

Government Finances

★ CITIZENSHIP AND YOU ★

If you borrow money because you spend more than you earn, you run a deficit. You have a responsibility to repay the sum you borrow. In this chapter, you will learn how federal deficits and surpluses influence the United States's economy.



To learn more about government expenditures and revenues, view the **Economics & You** video lesson 4: How Government Spends, Collects, and Owes.



FOLDABLES™ Study Organizer

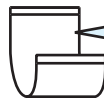
Organizing Information Study Foldable Make the following foldable to help you organize what you learn about financing our government.

Step 1 Collect two sheets of paper and place them about 1 inch apart.



Keep the edges straight.

Step 2 Fold up the bottom edges of the paper to form four tabs.



This makes all tabs the same size.

Step 3 When all the tabs are the same size, crease the paper to hold the tabs in place and staple the sheets together. Label each tab as shown. Then cut the three lower tabs in half, forming six tabs.

Staple together along the fold.

Government Finances	
Revenue	Expenditures
Federal	Federal
State	State
Local	Local



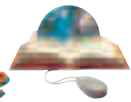
Reading and Writing

As you read the chapter, use your foldable to write what you learn about the revenues and expenditures of governments in the United States under each appropriate tab.

Government expenditures are used to build and maintain transportation systems such as “The Big Dig” in Boston. ▶



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Chapter Overview Visit the *Civics Today* Web site at civ.glencoe.com and click on **Chapter Overviews—Chapter 25** to preview chapter information.



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CONTENTS



The Federal Government

GUIDE TO READING

Main Idea

Every year, the federal government prepares a budget that accounts for trillions of dollars in revenues and expenditures.

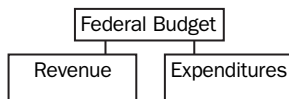
Key Terms

budget, fiscal year (FY), budget resolution, mandatory spending, discretionary spending, appropriations bill, tax return, payroll tax, Social Security, Medicare

Reading Strategy

Organizing Information

As you read, complete a chart like the one below by listing the main sources of federal revenue and types of expenditures.



Read to Learn

- How does the federal government prepare a budget?
- What are the main sources of federal revenue?
- What are the major types of federal expenditures?



Government plays a major role in most aspects of our lives. One measure of this role is government spending. The Citizen's Guide to the Federal Budget pointed out that in 2002 "your Federal Government will spend nearly \$2.0 trillion." Needless to say, that's a lot of money. In fact, that's almost \$7,000 for every man, woman, and child in the country; nearly \$5.4 billion per day; and about \$3.7 million per minute. 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.



The 2002 federal budget

Preparing the Budget

As the feature points out, the federal government spends a huge amount of money. In fact, purchases by the federal government equal about 18 percent of our GDP. Understanding the finances of the federal government is an important part of understanding how our economy works.

Each year, the federal government creates a **budget**. This budget is a blueprint of how the government will raise and spend money. Both the president and Congress help create it.

The government's budget year is actually not 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. Consequently, the budget that begins on October 1, 2004, is the fiscal year 2005 budget because 9 of the 12 months fall in that year.

The Budget Process

According to law, the president must present a proposed budget to Congress by the first Monday in February, although this deadline is sometimes missed when a new president assumes office. In this budget, the president outlines where he

or she thinks the government should spend its money. The president then formally sends the proposed budget to Congress along with an annual budget message.

Congress then takes the next step by passing 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.

Mandatory spending is spending that does not need annual approval. 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 like money for the Coast Guard, agriculture, space exploration, highway construction, and defense. Discretionary spending makes up only about one-third of the federal budget.

Appropriations Bills

Before the government can actually spend any money, Congress must pass an **appropriations bill**. This is a law that approves spending for a particular activity. Congress splits discretionary spending into 13 separate appropriations bills. These bills must go through the normal process for any bill. Each bill must be approved by both houses and acted upon by the president, either signed into law or vetoed.

The law requires all appropriations bills to be finalized by September 15. If that does not happen, Congress and the president can agree to a temporary, or “stop gap,” appropriation. These continuing bills are passed until the appropriations bill for that category of spending finally becomes law.

Reading Check **Describing** What is the purpose of the federal budget?

Federal Revenues

The federal budget has two main parts—revenues and expenditures. The main sources of federal revenues are shown in the graph on the left on page 544.

Taxes on Income and Profits

The income tax paid by individual Americans supplies nearly half of all the federal government’s revenue. A portion of the paychecks of workers is withheld each pay-day. At the end of the year, workers file a **tax return**. This is an annual report to the government that calculates the tax a worker must pay on his or her income. If more money has been withheld than the taxpayer owes in tax, the worker can receive a refund. If the amount withheld is less than the tax owed, the taxpayer must pay the difference.

Corporations also pay income tax on profits they earn. The corporate income tax provides the federal government with about 10 percent of its revenue.

Government Spending The federal government’s budget supplies money for many services and programs. **Is the space program an example of mandatory spending or discretionary spending?**



Payroll Taxes

The second-largest source of federal income is **payroll taxes**. About one-third of federal revenues come from payroll taxes. These taxes are deducted from a worker's paycheck to fund Social Security and Medicare. **Social Security** is a government program that provides money to people who are retired or disabled. **Medicare** pays some health care costs of elderly people.

Other Revenues

Consumers pay an excise tax when they purchase such goods as gasoline, tobacco, alcohol, legal betting, and telephone services. These taxes contribute only 3.4¢ of every dollar collected.

When wealthy people die, the federal government collects an estate tax on the wealth passed on to the deceased person's heirs. The government also charges a tax on

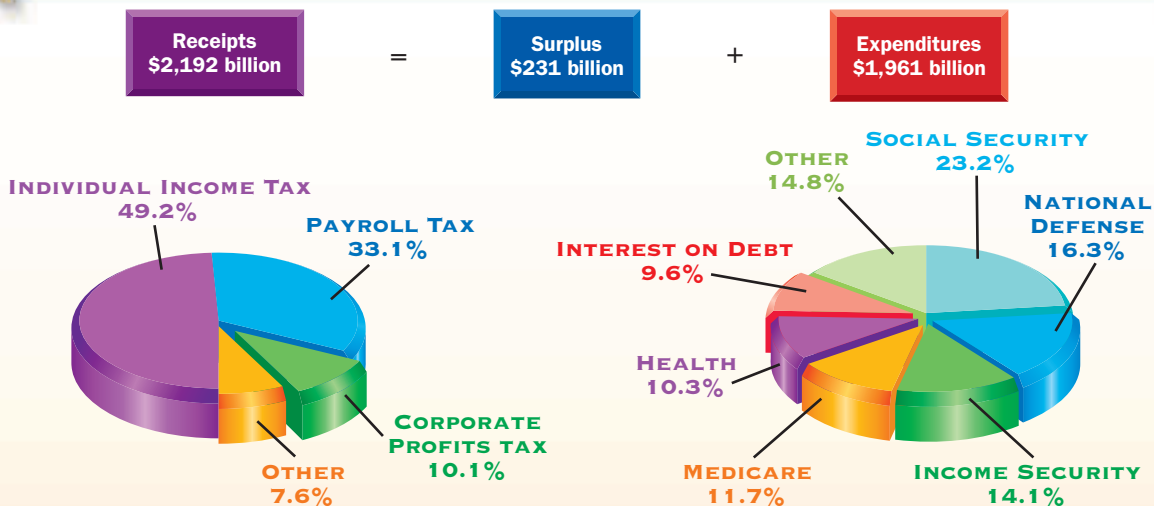
certain gifts. Together, these two taxes account for a tiny 1.3¢ of every federal revenue dollar. Miscellaneous sources account for about 2 percent of federal revenues. This category includes such sources as the entry fees for national parks and the fees paid by oil companies that drill for oil on public land.

Forms of Taxation

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

A proportional tax is the easiest type of tax to understand. 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, then you pay \$100 in taxes. If you earn \$10,000, you pay \$1,000 in taxes, and so on.

The Federal Budget, Fiscal Year 2002



Analyzing Graphs

The federal government planned to have a surplus of \$231 billion in fiscal year 2002. **What is the largest expenditure in the budget?**

With a progressive tax, the tax rate (the proportion of earnings taken in taxes) increases as your income increases. Therefore, the higher the income, the larger the percentage of income paid as taxes. A good example of a progressive tax is our federal income tax system.

A regressive tax is the opposite of a progressive tax. The percentage that you pay actually goes down as you make more money income. Examples of regressive taxes are Social Security taxes, gasoline taxes, and sales taxes. For example, 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.

 **Reading Check** **Identifying** What percentage of the federal government's revenues comes from payroll taxes?

Federal Expenditures

The graph on the right on page 544 also shows where the federal government planned to spend its money. As you can see, expenditures for FY 2002 were estimated at \$1.961 trillion.

Social Security, Medicare, Income Security, and Health

Social Security was the largest single spending category, accounting for about 23.2¢ of every federal dollar spent in FY 2002. Because the number of older people in the population is growing, this expense is expected to grow in the near future.

Medicare is also likely to rise as the population continues to age. This is the fourth-largest category of federal spending.

Income security includes retirement benefits paid to people who used to work in the government or who served in the military. It also includes retirement payments

American Biographies

Frances Perkins (1882–1965)

The Social Security tax owes its origins to Frances Perkins, the first female cabinet member. In 1934, President Franklin Roosevelt named Perkins—secretary of labor from 1933 to 1945—to chair the Committee on Economic Security. There she helped draft a new Social Security bill.



Perkins, a well-known social reformer, impressed people with her confidence. She had successfully waged battles for the rights of women, workers, and consumers. However, she worried about the fate of a broad Social Security program. Would the courts decide that the federal government had overstepped its power?

In late 1934, Perkins shared her concerns at a tea party hosted by Supreme Court Justice Harlan Stone and his wife. She wondered about the constitutional basis for a Social Security law. When nobody was looking, Justice Stone whispered: “The taxing power of the federal government, my dear.”

Perkins heeded Stone's advice and based the program on the government's right to levy payroll taxes to pay for it. As Stone predicted, the Supreme Court indeed upheld the Social Security Act of 1935 by a 7–2 decision.



to railroad workers and disabled coal miners as well as payments to poorer Americans for housing and child nutrition.

Health includes payments for Medicaid, which pays for health care for people with low incomes. This category also includes spending on research to find cures for diseases.



Economics and You

Principles of Taxation

Taxes are usually classified according to two major principles. Under the *benefits-received principle*, those who use a particular government service should support it with taxes in proportion to the benefit they receive. Those who do not use a service do not pay taxes for it. Under the *ability-to-pay principle*, those with higher incomes pay more taxes than those with lower incomes, regardless of the number of government services they use. On which principle is a tax on gasoline to pay for highway construction and repair based?

National Defense

National defense is the second-largest category of federal expenditures. The original FY 2002 budget set defense spending at about 16.3¢ of every federal dollar spent. Because of the cost of the war on terrorism that began in late 2001, though, the amount actually spent was higher. President Bush requested \$396.1 billion for defense

spending for fiscal year 2003. This figure represented \$45.5 billion above the previous year's levels, an increase of 13 percent.

Interest on Debt

Each year, some portion of the federal budget goes to pay interest on the money the government has borrowed. The amount paid depends on how much money has been borrowed and the interest rates of that debt. While it is only the sixth-largest expenditure in FY 2002, interest payments have ranked as high as third largest in the past.

Other Expenditures

The federal government also spends on programs from education to highways to natural resources. These categories account for billions of dollars of spending. Still, the government spends less in these areas than most people think.

Reading Check **Identifying** What is the federal government's second-largest expenditure?

SECTION ASSESSMENT

Checking for Understanding

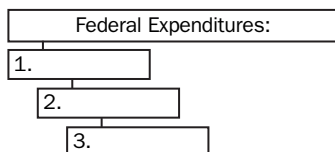
1. Key Terms Define the following terms and use them in sentences related to federal budgeting: **budget, fiscal year (FY), budget resolution, mandatory spending, discretionary spending, appropriations bill, tax return, payroll tax, Social Security, Medicare.**

Reviewing Main Ideas

- 2. Explain** What must Congress do before the government can actually spend any money?
- 3. Describe** What are the two main categories that are part of the federal budget?

Critical Thinking

- 4. Evaluating** If the government needed to increase government revenue, which kind of tax do you think should be increased?
- 5. Describing** on a diagram like the one below, list in order of priority the most important federal expenditures.



Analyzing Visuals

6. Summarize Study the 2002 federal budget on page 544. What two major categories are represented? What percentage of expenditures was budgeted for health?

★ BE AN ACTIVE CITIZEN ★

7. Categorize List five ways that local, state, and federal governments are involved in your daily life. Provide specific examples in your list.



Critical Thinking SKILLBUILDER

Writing a Journal

Why Learn This Skill?

A journal is a written day-to-day record of expenses, events, thoughts, and other accounts to which the journal keeper can refer at a later date. Governments and businesses keep journals of receipts and expenditures. Individuals, too, keep journals for business and personal reasons. Keeping a journal can help you keep track of school assignments, recall important information, and express your own thoughts.

Learning the Skill

To write a journal, follow these steps:

- Designate a notebook or other booklet with blank pages and reserve it for your journal entries.
- Start each entry with the date on which you record it.
- Write down any unique information or experience that you want to remember from that

day. Use language that is brief and to the point. Short phrases are often adequate.

- Express any thoughts you may have about data you record.
- Stay up-to-date. Record events on the day they happen.
- Refer to your journal entries for accurate information tailored to your own needs and interests.

Practicing the Skill

On a separate sheet of paper, write numbers 1–7. Place a check mark beside each number to indicate which items from the following list would be useful journal entries.

- 1 Amounts added to your savings account
- 2 Correct answers to questions you missed on a civics quiz
- 3 Time school started each morning
- 4 Steps you took to log on to the Internet on your computer
- 5 Amount of federal spending for next year as announced on the news
- 6 Your opinion on how the federal government spends tax money
- 7 Points about local spending on schools you wish to discuss in class



Journal writing is personal writing with a casual style.

Applying the Skill

Examine the sales receipts from purchases you make in one week. Make a journal entry recording the amount you are taxed each day for your purchases. At the end of the week, add your own generalization or opinion relating to government taxation.



Practice key skills with Glencoe's **Skillbuilder Interactive Workbook CD-ROM, Level 1.**

State and Local Governments

GUIDE TO READING

Main Idea

Like the federal government, state and local governments must prepare yearly budgets to account for annual revenue and expenditures.

Key Terms

intergovernmental revenue, sales tax, property tax, entitlement program, subsidize

Reading Strategy

Categorizing Information

As you read, complete a graphic organizer like the one below to show categories of state and local expenditures.

Expenditure Categories (Largest to Smallest)	
State	Local

Read to Learn

- What are the sources of revenue for state and local governments?
- What are the major expenditures for state and local governments?



Americans in Action

Congress extended the ban on taxes on Internet sales until 2006. Congress also opened the door for states to collect sales tax after that. According to a news report from CNN/Money, “the deal also gives states . . . five years to write a simplified tax-collection plan. . . . If [the plan is] approved by Congress, taxes on almost all online and catalog purchases would be collected.” Companies that sell over the Internet argue that there are too many sales tax rates imposed by as many as 7,600 state and local tax jurisdictions, the paper said. According to the new tax deal, states would have to agree on one national sales tax, or one rate per state.



Buying from an online shop

Sources of Revenue

State and local governments have their own budget approval processes, revenues, and expenditures. Of course, as shown by the Americans in Action feature, with 50 states and thousands of local government bodies, there are many differences among all these different governments.

State and local governments, like the federal government, have their own revenue sources. Each source is described on the following pages.

State Governments

The main sources of state government revenues are shown in the graph at the top of page 550. The most important are **intergovernmental revenues**. This 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 activities. As you can see from the figure, states receive 22¢ of every revenue dollar from intergovernmental revenues.

Sales Tax The second-largest source 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 turns over the taxes to the proper state government agency on a regular basis. Most states allow merchants to keep a small portion of what they collect to compensate for their time and bookkeeping costs. Sales taxes account for nearly 21¢ of each state revenue dollar, making them very important to state governments. That is why states are not pleased about the growth of shopping over the Internet, because most Internet sales are not subject to sales taxes. Five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—do not have sales taxes. In the other states, rates range from 2.9 percent to 7 percent.

Contributions The third-largest source of state revenue, accounting for 17.5¢ of every revenue dollar, comes from the

contributions that states and state government workers make to their own retirement plans. This money is invested until it is needed to pay retirement benefits.

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—such as Colorado and Rhode Island—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—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—have no state income tax at all.

Local Governments

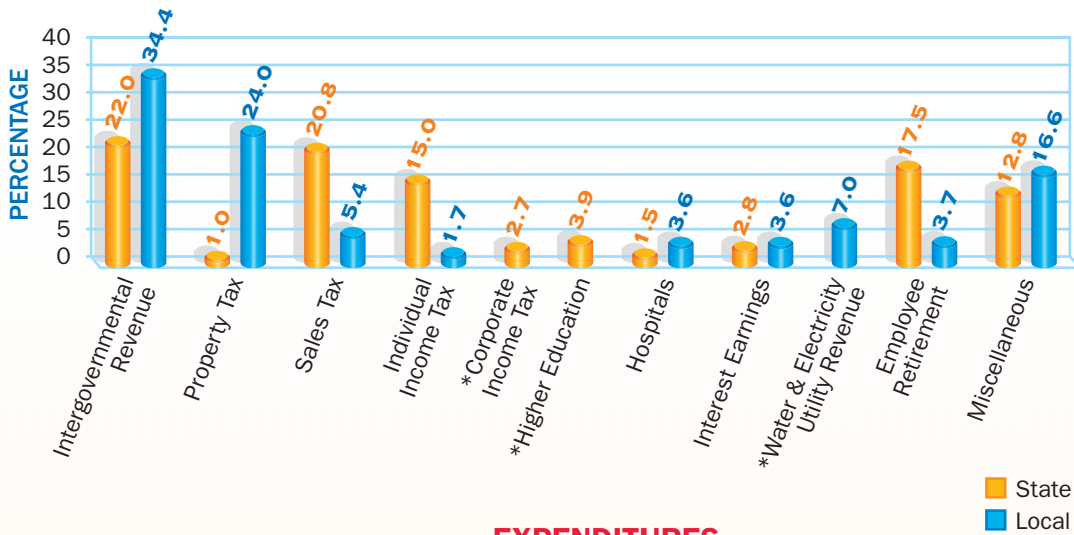
For many local governments, intergovernmental revenues are even more important than they are for states. About 34.4¢ of every local revenue dollar comes from other levels of government. States provide most of this money.

Education Local governments' largest spending category is primary and secondary education. **Which level of government has the major responsibility for college and university education?**

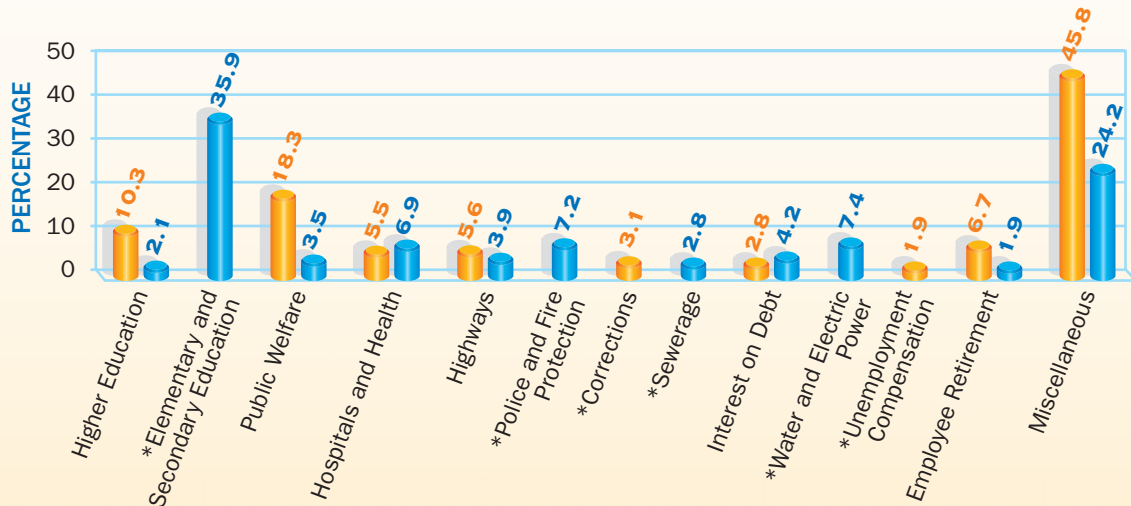


State and Local Government Revenues and Expenditures

REVENUES



EXPENDITURES



*Does not apply to both state and local
Source: U.S. Bureau of the Census.

Analyzing Graphs

State and local governments have their own sources of revenue and different spending responsibilities. Which level of government has the main responsibility for financing public welfare? What are the largest sources of revenue for state government?

Property Tax The second-largest source of local revenue comes from 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. Personal property includes such things as stocks and bonds, jewelry, furniture, automobiles, and works of art.

Most local governments now tax only real property. Although it may vary from state to state, government taxes property

based on its assessed value—the estimated value of each property used in the computation of the property tax.


Other Sources Revenue from water and electric utility systems is the third-largest source of revenue. The graph on page 550 shows that local governments receive 7 percent of revenue from these sources.

Local governments have other revenue sources as well. These include sales taxes, local income taxes, and fines and fees.

The local income tax is a tax on personal income. If the state and the local community both have an income tax, the taxpayer pays three income taxes: federal, state, and local.

The sales tax is a tax on the sale of goods or services, generally calculated as a percentage of the selling price. Many states allow their local governments to use this tax. In some places it is a selective sales tax that is applied to only a few items.

Fines paid for traffic and other violations, and fees for special services provide part of the income for local governments. Special assessments are fees that property owners must pay for local services that benefit them in some particular way. For example, a city may impose a special assessment when it improves a sidewalk.

 **Reading Check Summarizing** Is the rate of the sales tax the same in every state?

Expenditures

State and local governments' direct expenditures are shown in the lower graph on page 550. Bear in mind that this graph shows the proportion of government spending in the various categories. The fact that the two bars are the same height does *not* mean that state and local governments spend the same number of dollars.

State Governments

Government efforts to maintain basic health and living conditions for people who have insufficient resources of their own are called public welfare, or human services.

Public welfare is an important state government expenditure. Most of these expenditures cover **entitlement programs**. These programs provide health, nutritional, or income payments to people meeting established eligibility requirements. Costs for these programs tend to go up during a recession and down when the economy expands.

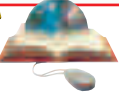
Higher Education The second-largest category of state spending is colleges and universities. Note that this spending—10.3¢ of every dollar—is much higher than the 3.9¢ that states collect from fees they charge for higher education. This shows how states **subsidize**, or pay part of the costs, of a college education. Without this subsidy, college students at state schools would have to pay more in tuition and other fees.

Highway construction and road improvement represent 5.6 percent of state expenditures. The federal government pays for much of the interstate highway system, but states maintain those and other highways that link smaller communities with larger ones.

The remaining categories take up a relatively small percentage of expenditures. Employee retirement, hospitals and health, and corrections account for 15.3¢ of every dollar that state governments spend. State governments also fund public education.

Local Governments

Local governments provide education, fire and police protection, water, sewage and sanitation services, trash collection, libraries, and recreation.

CIVICS Online 

Student Web Activity Visit civ.glencoe.com and click on **Student Web Activities—Chapter 25** to learn more about government revenue.

Education Providing education is one of the most important functions of government. In many states a large share of local tax revenues goes to pay for public schools. Some states pay a large percentage of local public school costs, but local school districts generally provide most of the money and make the key decisions regarding the operation of the public schools. The largest category of expenditures for local governments is elementary and secondary education. These expenditures account for more than one-third of local government spending.

Police and Fire Protection Police and fire protection are important and make up a large part of the local budget. 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. Because many cities draw water from the same body into which they discharge sewage, proper sewage treatment is vital to the conservation of useful water supplies. Many local governments maintain sewage treatment plants to deal with this problem.

At one time, most trash and garbage was buried. Because of environmental concerns, these landfills are no longer the simple solution to sanitation that they once were. Some local governments use garbage-processing plants to dispose of the community's solid wastes.

Reading Check Identifying What is the largest expenditure for local government?

SECTION 2 ASSESSMENT

Checking for Understanding

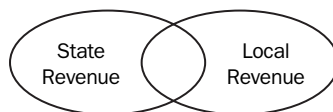
1. Key Terms Define the following terms and use them in sentences related to state and local governments: **intergovernmental revenue, sales tax, property tax, entitlement program, subsidize.**

Reviewing Main Ideas

- 2. Generalize** Why are many states not happy about the growth of Internet shopping?
- 3. Summarize** What is the source of most intergovernmental revenue for state governments? For local governments?

Critical Thinking

- 4. Evaluating Information** If you needed to raise local government revenues, which source of revenue would you target for an increase? Explain.
- 5. Making Comparisons** Re-create a Venn diagram like the one shown below. Then, compare state revenue sources to local revenue sources.



Analyzing Visuals

6. Interpret Study the two graphs that appear on page 550. What do they show? Are police and fire protection the responsibility of state or local governments?

★ BE AN ACTIVE CITIZEN ★

7. Research Contact your local government. Find out where it spends the greatest amount of money. What is its greatest source of revenue? Report your findings to the class.

Managing the Economy

GUIDE TO READING

Main Idea

Governmental budgeting is an uncertain process because governments sometimes collect more or spend more than anticipated. In an attempt to make budgeting more predictable, governments also try to influence the economy.

Key Terms

surplus, deficit, bond, debt, balanced budget, automatic stabilizer

Reading Strategy

Organizing Information

As you read, complete a graphic organizer like the one below to describe automatic stabilizers in the United States's economy.

Automatic Stabilizers	
Stabilizer:	What it does:
Stabilizer:	What it does:
Stabilizer:	What it does:

Read to Learn

- What are government surpluses and deficits?
- What is a balanced budget?



Americans in Action

To carry out all of their functions, governments spend huge sums of money. Because all resources are scarce, an increase in spending in one area will cause a decrease in spending in some other area. *U.S. News & World Report* noted that Texas lawmakers in early 2001 “had visions of an additional \$1 billion [that could be spent on] favored programs. But their dreams were fleeting: They quickly discovered that the extra money was needed to pay off budget overruns from the past two years. Spiraling Medicaid costs and increased prison expenditures had put the state nearly \$700 million over budget. . . . Texas isn’t the only state in financial trouble. Many other governors, including those in Missouri, Kansas, and Virginia, who could once deliver generous tax cuts thanks to a robust economy are also facing fiscal restraints. Some even ace tax-cut rollbacks. Among the major reasons . . . : soaring Medicaid costs coupled with [lower tax receipts].”



Governor Rick Perry
of Texas

Surpluses and Deficits

As the feature above reveals, governmental budgeting can be a difficult task. A budget, after all, is built on forecasts—predictions. 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 government can take to try to influence the economy in certain ways.

A government enjoys a **surplus** when it spends less than it collects in revenues. Look at the proposed federal budget on page 544. As you can see, the federal government planned to end the fiscal year with a surplus of \$231 billion.

A government runs a **deficit** when it spends more than it collects in revenues. Look at graph A on page 555. You will see that the federal government had deficits for almost all the years shown in the graph.

Debt

When the federal government runs a deficit, it must borrow money so it can pay its bills. The government does this by selling **bonds**. A bond is a contract to repay the borrowed money with interest at a specific time in the future. All the money that has been borrowed over the years and has not yet been paid back is the government's **debt**.

When the government has deficits, the total debt goes up. On the other hand, surpluses can be used to cut the debt. Suppose that the country 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 then it had a surplus of \$50 billion in the third year. That money could be used to reduce the debt to \$125 billion.

Because of huge budget deficits in the 1980s and early 1990s, the federal debt held by the public is now approximately \$3.4 trillion. This equals about \$11,800 for every man, woman, and child in America.

Balanced Budget

When spending equals revenues, the government has achieved a **balanced budget**. The federal government is not required by law to have a balanced budget, although many state and local governments are. In these cases, governments must cut their spending when revenues go down. This was the situation faced by some of the states in the Americans in Action feature.

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

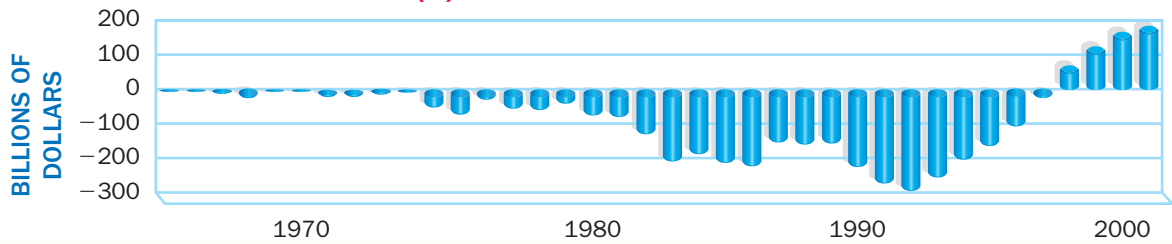
Reading Check **Describing** What is the federal debt? How do surpluses and deficits affect the debt?



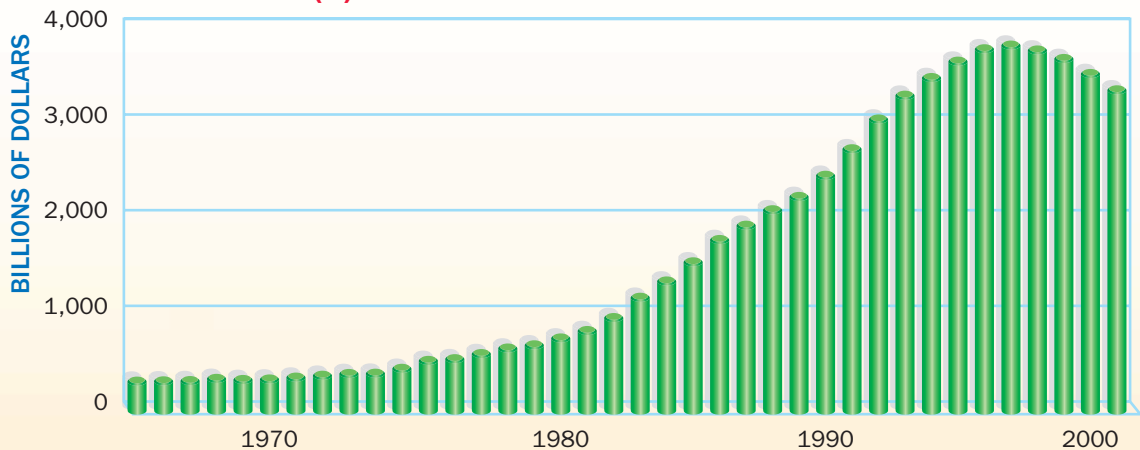
Government Spending
Social insurance programs pay benefits to retired and physically challenged people. **What happens when government expenditures are greater than government revenues?**

The Deficit and the Debt

(A) THE ANNUAL FEDERAL DEFICIT



(B) THE FEDERAL DEBT HELD BY THE PUBLIC



Analyzing Graphs

When the federal government operates at a deficit, the debt grows. When the government has a surplus, the debt decreases. In what year was the federal deficit the largest?

Online
UPDATE

Visit civ.glencoe.com and click on **Textbook Updates—Chapter 25** for an update of the data.

CLICK HERE

Fiscal Policy

You may recall from your reading of Chapter 23 that the federal government can try to use taxes and spending to help the economy grow. This practice is known as fiscal policy.

Fiscal Policy in Theory

In theory, the government can stimulate the economy during a recession by increasing spending and cutting taxes. Of course, these steps might also increase deficits. That would drive up the federal debt, creating problems for future generations.

When the economy begins to grow again, less stimulus is needed. In those times, the government can reduce spending and increase taxes. This would produce a surplus, which could lower government debt.

Fiscal Policy in Practice

In practice, 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 booming. As a result, the

Ruchit Shah has a favorite saying: “You live, you learn.” It’s a fitting philosophy, especially for a young man who has lived in three different countries and eight different towns and has started two successful businesses—all before his 18th birthday.

Born in India, the University of Texas freshman heads up ClickZen, a Web-based advertising agency he runs with his 17-year-old partner, Richard Hecker.

They pooled their resources—\$280—and launched ClickZen in the spring of 2000. In 2001, the firm had 25 employees and earned \$1.5 million in annual revenues.

“When I was a kid I always had the ambition to make a lot of money,” Shah told TIME. Shah adds, “The biggest myth is that it takes money to make money. We started with 280 dollars. It doesn’t take hard work, it takes smart work.” (It also takes parental support: neither Shah nor Hecker were old enough to sign the initial partnership papers, so that was left to their parents.)

Shah and Hecker are now thinking about how to give something back. They plan to launch a new Web site that they hope will promote world unity through information and education.

Says Shah: “While we’re looking to build our business, we’re also looking to make a difference in the world.”

Ruchit Shah from North Carolina



government sometimes stimulates the economy by spending large sums of money even when no stimulus is needed.

Further, some leaders might oppose increased spending or tax cuts on ideological grounds. Even when a majority of leaders can agree that a stimulus is needed, they often argue over where and how the money should be spent. As a result of these political issues, it is very difficult to get the government to act in a timely manner to stimulate the economy.

In addition, government action doesn’t always have the desired effect. Sometimes it takes a long time for political leaders to agree on a plan to stimulate the economy. It takes even longer for them to pass the supporting laws—appropriations, for instance—to put that plan into effect. By then, many months may have passed, and the economic situation may have changed.

Automatic Stabilizers

For these reasons, it is very difficult for the federal government to use fiscal policy to effectively stabilize the economy. Fortunately, 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.

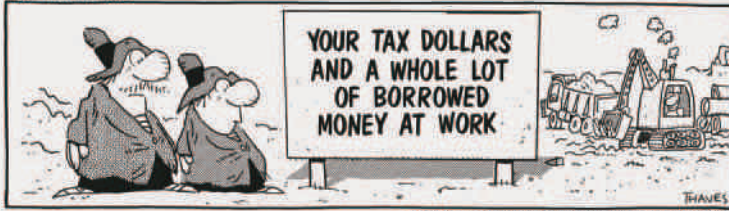
Unemployment insurance programs are one example. When people lose their jobs—as in a recession—they collect unemployment payments. These payments are not very large. Still, they do give people some help until they can find a new job—or until the economy improves and they are hired back by their former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

Many welfare programs also provide automatic assistance. For example, people might begin to collect welfare or Medicaid when their income falls below a certain



Political Cartoons

Frank and Ernest



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and it seems to be diverted toward money and
the world a more convenient

Schneider, two men with little hope, of regain-
ing the company's ——— the wage was

to be divert-
ing

Analyzing Visuals

Revenues collected through taxes make it possible for the government to provide services such as schools, parks, and roads—but tax dollars are not always sufficient to finance ambitious public projects. Explain the argument the cartoonist is making about the financing of the construction project shown in this image.

level. These payments are maintained to provide a minimum standard of living for low-income Americans. These payments help prevent consumer demand from falling even lower—which would force businesses to lay off even more workers.

The fact that the federal income tax is progressive is another stabilizer. Remember from Chapter 23 that progressive tax rates are lower at lower income levels. When people lose their jobs, their income goes down. This pushes them to lower income levels—

and puts them in a lower tax bracket. This 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 government *chooses* to implement.

Reading Check Identifying What are automatic stabilizers?

SECTION 3 ASSESSMENT

Checking for Understanding

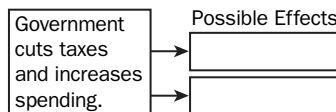
1. Key Terms Define the following terms and use them in sentences related to governmental management of the economy: **surplus, deficit, balanced budget.**

Reviewing Main Ideas

- 2. Summarize** How does a government that runs a deficit raise the money necessary to pay its debts?
- 3. Evaluate** What is the main advantage of automatic stabilizers?

Critical Thinking

- 4. Drawing Conclusions** Do you think the federal government should be required, like many state governments, to balance the budget every year? Explain.
- 5. Understanding Cause and Effect** In a graphic organizer like the one below, describe the possible effects of economic stimulus by the government.



Analyzing Visuals

6. Explain Look at the graphs that show the deficit and the debt on page 555. In what year did the federal debt first surpass \$1,000 billion?

★ BE AN ACTIVE CITIZEN ★

7. Research What is your share of the national debt today? Search the Internet under “national debt” for the debt total. Then divide that number by an estimate of the current population.

Assessment & Activities

Review to Learn

Section 1

- Just like private citizens, the government must develop a budget each year that predicts revenues and expenditures.
- The federal government's largest expenditures include Social Security, national defense, and income security.



Section 2

- State and local governments also have to prepare budgets every year that predict revenues and expenditures.
- The largest single category of spending for local governments is elementary and secondary education.



Section 3

- The federal government budgeting process tries to predict annual revenues and expenditures, and it tries to influence the economy through fiscal policy.
- Deficits add to the federal debt.

FOLDABLES™

Study Organizer

Using Your Foldables Study Organizer

Use your completed foldable to compare in an essay, table, or diagram either federal revenues to federal expenditures, state revenues to state expenditures, or local revenues to local expenditures. Share your comparison with the class.

Reviewing Key Terms

Write the key term that matches each definition below.

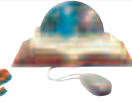
1. a 12-month financial planning period that may not coincide with the calendar year
2. the program that uses established eligibility requirements to provide health, nutritional, or income benefits to individuals
3. an act of Congress that approves government spending for particular purposes
4. government-funded health insurance for people age 65 and older
5. funds that one level of government receives from another level of government
6. an excess of government expenses over revenue
7. a tax based on the value of one's personal property and real property
8. a note from the government or a corporation promising to repay money with interest by a certain date
9. government spending that does not need the annual approval of the United States Congress
10. government expenditures that must be approved by Congress each year

Reviewing Main Ideas

11. What is the largest source of revenue for the federal government?
12. What was the largest single spending category in FY 2002 for the federal government?
13. What is the largest category of state government expenditures?
14. For which level of government does intergovernmental revenues comprise the largest percentage of revenue? Explain your answer.
15. Why is governmental budgeting such a difficult task?
16. Why is fiscal policy so difficult to enact in actual practice?

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Critical Thinking

- 17. Identifying Alternatives** What do you think the government's spending priorities should be? Give reasons for your answers.
- 18. Making Comparisons** In a graphic organizer like the one below, compare the major categories of federal government expenditures to the major categories of state and local government expenditures. Are there similarities?

Major Categories of Government Expenditures		
Federal	State	Local

Practicing Skills

- 19. Writing a Journal** List all the activities in which you take part during a three-day period in your journal. Next to each item on the list, indicate what role the government might have in that activity. Conclude with a summary on the pros and cons of government involvement in your life.

Analyzing Visuals

Study the federal budget on page 544. Then answer the following questions.

- 20.** What were the federal government's three main sources of revenue?
- 21.** What were its three largest categories of expenditures?



Economics Activity

- 22.** Many Americans are concerned over the future of the Social Security system. They fear that as the American population ages, more money will be withdrawn from the system than will be paid into it. Research the ideas put forward to secure the future of Social Security. Share your findings with the class.

★ CITIZENSHIP COOPERATIVE ACTIVITY ★

- 23.** Work in groups representing at least three regions of the United States. Each member should choose one or more states in the group's region to research. Determine which states in the region have the highest tax rate. The information needed will be:
- Highest tax rate applied to personal income
 - Highest tax rate applied to corporate income
 - Sales tax rate



Technology Activity

- 24.** Go to the IRS Web site at www.irs.gov/. Find out the following: What is e-file? How can you get help with e-filing?



Standardized Test Practice

Directions: Choose the *best* answer to the following question.

All of the following are ways to reduce a budget deficit EXCEPT

- A** cut government spending.
B increase tax revenues.
C cut tax revenues.
D raise tax revenues and decrease government spending.

Test-Taking Tip

When a question uses the word *except*, you need to look for the answer that does *not* fit.