Chapter 21 – Financing Government

**What role does the government play in managing the economy?**

Rank the following economic goals of government with 1 being the most important and 6 being the least.

* The government should give me total freedom to decide where I work, what I buy, how much I spend, and how much I save.
* The government should provide equal economic assistance and tax incentives to every type of industry and business.
* The government should provide assistance to help me and anyone else if we ever need help feeding our families, finding work, or finding an affordable place to live.
* The government should focus its efforts on making sure everyone has a job.
* The government should focus its efforts on making sure the economy is strong.
* The government should focus its efforts on making sure that the dollar is stable—that my money will be able to buy the same amount tomorrow and next month as it did today.

Share your rankings with two other students; explain your reasons and listen to theirs. Together, develop a hypothesis about why your rankings were similar or different. If the three of you had to make economic priorities for the country, how easy would it be? Why?

**Lesson 1** - Economic Goals and the Federal Budget

US Economic Goals

Two of a government’s primary functions are to **\_\_\_\_\_\_** the nation’s economy and **\_\_\_\_\_\_ \_\_\_\_\_\_\_** and economic security to their people. To fulfill these purposes, every nation needs a budget and a set of economic goals.

The United States is a **\_\_\_\_ \_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_** where the role of government is **limited**. Even so, different Americans have different opinions about how involved the government should be in the economy. **\_\_\_\_\_\_\_\_\_\_\_** often believe that the economy functions better without much government regulation and that economic freedom is more valuable than economic equity. **\_\_\_\_\_\_\_** tend to believe that government has a responsibility to protect workers and consumers from unsafe or unfair business practices so they may accept the need for more regulation of the economy. When the House, Senate, and president hold different views, it is often very **\_\_\_\_\_\_\_** to create a single economic policy or even a collection of economic strategies for the nation.

The ways in which the federal government collects and spends money reflect many economic goals. The nation’s **\_\_\_\_\_\_\_** is its plan for how much **\_\_\_\_\_\_\_\_** it expects to take in and how it plans to spend money. The budget is created by elected and appointed officials in the executive and legislative branches, along with their staff. The budget reflects their values and the needs of their constituents. Staff members in each branch play a big role, too, as do special interest groups who want the budget to favor their priorities.

When revenue and spending are equal, the budget is balanced. When there is extra money left, it is called a **\_\_\_\_\_\_ \_\_\_\_\_\_**. Almost every year, however, the federal government spends more than it takes in, creating a **\_\_\_\_\_\_ \_\_\_\_\_\_**. When there is a deficit in the federal government, the government borrows money to pay its bills. The total amount of money that the government has borrowed but not paid back in our nation’s history is known as the **\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_**.

The Budget Process

Every year, the government creates a budget that predicts revenue and controls spending for that year. In the case of the federal budget, the year does not begin on January 1. Instead, it begins October 1 and runs through the following September 30. This is called the **\_\_\_\_\_\_ \_\_\_\_\_\_**, or FY. For example, the fiscal year that began on October 1, 2013, was FY 2014.

Executive Branch

The budget process begins with the president, executive agency leaders, and economic analysts from the White House.Each federal **\_\_\_\_\_\_** and department draws up a list of its own spending plans. Their **\_\_\_\_\_\_** plans express important political choices—because they aim to promote the administration’s policies and priorities.

The department secretaries send their spending plans to the director of the **\_\_\_\_\_ \_\_ \_\_\_\_\_\_\_\_ \_\_\_\_\_\_** (OMB), which functions as part of the Executive Office of the President. OMB takes the first set of figures to the president, along with its analysis of the nation’s economic situation. The OMB, along with the president’s **\_\_\_\_\_\_\_\_ \_\_ \_\_\_\_\_\_\_ \_\_\_\_\_\_\_** (CEA) and the secretary of the treasury, confers with the president on the proposals. They make key decisions about the impact of the preliminary budget on the administration’s general economic policy and goals. They discuss such questions as: Will the budget increase or reduce federal spending? Which federal programs will be cut back and which programs will be expanded? Will the federal government need to borrow more money? Should taxes be raised or lowered?

The White House returns its decisions on the **\_\_\_\_\_\_** to the agencies and departments with guidelines to help them revise their plans. The Department of Defense, for example, might be told to cut its budget by $5 billion, and the Transportation Department might be told it can increase its budget by $1 billion. Over the next few months, the executive departments and agencies work on detailed budget plans that fit the president’s guidelines. During this time, OMB officials and agency heads **\_\_\_\_\_\_\_\_** cuts and additions to bring each agency’s budget in line with the president’s decisions.

The OMB submits a complete budget document to the president for final review and **\_\_\_\_\_\_\_**. Some last-minute juggling always takes place. Agency heads might make last-ditch efforts to convince the president to save a particular program. The president might order changes in parts of the budget in response to pressure from **\_\_\_\_\_\_ \_\_\_\_\_\_\_** or political party members. Finally, the administration rushes the president’s budget to the printer—often only days or perhaps hours before the February **\_\_\_\_\_\_\_\_\_\_**. Then the president formally sends the budget proposal to Congress along with an annual budget message. After receiving it, Congress takes the next steps in finalizing the federal budget.

Legislative Branch

In Congress, the formal budget-making process would follow these steps:

1. House and Senate budget committees review the major features of the president’s **\_\_\_\_\_\_ \_\_\_\_\_\_\_\_** and hold hearings to ask executive branch officials to defend their proposals.
2. Congress sends the budget proposals to its own staff of economic analysts at the **\_\_\_\_\_\_\_\_\_ \_\_\_\_\_ \_\_\_\_\_** (CBO).
3. After the **\_\_\_\_\_ \_\_\_\_\_ \_\_\_\_\_\_\_\_\_** has reviewed and revised the president’s budget, it sends its budget to the full House for a vote. The Senate follows the same process, identifying the total spending and tax plan for the coming year.
4. Typically, the budget plans from the House and Senate are different—a **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_** turns their separate plans into one budget.
5. The **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_** is sent to the Senate and to the House for a vote. The adopted budget resolution is used as a framework to consider appropriations bills for the next fiscal year.

Once the budget is approved and Congress has appropriated the funds, it becomes the responsibility of executive branch officials to manage the money their departments have been given. They must keep track of their **\_\_\_\_\_\_\_\_\_\_\_** and revenues. Congress has the power of oversight and can hold hearings or require reports from executive branch officials to make sure the budget is being implemented according to plan.

In 2011 there was **\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_** between the Republican-controlled House and the Democratic Senate and White House. Both sides agreed to try to reach a budget agreement to reduce the deficit by $1.2 trillion by the end of November 2011. To incentivize Congress to do so, the law included massive spending cuts (which most lawmakers oppose), divided evenly between defense and nondefense spending, across the entire federal budget that would be triggered if no deal was reached. The parties failed to reach an agreement, and the cuts, called ***\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_***, were triggered in the spring of 2013.

Federal Spending

The federal government was spending about $4.6 billion per year when **\_\_\_\_\_\_\_ \_ \_\_\_\_\_\_\_\_\_\_** became president in 1933. Today, that amount would pay for less than one day of the federal government’s expenditures. The government **\_\_\_\_\_\_\_\_\_** spends roughly $3.5 trillion per year.

Uncontrollables

About 70 percent of the federal budget consists of what are called *uncontrollables*. **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** are expenditures required by law or resulting from previous budgetary commitments. Most uncontrollables are direct benefit payments and interest payments on the national debt.

A major part of uncontrollable spending goes to pay for direct benefits, known as *entitlements*. **\_\_\_\_\_\_\_\_\_\_\_\_\_\_** are benefits that Congress must by law provide to individuals. They include Social Security, pensions for retired government employees, Medicare, Medicaid, and veterans’ benefits.

Entitlements have become a big part of the federal budget. In fact, almost half of every dollar goes for such items. The biggest entitlement program is **\_\_\_\_\_ \_\_\_\_\_\_\_**. In 2012 the government paid $774.6 billion in benefits.

The other important uncontrollable item in the budget is the **\_\_\_\_\_\_\_\_** that must be paid on the national debt. As yearly budgets have forced the federal government to borrow more and more money, interest on the debt has grown. In fiscal year 2012, the U.S. spent around $220 billion on interest on the debt, which was equal to about **\_ \_\_\_\_\_\_\_\_** of the total spending for the federal government that year.

Discretionary Spending

**\_\_\_\_\_\_\_\_\_\_\_\_\_\_** spending is usually thought of in two categories—defense and nondefense. One of the larger portions of the budget pays for national defense and the **\_\_\_\_\_\_ \_\_ \_\_\_\_\_\_\_** (DOD) budget. These expenditures fund the U.S. military and the weapons, aircraft, ships, and troops necessary to fight in wars and defend the United States.

The federal government also spends a sizable portion of tax revenues on the **\_\_\_\_\_\_\_, \_\_\_\_\_\_\_\_**, \_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_ and other areas. Much of this discretionary spending is in the form of grants to states and localities. State and local governments use federal grants for road repair, public housing, police training, school lunch programs, flood insurance, and so on. States and communities have come to rely on this intergovernmental revenue for an increasing share of their total revenue.

**Lesson 2** - Raising Revenue

Taxes and the Economy

**\_\_\_\_\_\_\_** are payments made by individuals and businesses to support government activities and provide government services. As you will learn, decisions about how to raise and spend government funds are almost always **\_\_\_\_\_\_\_**. Every time a tax law is changed or created, someone wins and someone loses. Government officials, political parties, business leaders, and average citizens all have different ideas about taxes.

Taxes in American History

When you think of taxes today, the individual income tax likely comes to mind. The individual income tax as we know it today is a relatively recent addition to our government, however. Until the 1890s, the federal government relied on tariffs, or taxes levied on imported goods, for revenue. These are also called *customs duties* or *import duties*. Congress has placed excise taxes on many goods. **\_\_\_\_\_\_\_ \_\_\_\_\_\_** are taxes on the manufacture, transportation, sale, or consumption of goods and the performance of services—gas and cigarette taxes are excise taxes, for example. Early targets included taxes on horse carriages, snuff (smokeless tobacco), and liquor. The federal government **\_\_\_\_\_\_\_\_\_** excise taxes to raise revenue or to protect **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_** and agriculture from foreign competition.

The Constitution places some limits on Congress’s power to tax, however. These limits meant that Congress could not institute an income tax until the **\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_**  was ratified, authorizing one. In the early years, the income tax applied only to wealthy people. Most Americans were not required to pay an income tax until **\_\_\_\_\_ \_\_\_ \_\_**, when the government desperately needed funds to pay for the war. By the middle of the twentieth century, the income tax was firmly entrenched as a large source of **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_**.

Taxes Today

In 2012 the federal government took in about $2.45 trillion in revenues—an average of $7,617 for each **\_\_\_\_\_\_** in the nation. In the post-World War II period, the government’s revenue has not kept up with its spending, so the federal government has had to **\_\_\_\_\_\_\_ \_\_\_\_\_** to make up the difference. While income taxes on individuals and corporations make up the largest part of government revenue, they are not the only source.

There are **five** main types of federal taxes today—**\_\_\_\_\_ \_\_\_\_**, **\_\_\_\_\_\_ \_\_\_\_\_\_**, **\_\_\_\_\_\_** and **\_\_\_\_\_ \_\_\_\_\_**, **\_\_\_\_\_\_ \_\_\_\_**, and **\_\_\_\_\_\_ \_\_\_\_\_\_\_ \_\_\_\_\_**. Excise taxes were an important source of government income in early America, but now they are much less important. Today excise taxes are imposed on gas, tobacco, liquor, airline tickets, and on some luxury goods. Customs duties, also called tariffs, are taxes on imported goods. **\_\_\_\_\_\_\_** has the authority to decide which imports will be taxed and at what rate. Congress has also given the president authority to revise tariff rates through executive orders. In doing so, the president takes trade agreements with other nations into account. A high customs duty is called a **\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_** and is often popular with **\_\_\_\_\_\_\_**, **\_\_\_\_**, and **\_\_\_\_ \_\_\_\_\_\_**.

Income and Social Insurance Taxes

Both income and social insurance taxes are levied as a **\_\_\_\_\_\_\_\_\_** of a taxpayer’s income, so people with no income do not pay these taxes. Income taxes go to the government’s general fund, while social insurance taxes are reserved to pay for social insurance programs like Social Security and Medicare.

Individual Income Tax

The income tax is a **\_\_\_\_\_\_\_ \_\_\_\_**. This means that people with higher incomes pay a larger share of their income in tax than do people with lower incomes. A **\_\_\_\_\_\_\_\_\_ \_\_\_\_** would make people with lower incomes pay a larger share of their income in taxes than people with higher incomes. For example, a car registration fee of $100 is regressive, because that $100 is a larger share of a poor person’s income than a rich person’s income. Even though tax \_\_\_\_\_ **rise** as income rises, people do not need to worry that they will lose money to taxes if they start earning more. A higher tax rate kicks in only on the income over a certain **\_\_\_\_\_\_\_**. For example, in 2013 the first $8,925 a single person earned was taxed at 10 percent whether that person earned $50,000 or $500,000. The next highest rate, 15 percent, applied to income over $8,925 but less than $36,250. The rates increased stepwise, until the top rate of 39.6 percent, which applied only to income over $400,000 for a single person. These brackets are known as **\_\_\_\_\_\_\_\_\_ \_\_\_\_ \_\_\_\_**.

**Income tax** is calculated based on a person’s **\_\_\_\_\_\_\_\_ \_\_\_\_\_**. It includes wages (or salary), tips, commission, investment income, lottery or gambling winnings, and more. Tax laws allow people to reduce their total taxable income through a variety of deductions and exemptions. People can deduct certain expenses that the government has decided not to tax, like contributions to charity. Exemptions also reduce taxable income. The most common is an exemption for taxpayers’ **\_\_\_\_\_\_\_\_\_**—someone who depends primarily on another person for basic items such as food, clothing, and shelter. Usually, dependents are children under the age of 18.

Throughout the year, employers take money out of workers’ paychecks and send it to the federal government. This **\_\_\_\_\_\_\_\_\_** pays the anticipated taxes owed. Then at the end of the year, nearly everyone who had an income that year must file a report with the federal government—a tax return. The deadline for filing income tax returns each year is April 15. If a worker’s paycheck withholding was too small, the taxpayer will owe the government money. If it was too large, the taxpayer must file for a **\_\_\_\_\_\_**.

Deductions

Income tax **\_\_\_\_\_\_\_\_** reduce the amount of someone’s income that is subject to tax. For example, people who own homes and are paying a mortgage on their home can deduct the interest they pay to the lender from their total income. People who receive health insurance through their employer are also able to deduct some **\_\_\_\_\_\_\_\_** from their total income.

Exemptions

Exemptions are a **\_\_\_\_\_\_\_** granted by government that legally excludes certain types of property, sales, or income from taxpaying obligations. Most states, for example, exempt educational and religious groups from paying property taxes. Over the years, railroads, airlines, farmers, businesses, builders, defense contractors, the unemployed, the elderly, and veterans have received tax exemptions. Some people believe that taxation of any kind is actually **theft**.

Tax Credit

Tax credits directly reduce the amount of tax a taxpayer owes. Some tax credits are available for people with **\_\_\_\_\_\_\_\_**, child care expenses, or educational expenses. Certain elderly and retired people may also be entitled to a tax credit, depending on the **\_\_\_\_\_\_** of their income. One tax credit, the **\_\_\_\_\_\_-\_\_\_\_\_\_ \_\_\_\_\_\_**, will even return more money than a low-income family owed in taxes.

Taxes and Public Policy

Tax deductions, exemptions, and credits function as a government **\_\_\_\_\_\_\_** to encourage a type of behavior or activity. Tax deductions for home mortgage interest, for example, encourage people to buy homes. That, in turn, helps the construction industry and promotes stable communities. A tax **\_\_\_\_\_\_\_\_** on oil exploration encourages people to invest their money in businesses that search for new energy sources.

Each exemption or deduction favors some people or activities at the expense of others. In these examples, people who own homes are given a tax break not available to those who **\_\_\_\_**. Oil exploration outfits are given a break not available to other energy sector businesses. Sometimes exemptions granted to one group negatively affect another group. **\_\_\_ \_\_\_\_\_\_\_** for the airline industry, for example, might adversely affect the railroad industry.

Finally, every tax break “costs” the government money in lost **\_\_\_\_\_\_\_**. For example, recall the tax break for retirement accounts: the government misses out on all the money it would have collected if contributions to retirement accounts were taxed.

Even though people with higher incomes often take advantage of deductions that lower their taxes, the top 10% of taxpayers pay about **\_\_\_-\_\_\_\_\_** of all income taxes. The figure is actually higher, around **\_\_%** of all income tax are paid by the top 10%.

Income Tax Reforms

Today, the federal income tax is a complicated maze of **\_\_\_\_\_**, **\_\_\_\_\_\_\_\_**, and **\_\_\_\_\_\_\_\_\_**. Critics of the income tax system believe that exemptions are unfair and argue that only **\_\_\_\_\_\_\_\_\_** or the wealthy take full advantage of them. Some economists and politicians have proposed reforming the tax system to remove most deductions and exemptions so that overall tax rates can be lowered. Calls for comprehensive tax reform have failed to gain traction in Congress, however.

The tax code has been modestly reformed in the past. In 1986 **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_** and Congress modified the income tax laws to reduce deductions, credits, tax shelters, and the number of tax brackets or rates. In 2001 President George W. Bush and Congress enacted massive **\_\_\_\_\_\_\_\_** tax cuts, and in 2003 they moved to make them permanent. This included a cut in the tax rate paid on a type of investment income called **\_\_\_\_\_\_ \_\_\_\_\_**. Meant to encourage investment in new businesses, lower capital gains rates often favor wealthier people with money to invest. In 2012 President Obama and Congress compromised to raise the income and capital gains tax rates on **\_\_\_\_-\_\_\_\_\_\_\_** individuals making over $400,000.

In 2017 **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_** and Congress enacted the biggest tax cut in history. These tax cuts went into affect February 2018 and gave **90%** of Americans some degree of tax relief, but more importantly, businesses began to repatriate their money back to the US because our corporate tax rate, which had been the highest in the developed world, was now at **22%**. Many companies began giving bonuses to their employees and some raised their **\_\_\_\_\_\_\_ \_\_\_\_** to $15 per hour.

Borrowing for Revenue

If the government spends more than it collects, as it has done in most recent years, it runs a **\_\_\_\_\_ \_\_\_\_\_\_**. To make up the difference, the government borrows money by having the **\_\_\_\_\_\_\_** Department issue **\_\_\_\_\_\_\_\_\_** in the form of bonds, notes, and treasury bills. Anyone can buy these securities, in effect lending money to the government. The government then pays the money back, with interest, over time. Because the federal government has borrowed so much money in the past, today it pays a huge amount of **\_\_\_\_\_\_\_**.

Government borrowing to fund annual budget deficits over time creates the public, or national debt.About**\_\_\_\_** of the government’s public debt is held by **\_\_\_\_\_\_ \_\_\_\_\_\_\_** and other countries that buy U.S treasury bonds. Congress has tried to control the size of the debt by setting a **\_\_\_\_ \_\_\_\_\_\_\_**, or legal limit to the amount the federal government can borrow. The debt ceiling has not been very effective in the past, because the government would have to shut down if the Treasury was unable to borrow enough money to pay its bills. As a result, the debt ceiling has been **\_\_\_\_\_\_ \_\_\_\_ \_\_\_\_\_\_** and has become a contentious issue as concerns about the size of the national debt have grown. Economists generally agree that too much debt can be bad for the country, but no one knows exactly how much debt is too much.

**Lesson 3** – Managing the Economy

The good news is that tax revenues resulting from the 2017 tax cuts hit a record high in the month of February of 2018 allowing for a payment of **$\_\_ \_\_\_\_\_\_\_** against the **\_\_\_\_\_\_\_ \_\_\_\_\_**. You may wonder how a tax cut would generate more tax revenue? The **2017 \_\_\_\_ \_\_\_\_\_\_ \_\_\_\_** allowed consumers to have more spendable income, while corporations to greatly reduce their tax burden and pass that savings on to their employees in the form of **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_**  and bonuses and to repatriate (bring back to the US from overseas) **\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_**  to grow their businesses in America, thereby expanding the tax base and increasing additional tax revenue.

Influencing the Economy

As candidates, politicians often set out economic plans—actions they want to take to improve some sector of the economy. The amount of influence they can actually have as lawmakers, however, varies widely. There are many ways that federal government actions influence the economy—from what programs money is spent on to how revenue is raised and taxes are assessed to how much debt is carried and how much money and credit is available to borrowers. Many Americans **\_\_\_\_\_\_\_** on what role the government should play in managing the economy. Our modified free enterprise system—sometimes called a ***\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_*** —means that the control over the economy is divided between **\_\_\_\_\_\_\_\_** and the **\_\_\_\_\_\_ \_\_\_\_\_**.

Economic Indicators

The American economy is massive, involving hundreds of millions of people and trillions of dollars. It can be difficult to know whether the overall economy is healthy or faltering from each individual person’s perspective. In order to get a sense of how things are going, government officials and the public refer to a variety of **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_**. These are market conditions, reports, or figures that give information about how the economy is performing. They include things like stock market **\_\_\_\_\_\_\_**, reports about employment levels, surveys about how consumers feel about the economy, information about construction and purchase of homes, reports on changing prices for goods and services, and more. If one or more of these indicators behave in an alarming manner, the government might want to take action to try to change economic conditions.

Beginning with the Great Depression of the 1930s, the federal government has played an **\_\_\_\_\_\_\_\_** role in managing the nation’s economy. The government can influence the economy in two main ways: by using **\_\_\_\_\_** policy or **\_\_\_\_\_\_\_** policy. **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_** involves using government spending and taxation to influence the economy. **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_**involves controlling the supply of money and credit to influence the economy. However, U.S. monetary policy is exercised by the Federal Reserve System, which is an **\_\_\_\_\_\_\_\_\_\_** agency of the federal government.

Fiscal Policy

The **\_\_\_\_\_\_\_ \_\_\_\_\_\_** is a major tool of fiscal policy because it shapes how much money the government plans to spend and how much it plans to collect through **\_\_\_\_\_** and **\_\_\_\_\_\_\_\_**. The president and Congress can use the budget to pump money into the economy to **\_\_\_\_\_\_\_\_** it or to take money out of the economy to **\_\_\_\_** it down.

To stimulate the economy, the government could spend money on various projects. Through increased spending, the government tries to put more people to work and increase economic activity. When the government spends more money, it buys things—labor, equipment, materials, or services for government programs. Instead of **\_\_\_\_\_\_ \_\_\_\_**, the government could also **\_\_\_\_\_ \_\_\_\_\_**. Lower taxes give **\_\_\_\_\_\_\_** and **\_\_\_\_\_\_\_** more purchasing power. People would have more money in their pockets and be able to buy more goods and services. Either increased spending or reduced taxes or both at the same time can increase overall demand for goods and services in the economy.

Demands for **\_\_\_\_\_\_\_** the deficit and **\_\_\_\_\_\_\_\_** the budget have grown since 1980 even though experts **\_\_\_\_\_\_\_\_** on what levels of debt and deficit are sustainable. Many economists believe that deficits are necessary if the government is going to use fiscal policy to shape the economy. Others say that the deficit as a percentage of the **\_\_\_\_\_ \_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_ (GDP),** the market value of all final goods and services produced in the nation in a year, is more important than the actual size of the deficit.  While there are merits to both positions, in 2013 the **\_\_\_\_\_** represented about 6 percent of **\_\_\_**. This is higher than the historical average, but is much less than in recent times of financial stress.

Monetary Policy

The American economy is based on a system of **\_\_\_\_\_\_\_\_\_** markets that make extensive use of **money** and **credit**. The amount of \_\_\_\_\_ and \_\_\_\_\_ available at any given time impacts the amount of borrowing and spending that businesses and individuals are able to do. Money is so important that the Constitution gave the **\_\_\_\_\_\_ \_\_\_\_\_\_\_** authority to “coin money [and] regulate the value thereof.” This means the federal government can create money and put it into circulation. This also means that the government can create an independent institution like the Federal Reserve System to manage the **\_\_\_\_\_ \_\_\_\_\_** and conduct **\_\_\_\_\_ \_\_\_\_\_\_**.

Monetary policy involves managing the supply of money and the cost of borrowing to meet the needs of the economy. In the United States, these responsibilities have been delegated to the **\_\_\_\_\_\_ \_\_\_\_\_\_ \_\_\_\_\_\_\_**.

The Fed’s **\_\_\_\_\_\_** is “to promote sustainable growth, high levels of employment, stability of prices to help preserve the purchasing power of the dollar, and **\_\_\_\_\_\_\_** long-term interest rates.” What does this mean? The Federal Reserve uses a variety of strategies aimed at keeping the **\_\_\_\_\_\_\_ \_\_\_\_** (the increase in consumer prices over time) low while helping the economy produce enough jobs for everyone who wants to work.

So, what happens when the Federal Reserve tells the US Treasury to print more money? In short, this action by the Fed devalues the money that we currently hold. Why would the Fed do this? Again, in short, because deficit spending by the Congress forces such an action.

Organization of The Fed

When the Federal Reserve System was established in **\_\_\_\_**, it was organized as a **\_\_\_\_\_\_\_-\_\_\_\_\_\_\_** stock corporation. The **\_\_\_\_\_\_\_ \_\_\_\_\_** in the country were required to contribute a portion of their financial capital to build the Fed, and in return they received shares of stock ownership. This meant that the Fed was technically **\_\_\_\_\_\_** by private commercial banks, which, as owners, received dividends on their stock ownership shares. However, to make sure that the Fed was operated in the public interest, a **\_\_\_\_\_ \_\_ \_\_\_\_\_\_\_\_** was established in Washington, D.C.

The **\_\_\_\_\_-\_\_\_\_\_\_**Board of Governors supervises the entire Federal Reserve System. The president selects these members whose appointments must be ratified, or **\_\_\_\_\_\_\_**, by the Senate. The president then selects one of the board members to chair the Board of Governors for a four-year term. Once appointed, board members and the chair are **\_\_\_\_\_\_\_\_** of the rest of the government. This allows the Board of Governors to make economic decisions largely independent of **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_**. Because of the unique nature of ownership and management, the Fed is often said to be a "privately-owned, publicly-controlled institution."

<https://www.youtube.com/watch?v=2Dq6r8qLnjI>



Janet Yellen

Making Monetary Policy

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| The Board of Governors has two major responsibilities in forming monetary policy. First, and most important, it determines the general **\_\_\_\_\_\_\_** and **\_\_\_\_\_** policies of the United States. Second, it **\_\_\_\_\_\_\_\_\_** the operations of the Federal Reserve Banks in the 12 districts across the country.  The Fed uses three tools to control the nation’s monetary policy and ensure the health of the economy. First, the Fed can raise or lower the **\_\_\_\_\_\_\_ \_\_\_\_\_\_**. The discount rate is the **\_\_\_\_\_ \_\_ \_\_\_\_\_\_\_** the Fed charges member banks for loans. Low discount rates encourage banks to borrow money from the Fed to make loans to their customers. High discount rates mean banks will borrow less money from the Fed, charge higher rates to their customers, and make fewer loans. When the economy is growing too slowly, the Fed will usually lower discount rates to stimulate the economy. If the economy is growing too fast and inflation is rising, the Fed will **\_\_\_\_\_\_\_\_** the discount rate to “cool off” lending.  Second, the Fed can put money into the economy by buying **\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_** on the open market. These **\_\_\_\_\_-\_\_\_\_\_\_ \_\_\_\_\_\_\_** stimulate and help expand the economy. The hope is that the increase of money in the economy will lower interest rates and increase consumer spending. If the Fed believes that inflation is growing too fast, it can stop buying or even sell government securities to decrease the supply of money entering the economy. As investors buy these securities, money is taken out of the economy, causing it to **\_\_\_\_\_ \_\_\_\_\_**.  Finally, the Fed can raise or lower the **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_** for member banks. Member banks must keep a certain percentage of their customers' deposits in their vaults or on deposit with the Federal Reserve Banks as a reserve against withdrawals. If the Fed raises the reserve requirement, banks must leave more money with the Fed. Thus, they have less money to **\_\_\_\_\_**. The Fed has been **\_\_\_\_\_\_\_\_** to use the reserve requirement as a policy tool because other monetary policy tools work better. However, the reserve requirement can be powerful should the Fed decide to use it.  *During Barack Obama’s 8 years in office, The Fed raised the discount rate 1 time. So far, during Donald Trump’s year in office, The Fed has raised the discount rate 3 times. Is this a political move on the part of The Fed or is there a sound reason for doing this?* |  |

Impacts of Fiscal and Monetary Policy

The Federal Reserve Board’s decisions have a major impact on the economy and on the daily lives of nearly every American. If the Fed raises **\_\_\_\_\_\_ \_\_\_\_\_**, buying a home or a car could become more **\_\_\_\_\_\_\_\_**. If the Fed lowers interest rates and the reduction encourages businesses and people to borrow money and make investments, companies might hire more workers to meet **\_\_\_\_\_\_ \_\_\_\_\_\_** or expand their business. If the Fed cuts back on buying securities, thereby lowering the amount of money circulating in the economy, consumers might spend less. Too much money circulating can create **\_\_\_\_\_\_\_** and lower the purchasing power of each dollar.

Federal monetary policy affects the economy at the national, state, and local levels. Research has shown that monetary policies influence states and localities differently. How states and localities respond to changes made by the Fed may depend on the **\_\_\_** of industries in a particular state or city.

Because the Fed’s actions can have such a strong impact on interest rates and the economy overall, investors watch the Fed’s reports and meetings carefully. **\_\_\_\_\_\_\_\_\_** by the Fed chair can cause rapid changes in the stock market as investors speculate about future Fed actions.

Conflicting Policies

The Fed is an **\_\_\_\_\_\_\_\_** policy-making institution. While the president and Congress largely control taxing and spending, they have little **\_\_\_\_\_\_** over the Fed. Thus, the Fed’s **\_\_\_\_\_** might help or hinder the economic programs of the president and Congress. Sometimes, when conflicting economic policies arise, the president or Congress might complain that the Fed is interfering with their economic programs.

Because of conflicts like these, some people would like to **\_\_\_\_\_** the Fed’s role and make it less independent. Others maintain that the nation needs an institution that is removed from political pressures to watch over monetary policy.

**Lesson 4** – Financing State and Local Governments

State Revenue

State governments raise revenue in a variety of ways. **\_\_\_\_\_**—usually including sales taxes, income taxes, property taxes, and license fees—account for the majority of the general revenue of the 50 states. States’ ability to tax is limited, however. The federal Constitution limits a state’s taxing powers in **\_\_\_\_\_** ways:

* A state cannot tax imports or exports. These make up interstate and foreign commerce that only Congress can tax or regulate.
* A state cannot tax federal property.
* A state cannot use its taxing power to deprive people of “equal protection of the law,” nor can it use its taxing power to deprive people of life, liberty, or property without “due process of the law.

Sales Tax

State governments began using the sales tax during the Great Depression in the 1930s. Sales tax is calculated as a **\_\_\_\_\_\_\_\_** of dollars spent to buy goods. For example, if the sales tax is 5 percent and you spend $100, the tax is $5. Today almost all states have a sales tax, which accounts for about **\_\_\_-\_\_\_\_\_** of their tax revenue. Sales taxes are of two types: the **\_\_\_\_\_\_\_** sales tax and the **\_\_\_\_\_\_\_** sales tax.

The **general** sales tax is imposed on items such as cars, electronics, household products, and other types of merchandise. In some states, food and drugs are not subject to this tax.

The **selective** sales tax is imposed on a narrower range of items, such as gasoline, liquor, or cigarettes. A selective sales tax is also called an ***\_\_\_\_\_\_ \_\_\_*.**

<https://www.cdtfa.ca.gov/formspubs/l510.pdf>

Traditionally, sales taxes have applied only to goods purchased. Today, however, some states are considering levying taxes on **services** as well. This means that getting a haircut, having your house cleaned, or taking a **dancing lesson** could all be taxed. Hawaii, New Mexico, and South Dakota already have such taxes in place on all services. Some states tax only certain services; for example, **Texas** taxes janitorial services.

Other Taxes

Some states impose **\_\_\_\_\_\_\_ \_\_\_\_** on the removal of natural resources such as oil, gas, coal, uranium, and fish from land or water. Severance taxes are good sources of revenue in **\_\_\_ and \_\_\_\_ \_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_** , such as Oklahoma, **Texas**, and Alaska. For **\_\_\_\_\_\_\_\_\_**, a severance tax on coal brings in significant revenues.

Inter-Governmental Revenue

By **\_\_\_\_\_\_\_\_\_** how federal money is supposed to be used, these grants influence the states in a number of ways. First, **\_\_\_\_\_\_** supply funds for programs that states might not otherwise decide to support. Grants also promote programs and goals that reflect **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_**. Finally, because grants come with certain guidelines and requirements, they often set **\_\_\_\_\_\_ \_\_\_\_\_\_\_\_** for a service in the states. For example, the federal government provides grants to make sure that all states provide a minimum public **\_\_\_\_\_\_\_**  program.

There are several kinds of categorical grants. Some are formula grants—federal funds go to all the states on the basis of a formula. Different amounts go to different states, often depending on a variety of factors, such as the state’s relative **\_\_\_\_\_\_\_** \_\_\_\_ or \_\_\_\_\_\_ \_\_\_\_\_\_. These grants usually require states to provide **\_\_\_\_\_\_\_ \_\_\_\_\_**. Others are project grants—state or local agencies or individuals may apply for funds for a variety of specific purposes: to fight crime, to improve a city’s subway system, or to control air and water pollution, among other things.

State governments usually prefer block grants over categorical grants as a form of federal aid. A **\_\_\_\_\_ \_\_\_\_** is a large grant of money to a state or local government to be used for a general purpose, such as public health or crime control. Block grants have fewer guidelines, and state officials have considerably more choice over how the money will be spent.

Borrowing

States borrow money, often to pay for large, long-term expenditures such as **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_** or other **\_\_\_\_\_\_\_ \_\_\_\_\_\_**. State governments borrow by selling bonds. A **\_\_\_\_\_** is a contractual promise on the part of the borrower to repay a certain sum plus interest by a specified date. In most states, voters must be asked to approve new bond issues. As of 2011, the states **\_\_\_\_\_** about $1.1 trillion to the federal government.

Financing Local Government

Local governments are responsible for providing services such as **\_\_\_\_\_ \_\_\_\_\_**, **\_\_\_\_\_\_\_**, parks, water, sewage treatment, **\_\_\_\_\_\_\_**, welfare, and **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_**. The costs for these services are enormous, and taxes—property taxes, sales taxes, income taxes, and fees—provide most of the revenues necessary to supply these services. Local governments also receive funds from state and federal government and borrow money in the form of **\_\_\_\_\_\_\_\_ \_\_\_\_\_**.

Property Tax

One of the oldest taxes—property taxes—once provided revenue for all levels of government. Today property taxes are the most important **\_\_\_\_\_** of revenue for local governments, accounting for about three-quarters of all tax revenues.

Property taxes are collected on **\_\_\_\_\_ \_\_\_\_\_\_\_**  and **\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_**. Real property includes land and buildings. Personal property consists of such things as stocks and bonds, jewelry, furniture, automobiles, and works of art. Most local governments tax only real property. If personal property is taxed at all, the rate is usually very low.

How do local governments determine what the property tax rate will be? A government tax assessor first calculates the **\_\_\_\_\_\_ \_\_\_\_\_** of the homes and other real property in the community. The market value of a house or a factory is the amount of money the owner could expect to receive if the property were **\_\_\_\_**.

Other Local Revenue Sources

Local governments sometimes impose **local income taxes**, sales taxes, and fines and fees, or operate government-owned businesses to raise additional revenue.

The local income tax is a **\_\_\_\_\_\_ \_\_\_\_\_\_\_\_**. If the state and the local community each have an income tax, the taxpayer pays three income taxes: federal, state, and local. The sales tax is a tax on most items sold in stores; many states allow their local governments to use this tax.

Fines paid for traffic and other violations and fees for special services provide some of the income for local governments. **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_**are fees that property owners must pay for services that benefit them—for example, an assessment to a homeowner when the city improves the sidewalk in front of the owner’s home. Some cities also earn revenue through housing projects and **\_\_\_\_\_\_\_ \_\_\_\_\_\_\_**.