Chapter 16: Financing Government

Section 2

Objectives

1. Describe federal borrowing.
2. Explain how the Federal Government’s actions can affect the economy.
3. Analyze the causes and effects of the public debt.

Key Terms

- deficit: the shortfall created when income is lower than expenses
- surplus: the excess created when income is higher than expenses
- demand-side economics: the view that increased government spending will create higher employment, boost the economy, and raise tax revenues
- supply-side economics: the view that lower taxes, not greater government spending, will boost the economy
- public debt: the total amount of money owed by the federal government
Introduction

• What effect does borrowing have on the federal budget and the nation’s economy?
  – Borrowing can be used to provide an economic stimulus for the nation and to pay off budget deficits in times of crisis or overspending.
  – However, such borrowing leads to future deficits and higher interest payments on the increasing public debt.

The Power to Borrow

• The Constitution gives Congress the power to borrow money. For 150 years Congress used this power to:
  – Pay for crises such as wars
  – Pay for large-scale projects such as the construction of the Panama Canal

  • For most of the past 80 years, the government has borrowed money to pay for yearly budget deficits because it spends more than it raises from taxpayers.

Deficits and Surpluses

• The government did not have a budget surplus from 1969 to 1998.
• The government creates the budget based on estimates.
  – What factors mentioned on the chart likely affected the budget for that year?

The Depression

• At the height of the Great Depression, one fourth of the nation’s labor force was unemployed and 18 million were dependent on public relief programs.

• State governments, private charities, and banks were all overwhelmed.

• The traditional approach was to keep government involvement in the economy limited and let the free market solve the problem.
Keynesian Economics

- In contrast, President Roosevelt's New Deal used the ideas of John Maynard Keynes to stimulate the economy.

- Keynes said that government should spend heavily on public programs during times of high unemployment.

Supply-Side Economics

- Under President Reagan, the theory of supply-side economics took hold.

- This theory says that lowering taxes increases the supply of money in private hands and boosts the economy without higher government spending.

- In 2008, supply-side supporter George W. Bush approved both an economic stimulus plan and a $700 billion bailout of home lending institutions, both Keynesian measures for dealing with a financial crisis.

Borrowing Money

- Checkpoint: How does the federal government borrow money?
  - Congress must authorize all federal borrowing. The Treasury Department then borrows money by selling securities to investors.
  - Securities are notes in which the government promises to repay a certain sum, plus interest, on a certain date.
  - Short term securities are usually Treasury notes, also called T-bills.
  - Long term securities are typically government bonds.

Borrowing Money, cont.

- Investors in U.S. securities include both American and foreign individuals, banks, investment companies, and other financial institutions.
  - To which group of investors does the government owe the most?
The Public Debt

- The U.S. government can borrow money while offering lower rates of interest than those charged to private investors.
  - This is because U.S. securities are seen as safe investments and their interest is not taxed.

- Still, borrowing so much money has produced a huge public debt for the federal government.
  - This debt includes all the borrowed money not yet repaid plus the interest owed.

The Public Debt, cont.

- There is no constitutional limit on the public debt.
- Congress has put limits on the debt but simply raised them when needed.
- The amount of the debt is hard to imagine and will affect future generations of taxpayers.

Review

- Now that you have learned about the effect borrowing has on the federal budget and the nation’s economy, go back and answer the Chapter Essential Question.
  - How should the federal budget reflect Americans’ priorities?