



# Government Spending

## Why It Matters


Have you ever wondered what the government does with the money withheld from your paycheck? As you travel from home to school over the next three days, list all the examples you see of goods and services provided by federal, state, or local government. Try to determine which level of government funded them and who benefits from them the most. Share your list with the class.

## The BIG Idea

All levels of government use tax revenue to provide essential goods and services.

Spending for national defense is a responsibility of the federal government. ▶



**Economics**  **ONLINE** **Chapter Overview** Visit the *Economics: Principles and Practices* Web site at [glencoe.com](http://glencoe.com) and click on *Chapter 10—Chapter Overviews* to preview chapter information.



SECTION

1

# The Economics of Government Spending

## GUIDE TO READING

### Section Preview

In this section, you will learn that the role of the federal government has grown, making it a vital player in the economy.

### Content Vocabulary

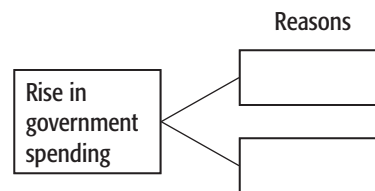
- pork (p. 261)
- public sector (p. 262)
- private sector (p. 263)
- transfer payment (p. 263)
- grant-in-aid (p. 263)
- subsidy (p. 264)
- distribution of income (p. 264)

### Academic Vocabulary

- constituents (p. 261)
- reluctant (p. 265)

### Reading Strategy

**Listing** As you read the section, complete a graphic organizer similar to the one below by listing reasons for the increase in government spending since the 1940s.



## ISSUES IN THE NEWS

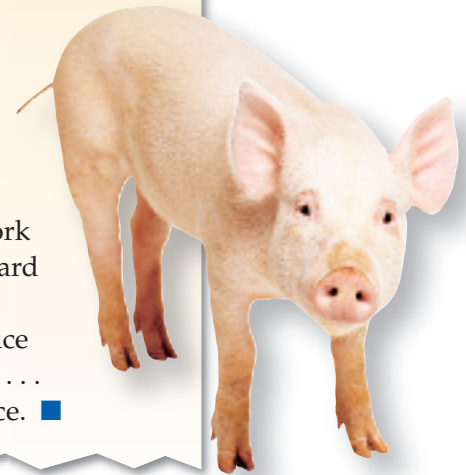
—George Will, *Washington Post*

### Grand Old Spenders

Conservatives have won seven of 10 presidential elections, yet . . . per-household federal spending [is] more than \$22,000 per year, the highest in inflation-adjusted terms since World War II. Federal spending . . . has grown twice as fast under President Bush as under President Bill Clinton, 65 percent of it unrelated to national security.

In 1991, the 546 pork projects . . . cost \$3.1 billion. In 2005, the 13,997 pork projects cost \$27.3 billion, for things such as improving the National Packard Museum in Warren, Ohio (Packard, an automobile brand, died in 1958).

Washington subsidizes the cost of water to encourage farmers to produce surpluses that trigger a gusher of government spending to support prices . . . [and] . . . almost \$2 billion is spent each year paying farmers *not* to produce. ■



**T**he amount of net spending by all levels of government—federal, state, and local—amounts to an ever-increasing portion of our GDP, the dollar measure of all final goods and services produced in a country in a year. It wasn't always this way, but sometimes politicians have a hard time saying "no" when it comes to taking care of their **constituents** and the interests of their home districts.

A recent political trend, as discussed in the news article above, is the increasingly popular use of pork in the federal budget. **Pork** is a term used by some to describe a line-item budget expenditure that circumvents normal budget-building procedures. Because most pork projects provide generous benefits to a small number of individuals or businesses, taxpayers generally would not otherwise approve the projects.

**pork** a line-item budget expenditure that circumvents normal budget procedures and benefits a small number of people or businesses



**public sector**  
that part of the  
economy made up of  
local, state, and federal  
governments

## Government Spending in Perspective

**MAIN Idea** The government spends its revenues on goods, services, and transfer payments.

**Economics & You** Do you wonder how the taxes you pay are spent? Read on to learn about government expenditures.

Spending by the **public sector**—the part of the economy consisting of federal, state, and local governments—was relatively low prior to the Great Depression. Since then, attitudes have shifted and spending has increased sharply.

### Spending Since the 1930s

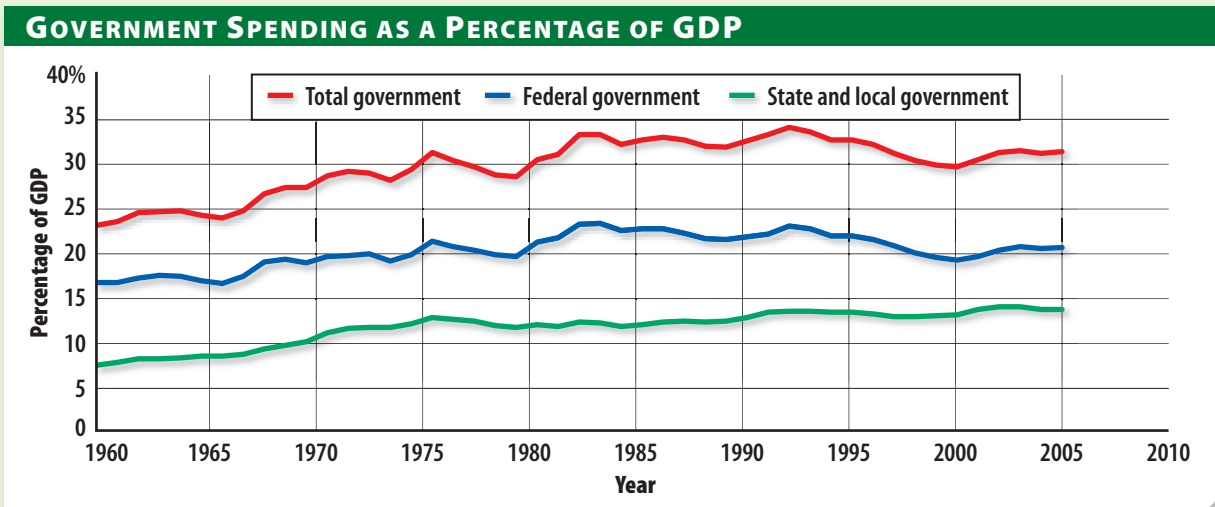
The growth in government spending since the 1930s had two main causes. First, a major change in public opinion gave government a larger role in everyday economic affairs. This change, in turn, was a response to President Franklin D. Roosevelt’s New

Deal, which used large-scale government projects to fight the Great Depression. The Tennessee Valley Authority (TVA), for example, brought low-cost electricity to millions of people in the rural South during the mid-1930s.

Second, massive government spending funded the United States involvement in World War II. This resulted in more people working, as factories converted to war production. Most people, some of whom faced unemployment during the 1930s, seemed to become more comfortable with the government’s larger role in the domestic economy.

As shown in **Figure 10.1**, expenditures by all levels of government—federal, state, and local—have grown ever since. From about 23 percent of GDP in 1960, they have increased to over 31 percent today. In fact, public-sector spending has grown so large that all levels of government combined now spend more than all of the privately owned businesses in the United States.

**Figure 10.1** ▶ **Government Spending**



Source: *Economic Report of the President*, 2006

- ▶ Spending by all levels of government has grown considerably since 1959. Between 2000 and 2005 alone, government expenditures have consumed an additional 5.4 percent of GDP, a \$674 billion increase.

**Economic Analysis** Does the graph show any period of decreased government spending?

**Graphs in Motion**

See StudentWorks™ Plus  
or [glencoe.com](http://glencoe.com).



Some people question how many goods and services government should provide and, therefore, what level of revenue collection is required to support these expenditures. Others question which services the government should provide and which services the **private sector**—the part of the economy made up of private individuals and privately owned businesses—should provide.

## Two Types of Spending

In general, government makes two broad kinds of expenditures. The first is in the form of goods and services. The government buys many goods, such as tanks, planes, ships, and even space shuttles. It needs office buildings, land for parks, and capital goods for schools and laboratories. The government also needs to purchase supplies and pay for utilities. Finally, it must hire people to work in its agencies and staff the military. Payments for these services include the wages and salaries for these workers. State and local governments have similar expenditures.

The second type of government expenditure is a **transfer payment**—a payment for which the government receives neither goods nor services in return. Transfer payments can be made to individuals and include Social Security, unemployment compensation, welfare, and aid for people with disabilities. With the exception of Social Security, people normally receive these payments solely because they need assistance.

A transfer payment that one level of government makes to another is known as a **grant-in-aid**. The receiving government counts this payment as intergovernmental revenue. Interstate highway construction programs are examples of grants-in-aid. The federal government grants money to cover the major part of the cost, while the states in which the highways will be built pay the rest. The construction of new public schools also can be financed through grants-in-aid.

**✓ Reading Check** **Contrasting** What is the difference between transfer payments and government spending on goods and services?

### Grants-in-Aid

States usually receive federal funds to pay for the majority of highway construction projects. ***Why do states rely on federal funds for such projects?***

**private sector**  
that part of the economy made up of private individuals and businesses

**transfer payment**  
payment for which the government receives neither goods nor services in return

**grant-in-aid**  
transfer payment from one level of government to another that does not involve compensation



**Allocation of Resources** States require students to take graduation exams because of federal legislation. *How can such laws affect the economy?*

## Impact of Government Spending

**MAIN Idea** Government spending has a direct impact on our economy.

**Economics & You** Have you considered attending a public college because a private one seems out of reach? Read on to find out how government spending affects your life.

The enormous size of the public sector gives it the potential to affect people’s daily lives in many ways. It can affect resource allocation, the distribution of income, production in the private sector, and the tax burden on people.

### Affecting Resource Allocation

Government spending decisions directly affect how resources are allocated. If the government spends its revenues on missile systems in rural areas, for example, rather than on social welfare programs in urban areas, the shift of resources stimulates economic activity in rural areas.

Public sector spending can indirectly affect allocation of resources. In agriculture, the decision to support the prices of cotton, milk, grains, or peanuts keeps the factors of production working in those industries.

If the government withdraws the **subsidies** for these crops, farmers would produce less of each and resources would be released for employment in other industries.

Government is so involved in the economy that even seemingly modest decisions can have an enormous impact on the things we produce. For example, because of the No Child Left Behind legislation, the government now requires schools to conduct extensive testing in reading and math.

As a result, some schools have increased the amount of time they spend on these subjects and therefore have decreased the amount of time spent on other subjects. The decision to downgrade or even drop other subjects diminishes the demand and eventually the production of textbooks and educational supplies used in those areas, while increasing the demand for resources needed for reading and math.

### Redistributing Income

Government spending also influences the **distribution of income**, or the way in which income is allocated among families, individuals, or other groups. Increasing or decreasing transfer payments, for example, can directly affect the incomes of needy families who receive financial support from the government.

**subsidy** government payment to encourage or protect a certain economic activity (*also see page 122*)

**distribution of income** way in which the nation’s income is divided among families, individuals, or other designated groups



Government decisions about where to make expenditures indirectly affect many people's incomes. The decision to buy fighter planes from one factory rather than another has an impact on the communities near both factories. The decision to spend billions on rebuilding Iraq and Afghanistan increased the incomes of those working in the national defense industries but not those who work in inner cities or other areas that lack such factories.

## Competing With the Private Sector

When the government produces goods and services, it often competes with the private sector. In higher education, many public colleges and universities compete with more expensive private ones. The cost difference often is due to the subsidies public institutions receive from their states.

In the area of health care, the government runs a system of hospitals for military veterans, which are funded with taxpayer

dollars. At the same time, these facilities compete with hospitals in the private sector that offer similar services.

## Increasing the Tax Burden

Finally, the growth of government spending has not gone unnoticed by the average American. The increased tax burden that is needed to support the expenditures has attracted enormous attention in recent years. Most people would like to reduce their taxes, but most people are also **reluctant** to give up the many benefits that government provides.

In short, spending by all levels of government, which amounts to about one-third of our GDP, has a large and often controversial impact on the American economy. Finding the money to pay for these expenditures is a difficult task. Yet many people seem to want even more of these goods, services, and transfer payments.

**✓ Reading Check** **Explaining** How does government spending affect the distribution of income?

### Skills Handbook

See page R44 to learn about **Detecting Bias**.

## SECTION

# 1

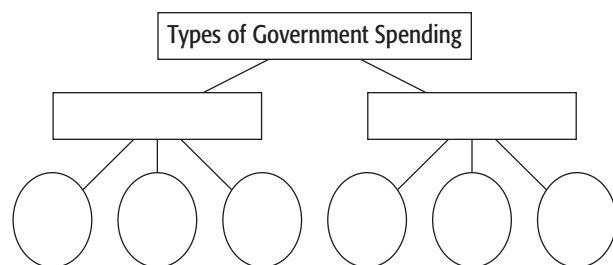
## Review

### Vocabulary

- 1. Explain** the significance of pork, public sector, private sector, transfer payment, grant-in-aid, subsidy, and distribution of income.

### Main Ideas

- 2. Identifying** In which three ways might government spending impact the economy?
- 3. Listing** Use a graphic organizer like the one below to list two kinds of government spending and provide three examples of each.



### Critical Thinking

- 4. The BIG Idea** Describe two reasons for the growth of government spending since the 1930s.
- 5. Analyzing Visuals** Look at Figure 10.1 on page 262. How does the spending by state and local governments compare to federal spending? What might explain any differences?
- 6. Explaining** Why are people often reluctant to support a reduction in government spending?
- 7. Detecting Bias** How does the “pork” spending described by the columnist on page 261 illustrate a conflict between political and economic goals?

### Applying Economics

- 8. Transfer Payments** Do you think that transfer payments, such as unemployment compensation, are a successful or unsuccessful way to accomplish the goal of economic security? Explain your answer.



In the United States, the government sector competes with the private sector for scarce resources. This does not just mean the resources to build interstate highways or ensure food safety. In fact, there is a particularly scarce resource the government is trying to lure from the private sector—brains.

## The NSA: Security in Numbers

The job offers arrived in plain envelopes. For decades, the mathematicians who accepted them stole off to Washington and the hush-hush National Security Agency, the nation’s top techno-spy center. Through the cold war, NSA math whizzes matched wits with the Soviets. Each side protected its own secret codes while trying to break the other’s.

Math is more important than ever at the NSA. Chances are, the world’s growing rivers of data contain terrorist secrets, and it’s up to the agency’s math teams to find them. But to land the best brains, the NSA must compete with free-spending Web giants such as Google and Yahoo! This is leading the agency to open up its recruiting process.

“We have to look at new and innovative ways to find talent,” says Cynthia Miller-Wentt, chief of the NSA’s recruitment office. . . . There’s a second hitch: Unlike the tech companies it must compete with,



the NSA can hire only U.S. citizens. This is a severe constraint. About half of the estimated 20,000 math graduate students at U.S. universities are foreigners. They’re off bounds, as are the bountiful math brains in India, China, Eastern Europe, and elsewhere.

The NSA’s pitch? First the agency appeals to the recruits’ patriotism. But there’s also a lifestyle lure. NSA officials say a good number of mathematicians prefer a suburban Maryland life and a government job with predictable hours to the more frantic pace and market gyrations of an Internet company. . . .

—Reprinted from *BusinessWeek*

### HOW MATH TRANSFORMS INDUSTRIES

#### Marketing

**Umbria:** The Colorado startup assigns numeric values to “picks” and “pans” of products that pop up on blogs and podcasts.

#### Consulting

**IBM:** Big Blue is building math profiles of 50,000 consultants so that computers can pick the perfect team for every assignment. Other tools eventually will be able to track their progress, hour by hour, and rate their performance.

#### Advertising

**Efficient Frontier:** The Silicon Valley startup calculates response rates and return on investment for every advertisement of online ad campaigns. It provides a broad shift from hunch-based campaigns to mathematical targeting.

Source: *BusinessWeek*

### Examining the Newsclip

- 1. Summarizing** What work do mathematicians perform for the NSA?
- 2. Analyzing** Why is it difficult for the NSA to compete with the Internet giants in hiring mathematicians?



SECTION  
**2**

# Federal, State, and Local Government Expenditures

## GUIDE TO READING

### Section Preview

In this section, you will learn that governments provide money for many services and programs.

### Content Vocabulary

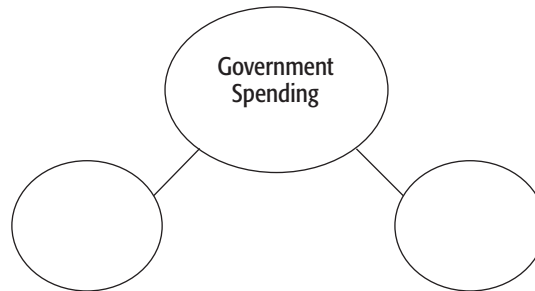
- federal budget (p. 267)
- fiscal year (p. 268)
- appropriations bill (p. 268)
- budget deficit (p. 269)
- budget surplus (p. 269)
- mandatory spending (p. 269)
- discretionary spending (p. 270)
- Medicare (p. 270)
- Medicaid (p. 271)
- balanced budget amendment (p. 271)
- intergovernmental expenditures (p. 272)

### Academic Vocabulary

- ambiguity (p. 267)
- coincide (p. 268)

### Reading Strategy

**Describing** As you read the section, complete a graphic organizer similar to the one below by describing the different types of government spending.



## ISSUES IN THE NEWS

—Los Angeles Times

### The President's Budget Plan

President Bush on Monday sent Congress a proposed \$2.77 trillion budget for 2007 that would boost Defense and Homeland Security while trimming the growth of Medicare and other social service programs . . . [and] . . . leave a deficit of \$354 billion next year—the fourth-largest ever in dollar terms—which would settle down to around \$200 billion for the subsequent four years. . . .

Departments that would gain the most under Bush's budget include the Pentagon, which would see spending rise 7%, and the Department of Homeland Security, where a 6% increase would go largely to immigration enforcement, air travel security and the Federal Emergency Management Agency. ■



When it comes to the numbers presented in the **federal budget**—the annual plan outlining proposed revenues and expenditures for the coming year—there is often a fair amount of **ambiguity**. As the news article above shows, the federal budget offers only a rough estimate of the actual revenues and expenditures.

For example, the economy could suddenly slow down or speed up, affecting the amount of tax revenues collected. In addition, events might occur that require unanticipated spending. This was the case after the terrorist attacks on September 11, 2001, and the subsequent wars in Afghanistan and Iraq.

**federal budget**  
annual plan outlining proposed expenditures and anticipated revenues





Student Web

Activity Visit the Economics: Principles and Practices Web site at [glencoe.com](http://glencoe.com) and click on Chapter 10—Student Web Activity for an activity on the federal budget.

# Federal Government Expenditures

**MAIN Idea** The federal government establishes a budget and allocates funds accordingly.

**Economics and You** Has your family created a budget to control income and expenses? Read on to learn how the federal government makes its budget decisions.

**fiscal year**

12-month financial planning period that may not coincide with the calendar year

**appropriations bill**

legislation authorizing spending for certain purposes

The federal budget spans a **fiscal year**—a 12-month financial planning period that may or may not **coincide** with the calendar year. The government’s fiscal year starts on October 1 and expires on September 30 of the following calendar year.

## Establishing the Federal Budget

The president’s Office of Management and Budget (OMB), part of the executive branch, is responsible for preparing the federal budget. However, the president’s budget is only a request, and Congress can approve, modify, or disapprove it. By law, the budget must be sent to both houses of Congress by the first Monday in February.

Once the House of Representatives receives the president’s budget request, it breaks down the budget into 13 major

expenditure categories and assigns each to a separate House subcommittee. Each of the subcommittees then prepares an **appropriations bill**, an act of Congress that allows federal agencies to spend money for a specific purpose. Subcommittees hold hearings, debate, and vote on each bill. An approved bill is sent to the full House Appropriations Committee. If it passes there, the bill is sent to the entire House for a vote.

The Senate acts on the budget after the House has approved it. The Senate may approve the bill as sent by the House, or it may draft its own version. If differences exist between the House and the Senate versions, a joint House-Senate conference committee tries to work out a compromise bill. During this process, the House and the Senate often seek advice from the Congressional Budget Office (CBO). The CBO is a nonpartisan congressional agency that evaluates the impact of legislation and projects future revenues and expenditures that will result from the legislation.

If the House and Senate both approve the compromise bill, they send it to the president for signature. Because Congress literally took apart, rewrote, and put back together the president’s budget, the final

### Public Hearings

Secretary of State Condoleezza Rice discusses the State Department’s budget with an appropriations committee.

**Which part of Congress holds hearings?**





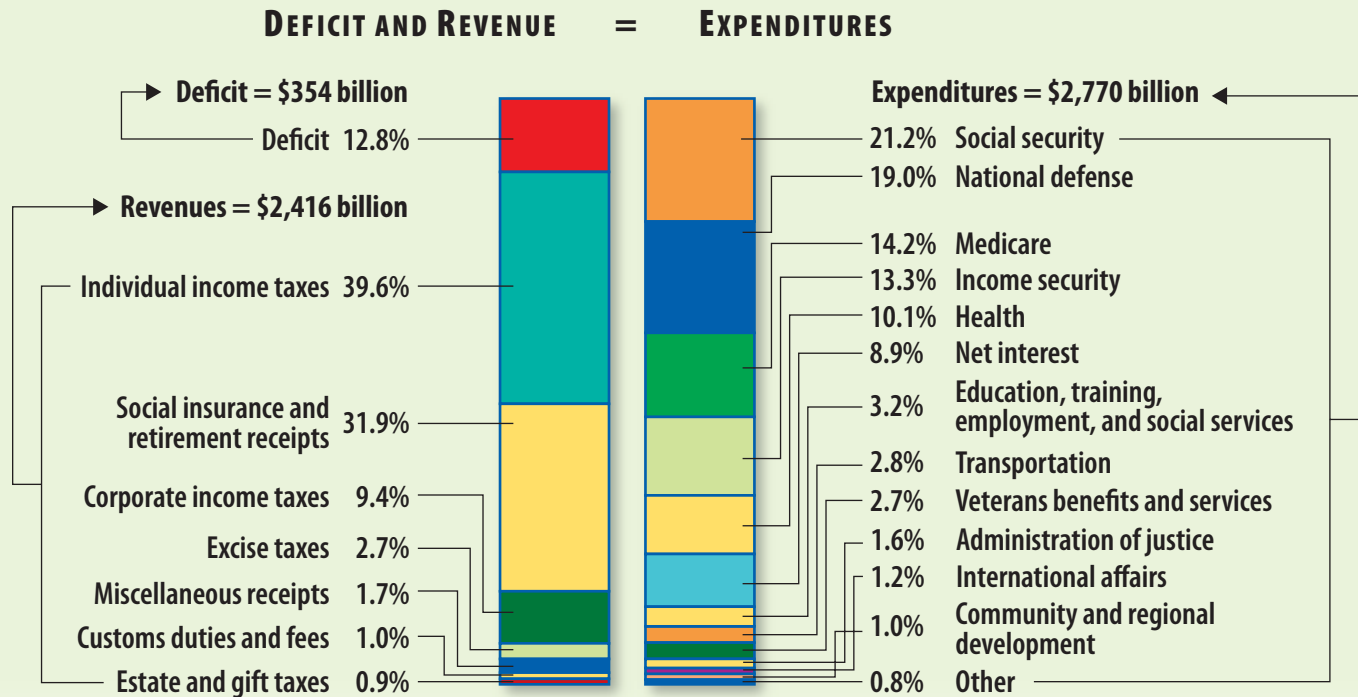
## Figure 10.2 ▶ The Federal Budget for Fiscal Year 2007

Graphs In Motion

See StudentWorks™ Plus or [glencoe.com](http://glencoe.com).

▶ In its budget, the federal government projected revenues of \$2,416 billion and planned on spending \$2,770 billion in fiscal year 2007. The difference of \$354 billion, or 12.8 cents of every dollar spent, would be borrowed from investors.

**Economic Analysis** *What is the largest mandatory spending item in the budget? The largest discretionary item?*



Sources: Department of the Treasury, Office of Management and Budget, 2006

version may not resemble the original proposal. In many cases, a bill may have changed considerably, with items added to the president's original budget.

If the budget was altered too much, the president can veto the bill and force Congress to come up with a budget closer to the original version. However, once signed by the president, the budget becomes the official document for the next fiscal year that starts on October 1.

The federal budget shown in **Figure 10.2** is called the fiscal year 2007 budget because 9 of the 12 calendar months fall within the year 2007. The figure shows \$2,416 billion (over \$2 trillion) of revenues and \$2,770 billion of spending, leaving a **budget deficit**—an excess of expenditures

over revenues—of \$354 billion. If expenditures were less than revenues, the result would be a **budget surplus**.

### Social Security

The individual expenditures in the federal budget can be grouped into broad categories. The largest is for payments to aged and disabled Americans through the Social Security program. Retired persons receive benefits from the Old-Age and Survivors Insurance (OASI) program. Those unable to work receive payments from disability insurance (DI) programs.

Spending for Social Security is sometimes called **mandatory spending**, or spending authorized by law that continues

**budget deficit**  
a negative balance after expenditures are subtracted from revenues

**budget surplus**  
a positive balance after expenditures are subtracted from revenues

**mandatory spending**  
federal spending authorized by law that continues without the need for annual approvals by Congress

**discretionary spending** spending for federal programs that must receive annual authorization

**Medicare** federal health-care program for senior citizens, regardless of income

without the need for annual approvals by Congress. This is because the total Social Security payments in any given year are dependent on the number of people eligible for Social Security and the level of benefits already approved by Congress.

### National Defense

For much of the late 1900s, national defense comprised the largest category of spending, although it is now second to Social Security. National defense includes

military spending by the Department of Defense and defense-related atomic energy activities, such as the development of nuclear weapons and the disposal of nuclear wastes.

Defense expenditures are called **discretionary spending**—spending that must be approved by Congress in the annual budgetary process. Unlike Social Security payments, which normally go up as the population gets older, annual defense expenditures can go up, down, or remain the same, depending on the will of the president and Congress.

## CAREERS

### Budget Analyst

#### The Work

- \* Research, analyze, develop, and execute annual budgets or financial plans
- \* Seek new ways to improve a company's efficiency and increase profits
- \* Review financial requests, examine past and current budgets, and research developments that can affect spending



#### Qualifications

- \* Keen analytical skills and knowledge of mathematics, statistics, accounting, and computer science
- \* Strong oral and written communication skills to present—and defend—budget proposals
- \* Ability to work well under deadlines
- \* Bachelor's degree, with most firms and government employers requiring a master's degree

#### Earnings

- \* Median annual earnings: \$56,040

#### Job Growth Outlook

- \* Average

**Source:** *Occupational Outlook Handbook, 2006–2007 Edition*

### Income Security

Income security consists of a wide range of programs that includes retirement benefits for both federal civilian employees and retired military. Other programs are designed to support people unable to fully care for themselves.

Federal programs pay for child care, foster care, and adoption assistance. Those unable to support themselves receive Supplemental Security Income (SSI), subsidized housing, federal child support, Temporary Assistance for Needy Families (TANF), and food stamps. Most income security expenditures are mandatory and therefore not authorized annually.

### Medicare

**Medicare**, a health-care program available to all senior citizens regardless of income, began in 1966 and is another mandatory program. It provides an insurance plan that covers major hospital costs. Medicare also offers optional insurance that provides additional coverage for doctor and laboratory fees, outpatient services, and some equipment costs.

In recent years, Medicare expenditures have risen dramatically as the population has aged and the cost of caring for the elderly has gone up. Given the increasing cost of medicine and current population trends, increases in this category of expenditure are expected to continue.



## Health

Health-care services for low-income people, disease prevention, and consumer safety account for a significant part of the federal budget. **Medicaid**, for example, is a joint federal-state medical insurance program for low-income persons. Because the payments have already been determined by Congress, this is one of the mandatory expenditure programs. Other mandatory programs include health-care services for working and retired federal employees.

Some programs in this category are discretionary. The Occupational Safety and Health Administration (OSHA), which monitors occupational safety and health in the workplace, is one such program. Other discretionary programs include AIDS and breast cancer research, substance abuse treatment, and mental health services.



## Net Interest on Debt

When the federal government spends more than it collects in taxes and other revenues, it borrows money to make up the difference. The government has to pay interest on this debt, and the interest currently makes up the sixth-largest category of federal spending.

The amount of interest paid is a mandatory expenditure that varies with changes in interest rates and the size of the federal debt. The federal government is still running deficits and therefore adding to its total debt. If interest rates rise, then this will become an increasingly larger category in the federal budget.

## Other Expenditure Categories

Other broad categories of the federal budget include education, training, employment, and social services; transportation; veterans' benefits; administration of justice; and natural resources and the environment. They include both mandatory and discretionary spending.

**✓ Reading Check** **Summarizing** What steps are involved in establishing the federal budget?

## State Government Expenditures

**MAIN Idea** At the state level, expenditures include public welfare and higher education.

**Economics and You** If you want to attend college, have you found money available for financial aid? Read on to learn where these funds come from.

Individual states, like the federal government, also have expenditures. Like the federal government, states must approve spending before distributing funds.

## The Budget Process

At the state level, the process of creating a budget and getting approval for spending can take many forms. For example, some states such as Kentucky have bi-annual budgets, or budgets that cover two years at a time. In most states, the process is loosely modeled after that of the federal government. Unlike the federal government, however, some states have a **balanced budget amendment**—a constitutional provision requiring that annual spending not exceed revenues.

**Medicaid** People with disabilities are among those eligible for Medicaid if they cannot afford health care. **Why is Medicaid a mandatory expenditure?**

**Medicaid** joint federal-state medical insurance program for low-income people

**balanced budget amendment** constitutional amendment requiring government to spend no more than it collects in taxes and other revenues, excluding borrowing



**intergovernmental expenditures** funds that one level of government transfers to another level for spending

Under this provision, states often must cut spending when revenues drop. A reduction in revenues may occur if sales taxes or state income taxes fall because of a decline in the general level of economic activity.

### Intergovernmental Expenditures

As **Figure 10.3** on the opposite page shows, the largest category of state spending is **intergovernmental expenditures**—funds that one level of government transfers to another level for spending. These funds come from state revenue sources such as sales taxes, and they are distributed to counties, cities, and other local communities to cover a variety of educational and other municipal expenditures.

### Public Welfare

The second largest category of state expenditures is public welfare. These payments take the form of cash assistance, payments for medical care, spending to maintain welfare institutions, and other welfare expenditures.

### Insurance Trust and Retirement

Many states have their own insurance and retirement funds for state employees. The money in these funds is invested until

employees retire, become unemployed, or are injured on the job. Contributions to these funds make this category a significant expenditure. Their main beneficiaries are teachers, legislators, highway workers, police, and other state employees.

### Higher Education

State governments have traditionally taken responsibility for the large task of funding state colleges and universities. In most states, the tuition that students pay covers only a portion of higher education expenses. States usually budget funds to pay the remainder of the cost. On average, higher education is the fifth-largest state expenditure.

### Other Expenditures

The expenditures in the remaining state budget categories are relatively small. As Figure 10.3 shows, states spend money on a wide range of activities including corrections; utilities such as electricity, gas, and water; hospitals; and parks and recreation. Highways and road improvements are possible exceptions because they may require larger amounts of state money.

**✓ Reading Check** **Explaining** How does a balanced budget amendment work?

Bob Rowan/Progressive Image/Corbis

**Higher Education**  
States usually fund part of the expenses for state colleges and universities.  
**What are other large categories of state expenditures?**



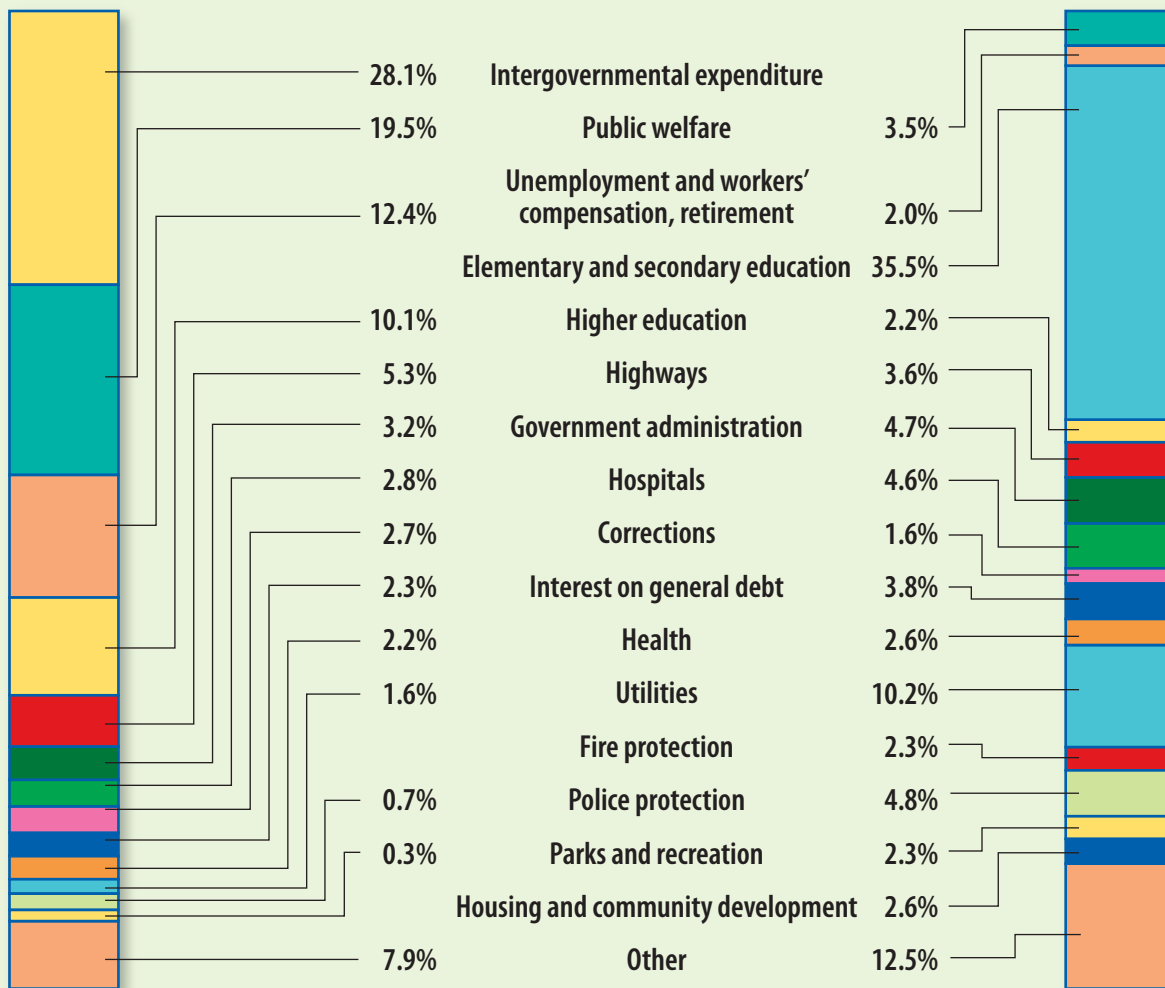
# Figure 10.3 ▶ State and Local Expenditures

▶ Both state and local expenditures consist of a myriad of categories. Intergovernmental expenditures and public welfare use up almost half of state budgets, while education is the main expenditure for local governments.

**Economic Analysis** *How do expenditures for public welfare, education, and utilities compare between state and local governments?*

State \$1,359 billion

Local \$1,195 billion



Source: Bureau of the Census, August 2006

Variations due to rounding



# The Global Economy & YOU



## Footing the Bill for Public Education

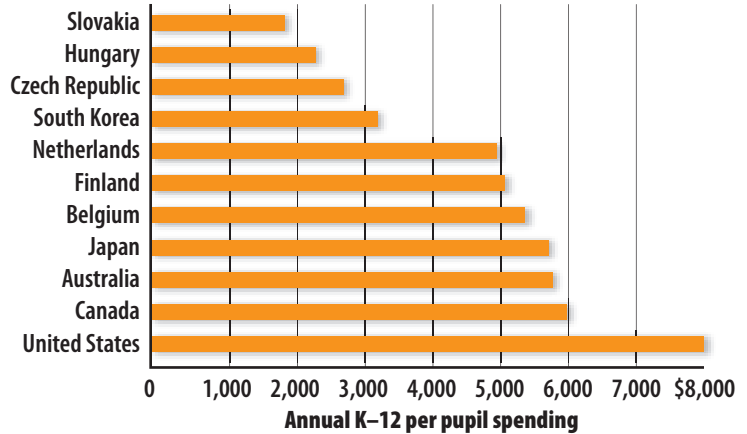
Nearly 50 million students are enrolled in public elementary and secondary schools in the United States. Property taxes and intergovernmental revenues are the largest funding sources for these schools.

How much does your education cost in taxpayer dollars? For the 2002–2003 school year, expenditures per student averaged \$8,044 in the United States. New Jersey had the highest expenditures with \$12,568 per student. Utah was at the lowest end of the range, with expenditures at \$4,838 per student.

As the world becomes more economically interdependent, you will face increasing global competition for jobs after you graduate. While the United States spends on average more on education to prepare you and other students, this spending is no guarantee of success. When students all over the world participated in a math achievement test, U.S. students ranked

lower in the test than did those of other countries. Perhaps money can buy schools, but it cannot buy student learning.

### INTERNATIONAL EDUCATION SPENDING



Source: National Center for Education Statistics

## Local Government Expenditures

**MAIN Idea** Local governments spend money mainly on education, utilities, and public safety.

**Economics and You** Have you ever wondered who pays for textbooks or extracurricular activities at your school? Read on to find out about the responsibilities of local governments.

Local governments include counties, parishes, townships, municipalities, tribal councils, school districts, and other special districts. The different categories of expenditures made by these local governments are illustrated in Figure 10.3 on the previous page.

### The Budget Process

At the local level, power to approve spending often rests with the mayor, the city council, the county judge, or some

other elected representative or body. The methods used to approve spending and the dates of the fiscal year itself are likely to vary considerably from one local government to the next.

Generally, the amount of revenues collected from property taxes, city income taxes, and other local sources is relatively small and limits the spending of local agencies. Some local governments are even bound by state requirements to avoid deficit spending.

### Elementary and Secondary Education

Local governments have primary responsibility for elementary and secondary education. Expenditures budgeted in this category include administrators' and teachers' salaries, wages for maintenance and cafeteria workers, textbooks, and other supplies. School districts also pay

for the construction and upkeep of all school buildings. Schools account for more than one-third of all local government spending, making it the largest item in most local budgets.

## Utilities

Public utilities serve communities by providing services such as sewerage, electricity, natural gas, and water. For most local governments, spending on these utilities amounts to the second-largest expenditure and consumes about 10 percent of local spending.

In the typical community, the majority of expenditures on utilities are for schools, libraries, civic centers, and administrative buildings. Street lighting and traffic lights account for other expenditures.

## Public Safety and Health

Most communities maintain a full-time, paid police force. Many have fire departments with paid, full-time firefighters as

well. However, some communities, especially those with smaller populations and limited budgets, maintain volunteer fire departments to keep the cost down. On the other hand, some communities, especially larger cities, own and staff their own hospitals.

Spending for health and safety in general tends to be about equal for each local government. However, the spending on these categories varies greatly from one state to another.

## Other Expenditures

Highways, roads, and street repairs absorb most of the remaining spending. This category includes the repair of potholes, the installation and repair of street signs, snow removal, and other street-related items that are not covered by state budgets.

**✓ Reading Check** **Synthesizing** Which local expenditures would you categorize as mandatory spending, and why?



See page R47 to learn about **Making Predictions**.

### SECTION

## 2

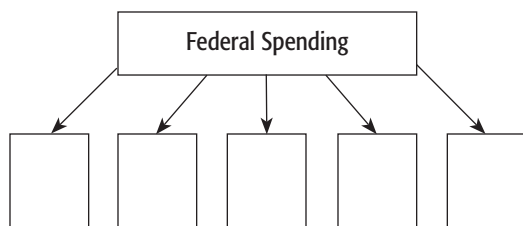
## Review

### Vocabulary

1. **Explain** the significance of federal budget, fiscal year, appropriations bill, budget deficit, budget surplus, mandatory spending, discretionary spending, Medicare, Medicaid, balanced budget amendment, and intergovernmental expenditures.

### Main Ideas

2. **Listing** Use a graphic organizer like the one below to list the five largest federal government expenditures.



3. **Discussing** What is the focus of state budgets?
4. **Describing** How do local governments spend their funds?

### Critical Thinking

5. **The BIG Idea** Describe the difference between mandatory and discretionary spending.
6. **Making Predictions** People are living longer, and families have fewer members. How will the combination of these two factors affect future transfer payments such as Social Security?
7. **Making Generalizations** If you were to argue for reduced spending at the state and local levels, which categories would you choose?
8. **Analyzing Visuals** Look at Figure 10.3 on page 273. Why do state expenditures not include elementary and secondary education? Do they not pay for it? Explain.

### Applying Economics

9. **Local Government Spending** Conduct research on the budget procedures for your local city or county government. Write an essay describing how the budget is created and who has spending authority.





# CASE STUDY

## Boeing Going Strong

### Wide Range of Products

The United States government spends billions of dollars for defense every year; in 2005 alone, that amount exceeded \$500 billion. One of the companies the government has turned to for its defense needs is aircraft manufacturer Boeing. Employees at Boeing have built helicopters and passenger planes, fighter planes and missiles, satellites and spacecraft. They have sent astronauts to the moon and brought countries together aboard the International Space Station.



### NEWS FLASH

#### Fighting Terrorism

In 2002, Boeing was awarded a contract by the U.S. Department of Transportation to provide explosive detection systems in 438 U.S. airports.

Seaplane. Just a year later the company began its relationship with the government through test flights for the U.S. Navy. The Navy responded by ordering 50 seaplane trainers for a total of \$116,000. Almost 90 years later in 2003, the Navy purchased 210 Super Hornets for a staggering \$8.6 billion.

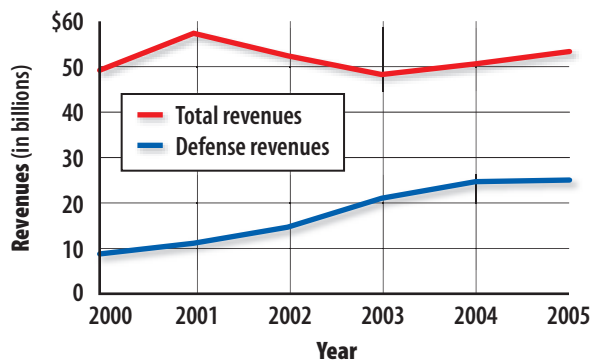
### Boeing's Defense Link

William Boeing, founder and owner, started the company in 1916 with the incorporation of the Pacific Aero Products Company. That same year, Boeing produced its first airplane, the B&W

### Ahead of the Pack

Over time, Boeing has become the world's leading aerospace producer and the largest manufacturer of commercial jetliners and military aircrafts combined. From its small beginnings, the company now has customers in nearly 150 countries, with 150,000 workers in 48 states and 67 countries. While Boeing sells its products to both governments and private customers, defense revenues make up more than half of total revenues—and help Boeing to be the second-largest defense company in the United States.

BOEING DEFENSE AND TOTAL REVENUES



Source: www.defensenews.com

### Analyzing the Impact

- Summarizing** Why is defense spending important to Boeing?
- Drawing Conclusions** What world events may have contributed to the increase in defense revenues from 2000 to 2005?



SECTION  
**3**

# Deficits, Surpluses, and the National Debt

## GUIDE TO READING

### Section Preview

In this section, you will learn that deficit spending has helped create a national debt.

### Content Vocabulary

- deficit spending (p. 278)
- national debt (p. 278)
- balanced budget (p. 278)
- trust funds (p. 278)
- per capita (p. 279)
- crowding-out effect (p. 281)
- “pay-as-you-go” provision (p. 282)
- line-item veto (p. 282)
- spending cap (p. 282)
- entitlement (p. 283)

### Academic Vocabulary

- mandate (p. 282)
- instituted (p. 282)

### Reading Strategy

**Discussing** As you read the section, list the various attempts by government to reduce the federal deficit and the national debt, then discuss the results.

Attempt	Result

## ISSUES IN THE NEWS

—*The Kentucky Post*

### Expensing Our Wars

[T]he chairman of the Senate Budget Committee, Judd Gregg, a Republican from New Hampshire, is considering treating the cost of the wars in Iraq and Afghanistan as a regular budget item.

The Bush administration has spent \$440 billion so far on those wars, \$120 billion of it this fiscal year, and the meter is running at the rate of \$4.5 billion a month in Iraq and \$800 million a month in Afghanistan.

The wars have been funded in a series of five emergency spending measures [that] are intended to deal with sudden, unexpected and short-term emergencies like [hurricane] Katrina. The bills are passed outside the regular appropriations process and are carried off budget, [which] tends to minimize the apparent cost. ■



In the past 45 years, the federal budget has shown a surplus only five times. The first was in 1969, and the last four occurred in the years 1998 to 2001. Federal budget deficits in most years have added to the total amount of debt that the government owes. Since 2001 more than \$2 trillion in debt has been added, bringing the total national debt to about \$8.5 trillion.

Deficits occur for a number of reasons. For one, tax reductions are politically popular. For another, most people are in favor of the government spending more money on them. Finally, expenses such as wars and natural disasters are difficult to predict. However, as we read in the news article, expenditures don't go away simply because they are not recorded in the budget.



### deficit spending

annual government spending in excess of taxes and other revenues

### national debt

total amount borrowed from investors to finance the government's deficit spending

### balanced budget

annual budget in which expenditures equal revenues

### trust fund

special account used to hold revenues designated for a specific expenditure such as Social Security, Medicare, or highways

## From Deficits to Debt

**MAIN Idea** Because of deficit spending, the national debt has increased dramatically.

**Economics and You** Do you recall news stories about the nation's budget deficit? Read on to learn how deficits are created.

Historically, a remarkable amount of **deficit spending**—or spending in excess of revenues collected—has characterized the federal budget. Sometimes the government plans deficit spending. At other times, the government is forced to spend more than it collects because unexpected developments cause a drop in revenues or a rise in expenditures.

### Predicting the Deficit

The government projected a \$354 billion deficit for fiscal year 2007. Whether this is the actual amount at the end of the fiscal year, however, depends on the way expenditures are reported and the state of the economy.

For example, no money was budgeted for the wars in Afghanistan and Iraq in the fiscal year 2007 budget. Instead, the president and Congress made nearly \$100 billion of “supplemental requests” to cover the anticipated war costs. These war expenditures will ultimately be reflected in the amount of money the government spends, but they did not appear in the budget when it was first released.

Second, changes in the economy affect budget projections. Strong economic growth could cause the deficit to shrink because of

higher tax collections and lower unemployment claims. Likewise, a downturn in the economy could result in lower tax collections and higher unemployment insurance payments.

### Deficits Add to the Debt

**Panel A** of **Figure 10.4** on the opposite page shows the history of the federal budget deficit since 1965. When the federal government runs a deficit, it must finance the revenue shortage by borrowing. It does this by selling U.S. Treasury notes and other securities to the public. If we add up all outstanding federal notes, bonds, and other debt obligations, we have a measure of the **national debt**—the total amount borrowed from investors to finance the government's deficit spending.

As **Panel B** in **Figure 10.4** shows, the national debt grows whenever the government runs a deficit by spending more than it collects in revenues. If the federal budget runs a surplus, then some of the borrowed money is repaid and the amount of total debt goes down, as it did from 1998 to 2001. If the federal government achieves a **balanced budget**—an annual budget in which expenditures equal revenues—the national debt will not change.

### A Growing Public Debt

The national debt has grown almost continuously since 1900, when the debt was \$1.3 billion. By 1929 it had reached \$16.9 billion, and by 1940 it was \$50.7 billion. By mid-2006 the total national debt had reached about \$8.5 trillion.

Some of this debt is money that the government owes itself. For example, approximately \$3.5 trillion of this debt is in government **trust funds**—special accounts used to fund specific types of expenditures such as Social Security and Medicare. When the government collects the FICA or payroll tax, it puts the revenues in these trust accounts. The money is then invested in government securities until it is paid out.

## Did You Know?

➔ **Deficits Anyone?** European countries that want to become members of the European Union (EU) and adopt the euro as their currency have to take their deficits seriously. To be eligible, they must be able to control their economies—and that includes their budgets. In order to be accepted into the “euro zone,” a nation is expected to keep its budget deficit at less than 3 percent of its GDP and its public debt at less than 60 percent of its GDP.

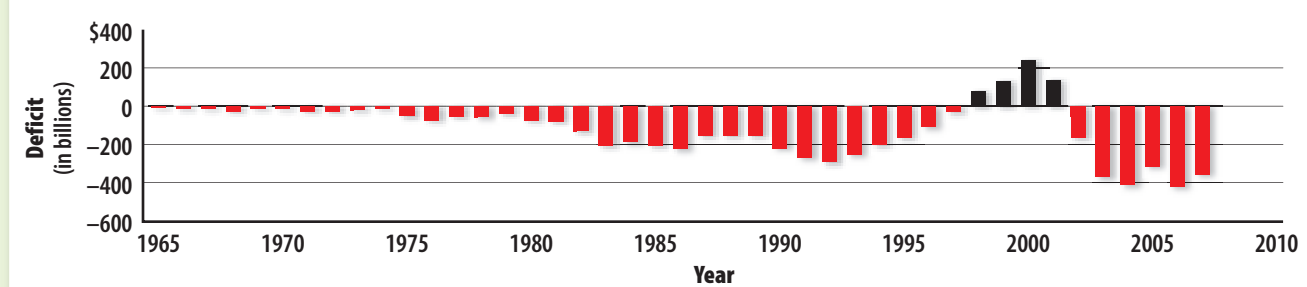


## Figure 10.4 ▶ The Federal Deficit and the National Debt

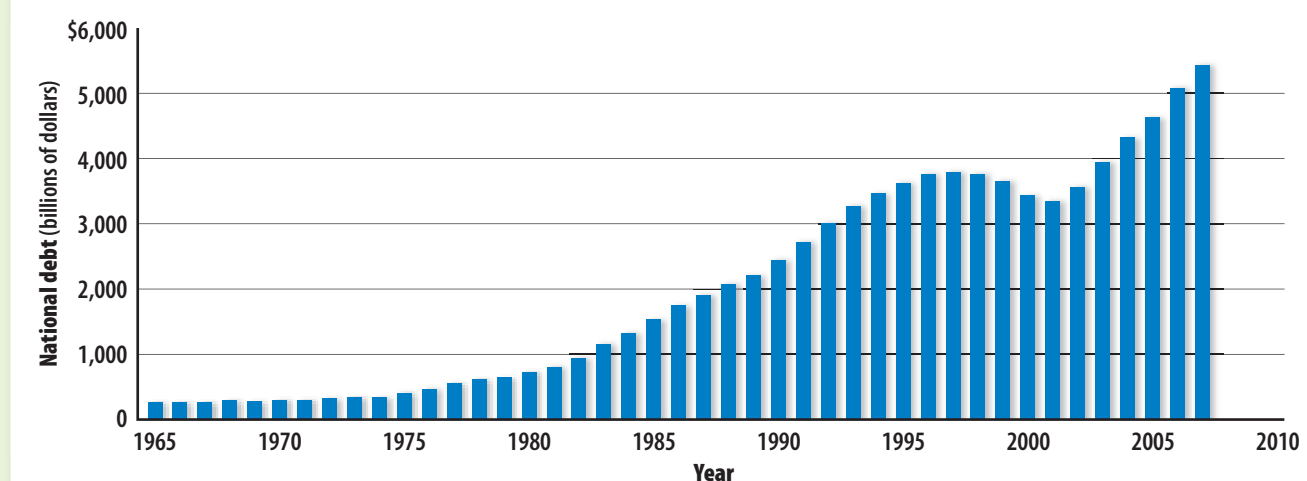
▶ Panel A shows the annual budget deficit since 1962. Panel B shows the national debt during the same time period. The government ran a surplus from 1998 to 2001 which allowed it to pay off some of the national debt.

### Economic Analysis Why has the deficit increased so rapidly since 2002?

#### A ANNUAL BUDGET DEFICIT



#### B NATIONAL DEBT



Sources: Congressional Budget Office, 2006; *Economic Report of the President*, 2006

Because trust fund balances represent money the government owes to itself, most economists tend to disregard this portion of the debt. Instead, they view the public portion of the debt—which amounted to nearly \$5 trillion in mid-2006—as the economically relevant part of the debt.

**Figure 10.5** on the next page presents two alternative views of the total national debt held by the public. **Panel A** shows the debt as a percentage of GDP. In **Panel B**, the national debt is computed on a **per capita**, or per person, basis.

### Public vs. Private Debt

Despite the size of the public debt, several important differences between public and private debt mean that the country can never go bankrupt. One is that we owe most of the national debt to ourselves—whereas private debt is owed to others.

Another difference is repayment. When private citizens borrow, they usually make plans to repay the debt by a specific date. When the government borrows, it gives little thought to repayment and simply issues new bonds to pay off the old bonds.

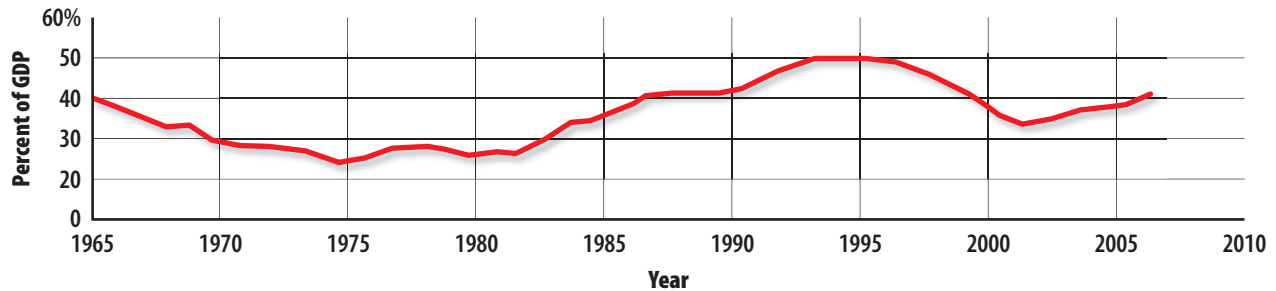
**per capita**  
per person basis; total  
divided by population

## Figure 10.5 ▶ Two Views of the National Debt

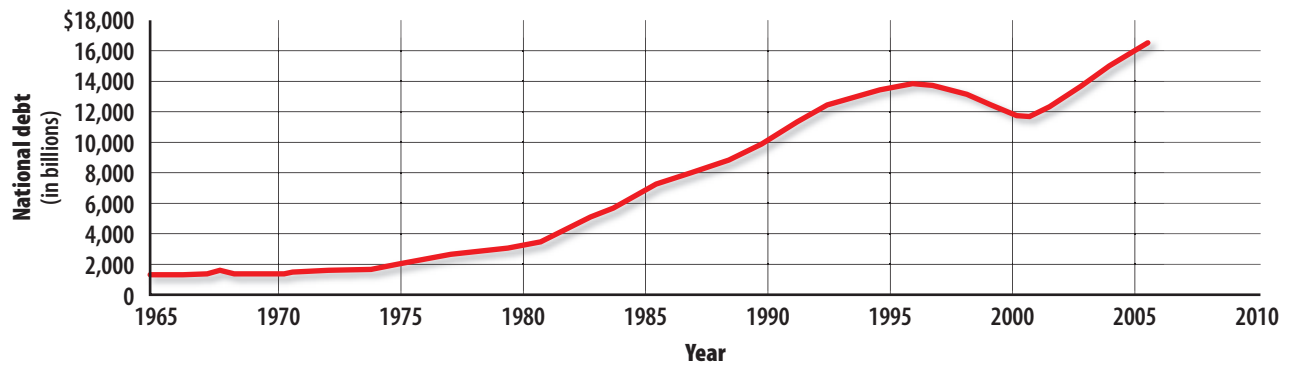
- ▶ The national debt as a percent of GDP has ranged from about 34 to almost 50 percent since 1965. The amount owed per person increased most years during the same period.

**Economic Analysis** *What has happened to the size of the national debt since 2001?*

### A AS A PERCENTAGE OF GDP



### B ON A PER-CAPITA BASIS



Source: Congressional Budget Office

A third difference has to do with purchasing power. When private individuals repay debts, they give up purchasing power because they have less money to buy goods and services. The federal government does not give up purchasing power, because the taxes collected from some groups are simply transferred to other groups. The exception is the 15 to 20 percent of the public debt owned by foreigners. When payments are made to investors outside the United States, some purchasing power is temporarily diverted from the U.S. economy.

**✓ Reading Check** **Contrasting** What are the differences between public and private debt?

## Impact of the National Debt

**MAIN Idea** The national debt affects the distribution of income and transfers purchasing power from the private to the public sector.

**Economics and You** Do you hear your parents talk about interest rates? Read on to learn how the national debt affects interest rates.

Even though we owe most of the national debt to ourselves, it affects the economy by transferring purchasing power, reducing economic incentives, causing a crowding-out effect, and redistributing income.



John Cole / Scranton Times-Tribune

## National Debt

The more the government borrows today, the more future generations will have to repay.

**What other effects does the national debt have on the nation?**

### Transferring Purchasing Power

The national debt can cause a transfer of purchasing power from the private sector to the public sector. In general, when the public debt increases, taxes increase and people have less money for themselves.

Purchasing power can also be transferred from one generation to another. If the government borrows today and leaves the repayment to future taxpayers, then today's adults will consume more and their children less. The accumulation of debt by one generation can thus reduce the economic well-being of the next.

### Reducing Economic Incentives

Government can reduce economic incentives if it appears to spend money in a careless manner. A community, for example, may use a federal grant to purchase expensive equipment that its citizens would not want to pay for themselves. If the taxpayers that benefit from a project would not fund it themselves, other taxpayers would not want their taxes to go to such projects.

### Crowding Out

When the federal government uses deficit spending, it must borrow money in financial markets. This borrowing can drive

interest rates up, forcing all borrowers to pay more for the temporary use of funds.

Because the government borrows so much, it competes with businesses and individuals such as potential home buyers for available money. This competition can cause a **crowding-out effect**—the higher-than-normal interest rates caused by heavy government borrowing. If private borrowers cannot afford the higher interest rates, they are squeezed out of the market.

### Redistributing Income

Finally, the national debt and the tax structure can impact the distribution of income. Suppose that the government taxes upper-income individuals and spends the money on the poor. This would redistribute income from the rich to the poor. The opposite would happen if the poor were taxed and the money spent on the rich. In either case, the people paying less in taxes would benefit from the tax policy.

This is not a purely hypothetical situation. The individual income tax cuts made since 2001 have made income taxes *less* progressive, shifting some of the tax burden from higher- to lower-income groups.

**✓ Reading Check Analyzing** How does the transfer of purchasing power between generations affect you?

### crowding-out effect

higher-than-normal interest rates and diminished access to financial capital faced by private borrowers when they compete with government borrowing in financial markets

## Figure 10.6 ▶ The Size of the National Debt

- ▶ The publicly held portion of the national debt reached \$5 trillion in 2006 and continues to rise. Attempts to reduce the debt by legislation alone have failed. The only other ways to reduce it are by raising taxes or reducing federal spending.

**Economic Analysis** *Why is it difficult for legislators to increase revenues or reduce spending?*

### WILL WE EVER SHRINK THE NATIONAL DEBT?

A \$1 bill is about 6 inches (15.2 cm) long. If 5 trillion of these bills were laid end to end, they would form a chain 474 million miles (764 km) long—more than enough to stretch from the surface of the earth to the surface of the sun and back—two and a half times!



#### “pay-as-you-go” provision

requirement that new spending proposals or tax cuts must be offset by reductions elsewhere

#### line-item veto

power to cancel specific budget items without rejecting the entire budget

#### spending cap

limits on annual discretionary spending

#### Skills Handbook

See page R35 to learn about **Identifying the Main Idea**.

## Reducing Deficits and the Debt

**MAIN Idea** Congress has tried a number of measures to reduce deficits and the national debt.

**Economics and You** Did your parents teach you how to avoid overspending? Read on to learn about attempts to limit the nation’s debt.

In order to control the size of the national debt, we have to first address the federal budget deficit. Concern over deficit spending since the 1980s has led to a number of attempts to control it.

### Legislative Failures

One of the first significant attempts to control the federal deficit took place when Congress tried to **mandate** a balanced budget. The legislation was formally called the Balanced Budget and Emergency Deficit Control Act of 1985, or Gramm-Rudman-Hollings (GRH) after its sponsors.

Despite high hopes, GRH failed for two reasons. First, Congress discovered that it could get around the law by passing spending bills that took effect two or three years

later. Second, the economy started to decline in 1990, triggering a suspension of budget cuts when the economy was weak.

In 1990 Congress passed the Budget Enforcement Act (BEA). The BEA’s main feature was a **“pay-as-you-go” provision**—a requirement that new spending proposals or tax cuts must be offset by reductions elsewhere in the budget. If no agreement on the reductions could be reached, then automatic, across-the-board spending cuts would be **instituted**. Congress soon discovered that cutting spending was more difficult than it thought, so it suspended the provision in order to increase spending.

In 1996 Congress gave the president a **line-item veto**—the power to cancel specific budget items without rejecting the entire budget—but the Supreme Court declared it unconstitutional. This was followed by the Balanced Budget Agreement of 1997, which featured rigid **spending caps**—legal limits on annual discretionary spending—to assure that Congress balanced the budget by 2002. However, the caps required politically unpopular cuts in many programs such as health, science, and education, so the caps were also abandoned.



## Raising Revenues

President Clinton’s Omnibus Budget Reconciliation Act of 1993 was an attempt to trim \$500 billion from the deficit over a five-year period. The act featured a combination of spending reductions and tax increases that made the individual income tax more progressive—especially for the wealthiest 1.2 percent of taxpayers.

Higher tax rates, along with strong economic growth, combined to produce four consecutive years of federal budget surpluses. By 2001 Congress expected annual surpluses for another 10 years. Rather than pay down the debt, however, Congress cut tax rates while also increasing spending.

## Reducing Spending

Another way to control the deficit is by reducing federal spending. This can be more difficult than it sounds because spending is subject to unexpected change.

For example, the 2001 terrorist attacks led to unplanned government spending on homeland security and wars in Afghanistan

and Iraq. Because this was also the first year of President Bush’s tax cuts, and because economic activity was low, the federal government had fewer tax revenues to spend. As a result, record federal budget deficits returned in 2002.

In addition, spending was difficult to reduce because the federal budget had so many **entitlements**—broad social programs with established eligibility requirements to provide health, nutritional, or income supplements to individuals. People are entitled to draw benefits if they meet the eligibility requirements. Although most entitlements are classified as mandatory spending, Congress can revise them. Still, this is difficult to do for members of Congress because the programs are so popular.

In the end, Congress has a difficult task ahead. Any action to reduce budget deficits and the national debt will depend on the willpower of Congress to make unpopular and difficult choices.

**entitlement**  
program or benefit using established eligibility requirements to provide health, nutritional, or income supplements to individuals

**Reading Check** **Describing** What events in 2001 have added to the national debt?

### SECTION

## 3

## Review

### Vocabulary

- 1. Explain** the significance of deficit spending, national debt, balanced budget, trust fund, per capita, crowding-out effect, pay-as-you-go provision, line-item veto, spending cap, and entitlement.

### Main Ideas

- 2. Describing** What is the difference between the national debt and the federal deficit?
- 3. Listing** Use a graphic organizer like the one below to list five ways the national debt can affect the economy.

National Debt: Possible Effects on the Economy	
1.	
2.	

- 4. Identifying** What were the results of government efforts to reduce deficits?

### Critical Thinking

- 5. The BIG Idea** Why is it so difficult to rein in the national debt? Use examples to explain your answer.
- 6. Analyzing Visuals** Look at Figure 10.5 on page 280. Why do you think the national debt as a percentage of GDP has not risen at the same rate as the debt per capita?
- 7. Determining Cause and Effect** How can the federal debt affect worker incentives?
- 8. Drawing Conclusions** Which do you think is a better way to reduce budget deficits: pay-as-you-go provisions or line-item vetoes? Explain your answer in a brief paragraph.

### Applying Economics

- 9. Deficit Spending** If you were given the task of reducing entitlement programs to limit deficit spending, which ones would you select to reduce or alter? Write a short essay that includes the reasons for your choices.



# Profiles **in** Economics



*Alice Rivlin is an outspoken critic of budget deficits. She argues that spending cannot be brought under control until Congress is willing to take action. While the problems are large, Rivlin believes that “we will find ways to solve them.”*

## Alice Rivlin (1931– )

- founding director of the Congressional Budget Office
- director of the White House Office of Management and Budget
- vice chair of the Federal Reserve Board

### Ms. Economics

At a time when few women had full-time jobs, fewer went to college, and almost none pursued economics, Alice Rivlin discovered the subject and found her niche. Rivlin is well known for her insistence on solid analysis, innovative thinking, and a steadfast insistence on “fiscal sanity”—balanced federal budgets and a low national debt. These traits served her well as the founding director of the Congressional Budget Office. Rivlin likened the job to an entrepreneurship, because she had to find ways to provide Congress with nonpartisan projections on the impact of proposed legislation on the nation’s budget and debt.

### Balancing the Federal Checkbook

Rivlin believed that Reaganomics had a negative effect on the U.S. economy. In 1992 she published *Reviving the American Dream: The Economy, the States, and the Federal Government*, which outlined her plan for “fiscal sanity” and the responsibilities of national and state governments. She believes that competition between states to attract corporations leads to too many tax breaks, resulting in too few tax dollars to implement needed—and often federally mandated—social programs. Instead states should engage “in an aggressive effort to improve their infrastructure and improve their education systems in order to attract business.”

The book influenced then-presidential candidate Bill Clinton, for whom she became Director of the White House Office of Management and Budget. In this position she oversaw a transition from federal debt to surplus in just two years. This success led her to membership on the Federal Reserve Board. Today Rivlin looks for ways to fight budget deficits as a Senior Fellow at the Brookings Institution, an economics and policy think tank located in Washington, D.C.

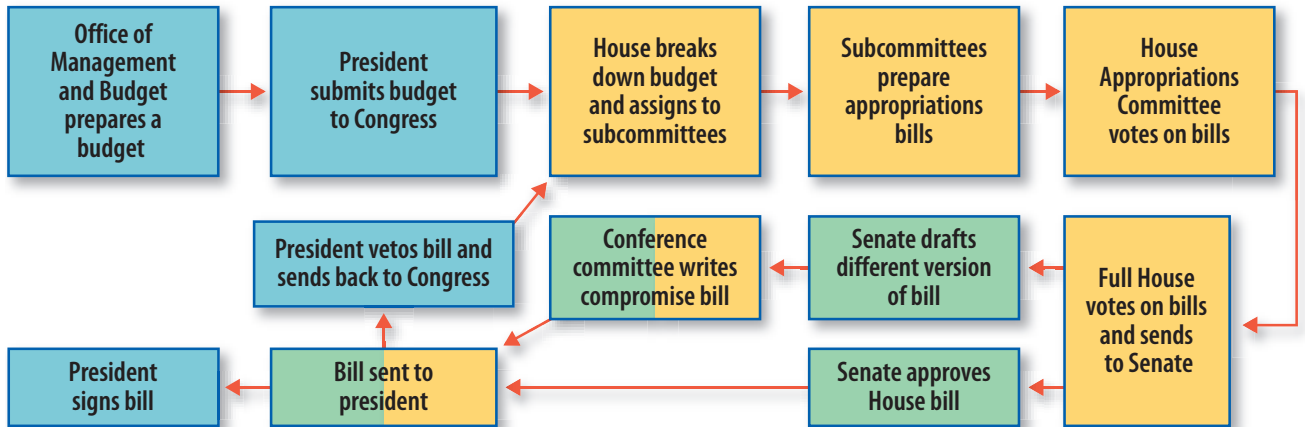
### Examining the Profile

1. **Summarizing** How does Rivlin define “fiscal sanity”?
2. **Determining Cause and Effect** According to Rivlin, what is the best way for states to attract business?



Study anywhere, anytime!  
Download quizzes and flash cards to your PDA from [glencoe.com](http://glencoe.com).

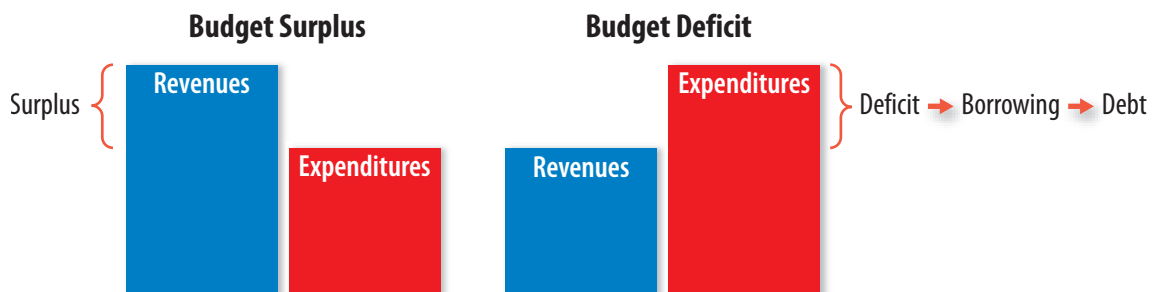
**Federal Budget Process** Each year, the president sends a federal budget to Congress. The budget undergoes a lengthy approval process until it is signed into law.



**Major Budget Categories** The major budget categories vary for federal, state, and local governments. The focus of the federal government is on nationwide programs and expenditures. States pass on much of their budget to local governments and spend the rest on state-level programs. Local governments focus their expenditures on local needs.



**Surpluses, Deficits, and Debt** When revenues exceed expenditures, governments enjoy a budget surplus. If revenues are less than expenditures, governments are faced with a budget deficit. They then have to borrow money to meet expenditures and incur debt.



# Assessment & Activities

## Review Content Vocabulary

Write a sentence about each pair of terms below. The sentences should show how the terms are related.

- public sector, private sector
- transfer payment, grant-in-aid
- distribution of income, deficit spending
- federal budget, fiscal year
- appropriations bill, balanced budget amendment
- deficit spending, national debt
- deficit spending, crowding-out effect
- entitlement, balanced budget
- mandatory spending, discretionary spending
- spending cap, budget deficit

## Review Academic Vocabulary

Each of the sentences below contains a synonym for one of the following terms. Match the sentence to the term.

- constituents
  - reluctant
  - coincide
  - ambiguity
  - mandate
  - instituted
- States have a requirement to provide public schools.
  - The federal budget leaves some uncertainty about actual expenditures.
  - The state legislature was hesitant when it came to reducing spending for roads.
  - The fiscal year often does not correspond with the calendar year.
  - The representative was concerned about maintaining the support of the voters in his district.
  - Some states have passed balanced budget amendments.

## Review the Main Ideas

### Section 1 (pages 261–265)

- Explain** the two kinds of government spending.
- Describe** the way the government competes with the private sector.
- Explain** why politicians insert “pork” items into other legislation.

### Section 2 (pages 267–275)

- Identify** the purpose of a balanced budget amendment.
- Identify** the categories of federal, state, and local spending by using a graphic organizer like the one below.

Categories of Spending		
Federal	State	Local

- List** the three major categories of spending by local governments.

### Section 3 (pages 277–283)

- Discuss** the relationship of the federal deficit to the federal debt.
- List** four legislative attempts to deal with the problem of federal budget deficits.
- Explain** why entitlements are so named.

## Critical Thinking

- The BIG Idea** Why is it more difficult for politicians to reduce mandatory spending than discretionary spending?
- Comparing and Contrasting** What is the difference between transfer payments and government spending on goods and services?

**28. Drawing Conclusions** Review the discussion on attempts to reduce the deficit on pages 282 and 283. Use a chart similar to the one below to outline the main features and weaknesses of these legislative attempts. Can you find a common reason why these attempts have failed? What do you think would need to be done to avoid future failures?

Legislation	Features	Weaknesses

- 29. Determining Cause and Effect** How does a balanced budget amendment affect the budget process?
- 30. Making Inferences** Do you think transfer payments are the best way to distribute tax revenue? How would the tax collection system have to change if the government levels that actually spend the money had to collect the taxes themselves?

### Applying Economic Concepts

- 31. Human Capital** Which of the categories in Figure 10.3 on page 273 reflect an investment in human capital?
- 32. Government Spending** Make a list of ways you and your family benefit from government expenditures. Provide at least one example each for the federal, state, and local government.

### Math Practice

- 33.** A neighbor spent \$25,000 a year for 10 years and had an annual income of \$20,000 during this period. What is the neighbor's total debt?

### Analyzing Visuals

- 34. Classifying Information** Examine the major types of federal expenditures in Figure 10.2 on page 269. Classify each as to whether they are entitlement or nonentitlement programs.

### Thinking Like an Economist

- 35. Critical Thinking** An economist likes to think in terms of trade-offs and opportunity costs. If you wanted to make changes to a balanced state budget in any given year, what would be the opportunity cost of lowering taxes? Of increasing discretionary spending?

### Writing About Economics

- 36. Persuasive Writing** Which of the two types of government spending has the most impact on the economy? Explain your answer in a two-page paper.

### Interpreting Cartoons

- 37. Critical Thinking** What is the topic of the cartoon below? What point is the cartoonist making about the topic? How does he do it? Do you think the cartoon is effective?



Paul Combs, Editorial Cartoonist / The Tampa Tribune.