Magruder’s American Government

CHAPTER 16
Financing Government
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SECTION 1  Taxes

SECTION 2  Nontax Revenues and Borrowing

SECTION 3  Spending and the Budget
Taxes

• How and why does the Constitution give Congress the power to tax?

• What are the most significant federal taxes collected today?

• Why does the Federal Government impose taxes for nonrevenue purposes?
The Power To Tax

• Article I, Section 8, Clause 1 of the Constitution grants Congress the power to tax.

• The Sixteenth Amendment gives Congress the power to levy an income tax.

Limits on the Power to Tax

• The power to tax is also limited through the Constitution. According to the Constitution:

  1. Taxes must be used for public purposes only.
  2. Federal taxes must be the same in every State.
  3. The government may not tax exports.
Current Federal Taxes

The Income Tax

- The income tax is the largest source of federal revenue today. The tax is also a **progressive tax**, that is, the higher the income and the ability to pay, the higher the tax rate.

Individual Income Tax

- Individual income taxes regularly provide the largest source of federal revenue.
- The tax is levied on each person’s taxable income.

Corporation Income Tax

- Each corporation must pay a tax on its net income, that is, on the earnings above the costs of doing business.
There are three main types of social insurance taxes levied:

**OASDI**
- The Old-Age, Survivors, and Disability program is the basic Social Security program.

**Medicare**
- Medicare is health insurance for the elderly and part of the Social Security program.

**Unemployment Compensation**
- The unemployment compensation program pays benefits to jobless workers and is also part of the overall Social Security program.
Other Types of Taxes

Excise Taxes

- An excise tax is a tax laid on the manufacture, sale, or consumption of goods and/or the performance of services.

Custom Duties

- A custom duty is a tax laid on goods brought into the U.S. from abroad.

Estate and Gift Taxes

- An estate tax is a levy imposed on the assets (estate) of one who dies. A gift tax is one imposed on the making of a gift by a living person.
The Federal Government’s Income

Federal revenue comes from several different sources:

<table>
<thead>
<tr>
<th>The Federal Government’s Income (in billions of dollars)</th>
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<tbody>
<tr>
<td>--------------------------------</td>
</tr>
<tr>
<td>Individual income taxes</td>
</tr>
<tr>
<td>Corporation income taxes</td>
</tr>
<tr>
<td>Social insurance taxes and contributions</td>
</tr>
<tr>
<td>Excise taxes</td>
</tr>
<tr>
<td>Estate and gift taxes</td>
</tr>
<tr>
<td>Customs duties</td>
</tr>
<tr>
<td>Miscellaneous receipts</td>
</tr>
<tr>
<td>Total receipts**</td>
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</tbody>
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*Estimated
**Columns may not add to totals due to rounding and additional sources of income.

SOURCE: Office of Management and Budget
• Besides taxing for revenue purposes, the Federal Government sometimes taxes for the purpose of regulating and even discouraging some activity that Congress thinks is harmful or dangerous to the public.

• The Supreme Court has upheld Congress’s taxing for nonrevenue purposes.

• However, the Supreme Court can still rule a tax unlawful if it finds that the tax was imposed for improper reasons.
Section 1 Review

1. Most of the Federal Government’s income comes from
   (a) custom duties.
   (b) licenses.
   (c) estate taxes.
   (d) income taxes.

2. OASDI, Medicare, and unemployment compensation program taxes are all types of
   (a) social insurance taxes.
   (b) progressive taxes.
   (c) nonrevenue taxes.
   (d) freedom taxes.

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SECTION 2
Nontax Revenues and Borrowing

• What are the nontax sources of government revenues?

• How does the Federal Government borrow money?

• What are the causes and effects of the public debt?
Nontax Revenues and Borrowing

Nontax Revenues

• Nontax revenues come from a variety of sources, including canal tolls; fees for passports, copyrights, and patents; interest earned; and selling philatelic stamps.

Borrowing

• Congress has the power “[t]o borrow Money on the credit of the United States.” (Article I, Section 8, Clause 2).
• A deficit is the shortfall between income and spending.
• A surplus is more income than spending.
• Congress must authorize all federal borrowing.
The **public debt** is the government’s total outstanding indebtedness. It includes all of the money borrowed and not yet repaid, plus the accrued, or accumulated, interest.
### Causes and Effects of the Public Debt

#### Causes:
- Deficit financing
- Failure to repay the debt over time
- Interest accruing on the existing debt

#### Effects:
- Increased revenue needed to pay off the debt
- Fears of financial obligations for tomorrow’s taxpayers
1. Examples of nontax revenues include all of the following EXCEPT
   (a) profits made by the U.S. Mint.
   (b) customs duties.
   (c) the sale of philatelic stamps.
   (d) passport fees.

2. Deficit spending means that the government
   (a) spends more money than it gains in revenue and borrows the rest.
   (b) spends less money than it gains in revenue.
   (c) balances the budget every year.
   (d) spends an amount of money that is equal to the amount of money it gains in revenue.

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• What are the key elements of federal spending?

• How do the President and Congress work together to create the federal budget?
Federal Spending

Spending by the Federal Government accounts for billions of dollars and has effects on the economy as a whole.

Spending Priorities

- **Entitlements** are benefits that federal law says must be paid to all those who meet the eligibility requirements. Entitlements are the largest sector of government spending.
- Interest on the public debt has grown to be the second largest category of federal spending.
- Outlays for defense spending account for another large section of the federal budget.
Creating the Federal Budget

Federal agencies send their money requests to the Office of Management and Budget (OMB).

The OMB reviews agency requests and melds them into the President’s budget. In January or February, the President sends his budget to Congress.

Congress reviews budget, enacts several appropriations measures.

The President signs funding measures.

OR

The President vetoes one or more funding measures. If Congress cannot get a $2/3$ majority to override veto, Congress and the President must reach a compromise to resolve the dispute(s).
Section 3 Review

1. Uncontrollable spending refers to
   (a) the monies required to ensure military readiness.
   (b) spending that Congress and the President cannot change.
   (c) the government’s accounting system.
   (d) what the government does with our tax money.

2. Which of the following sequence of groups most closely resembles the federal budget creation process?
   (a) Federal agencies > the President > Congress > Office of Management and Budget
   (b) the President > Congress > Office of Management and Budget > federal agencies
   (c) Federal agencies > Office of Management and Budget > Congress > the President
   (d) Office of Management and Budget > federal agencies > the President > Congress

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