

# Financing Our Governments

## CIVIC PARTICIPATION

**A**s taxpayers, American citizens share most of the burden of financing local, state, and federal governments. In return, we receive a host of services that make our lives better and more secure. Contact your local town hall or city hall for information about the current budget, including sources of revenue and expenses. How much state or federal money

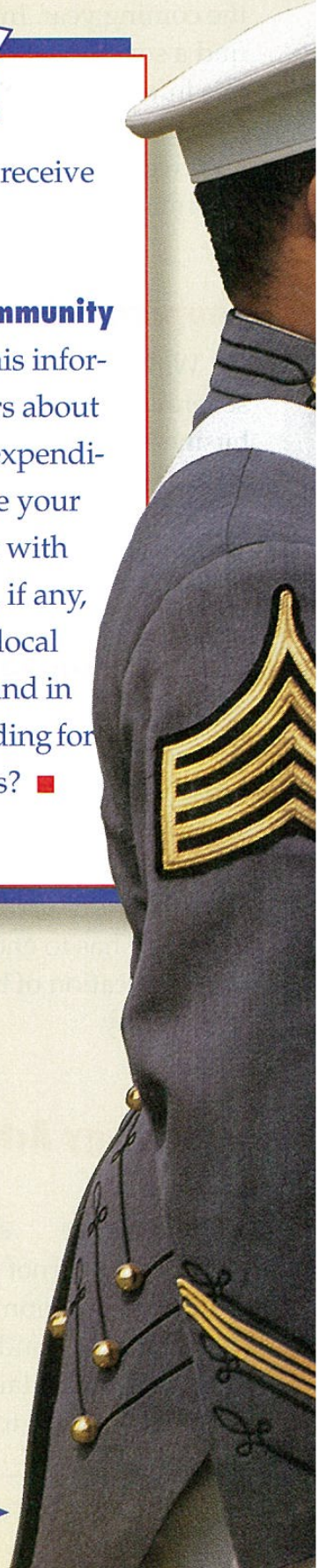
does the community receive for local programs?

### Working in Your Community

After you have this information, ask neighbors about their views on local expenditures and taxes. Share your community's budget with them. What changes, if any, would they make in local taxes and spending and in state and federal funding for local programs? ■

### Your Civics Journal

As you study this chapter, think about the various services your local, state, and federal governments provide. Write these in your civics journal, along with your feelings about the importance of these services. What changes, if any, would you make in these services?











# The Power to Tax

## FOCUS

### TERMS TO KNOW

revenue, progressive tax, regressive tax

### OBJECTIVES

- Explain the importance of **taxation**.
- Describe three **limits on taxation** found in the United States Constitution.
- Identify and describe four basic **principles of taxation**.

Every government has expenses. It must pay the salaries of elected officials and public employees. It must also pay for the services it provides to citizens. Government spending is one of the most controversial aspects of government policy. Some people feel that governments should spend less. Others feel governments should spend more. Almost everyone has different ideas about what the money should be spent on. People's feelings about public spending generally reflect their deepest beliefs about the purpose of government.

Governments, like individuals, must receive money before they can spend it. Money governments receive is generally called **revenue**. While governments get revenue from a variety of sources, the most important source is taxes. State and local governments usually get 60 to 80

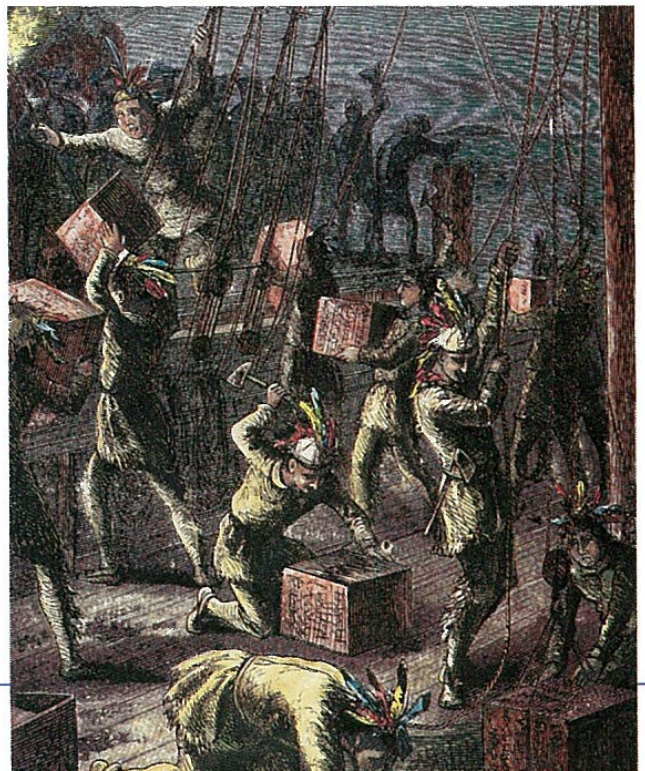
percent of their revenue through taxes. The federal government gets nearly all of its revenue from taxes.

## Taxation

The power to tax is an important source of a government's strength. Laws and regulations are worthless unless a government can raise the money necessary to carry them out. For this reason governments have almost always required their citizens to pay some form of taxes. Ancient Mesopotamian farmers had to give a portion of their crops to the government. Ancient Romans paid sales taxes, just as we do today.

Sometimes governments abuse their power to tax. Many times throughout history, citizens have turned against their government because they believed their taxes were unfair. One such revolt led to the American colonists' decision to declare independence from Britain in 1776.

**Tea and Taxes** British taxes on a shipload of tea angered American colonists, and they threw the tea into Boston Harbor. *Why is a government's power to tax important?*





When the American Revolution was over, citizens denied their new government the power to tax in order to avoid similar revolts. Under the Articles of Confederation, the government could request—but not demand—contributions from the states. The inability to raise money was a major weakness of the Confederation government.

The United States Constitution, on the other hand, included provisions on the power of taxation. The writers of the Constitution realized that the federal government needed a reliable source of revenue to operate effectively. At the same time, they wanted to prevent Congress from abusing its power to tax, as the British Parliament had done. For this reason they gave Congress a *limited* power to tax.

## Limits on Taxation

The writers of the Constitution gave Congress “the power to lay and collect taxes.” However, they placed certain restrictions on this power to prevent abuses. They wanted to make sure that the people being taxed would have a voice in the tax law. For this reason all tax bills must be introduced in the House of Representatives, where representation is based on population. They also wanted to be sure that the taxes would fall fairly on all citizens. Thus the Constitution requires that any tax the federal government imposes must apply uniformly throughout the country.

In addition, the Constitution restricts the power of state governments to collect taxes. Unlike the federal government, states are not permitted to tax interstate or foreign commerce. Also, as the result of an 1819 Supreme Court decision, states may not tax the federal government.



**Limits on Taxation** Angry citizens protest increased property taxes. Which amendment to the Constitution ensures that tax laws apply equally to all?

One of the most important limits on the taxation power of state governments is the Fourteenth Amendment. The amendment’s guarantee of “equal protection of the laws” to all citizens prevents states from taxing one group of citizens more heavily than another—without good reason. For example, a state government may not require Republicans to pay heavier taxes than Democrats. It may, however, require wealthy people to pay more taxes than poor people.

Many state constitutions further limit taxation. The limits may include the kinds of taxes the state legislature can pass and how high those taxes can be. As you discovered in Chapter 14, local governments get their powers directly from state governments. Therefore, all restrictions on state taxation—whether found in the United States Constitution or in state constitutions—apply to local governments as well.





**Local Taxes** A property owner pays local taxes. What is an example of a tax collected in the most convenient way possible?

## Principles of Taxation

No one enjoys paying taxes. Taxpayers complain less, however, when they feel that their government is collecting taxes fairly and using the money wisely. In 1776 the English economist Adam Smith developed four guidelines for taxation.

The first guideline is that taxes should be *based on a person's ability to pay*. In other words wealthy people should be taxed at a higher rate than poor people. Such a tax, in which people who earn more money pay more taxes, is known as a **progressive tax**. A **regressive tax**, on the other hand, is one in which people pay the same amount no matter how wealthy or poor they are. A regressive tax places a heavier burden on the poor.

Smith's second guideline is that a tax should be *clear and straightforward*. People should be able to figure out exactly how much they must pay in taxes. When this guideline is followed, people can plan their finances wisely.

The third guideline is that a tax should be *collected in the most convenient way possible*. A sales tax, for example, should be paid when the sale is made.

Smith's final guideline is that each tax should be *collected efficiently*. Whenever a government collects a tax, a small portion of the revenue goes to pay for the cost of tax collection. According to this guideline, collection costs should be kept as low as possible so that more tax money can be spent for the public good.

Most economists add a fifth guideline that Adam Smith did not include. This guideline is that taxes should be *reasonable*. When taxes are high, people and businesses have less money to save and invest. Moreover, people may not work as hard because they know they will have to pay the government a large portion of the money they earn.

### ★ SECTION 1 REVIEW ★

#### UNDERSTANDING VOCABULARY

*Define* revenue, progressive tax, regressive tax.

#### REVIEWING OBJECTIVES

- 1 What is the importance of taxation?
- 2 What are three limits on taxation found in the United States Constitution?
- 3 What are four basic principles of taxation?





# Types of Revenue

## FOCUS

### TERMS TO KNOW

income tax, tax return, exemption, deduction, taxable income, property tax, sales tax, excise tax, tariff

### OBJECTIVES

- Explain why **income taxes** are considered progressive taxes.
- Explain how **property taxes** are determined.
- Identify and compare two kinds of **sales taxes**.
- Identify and describe three **other types of taxes** the federal government imposes.
- Identify three sources of **nontax revenue**.

**T**here is no such thing as a perfect tax. No single form of taxation can satisfy all the guidelines you read about in the preceding section. For this reason most governments use several different kinds of taxes to raise revenue. The advantages of one tax can help make up for the disadvantages of another.

## Income Taxes

An **income tax** is a tax on income—the money an individual or business earns. The Sixteenth Amendment, passed in 1913, gave the government the

power to levy, or collect, such a tax. Today the federal government gets about half its total revenue from income taxes. Most states and many cities have income taxes as well and rely on these as an important source of revenue.

The United States levies two types of income taxes—personal and corporate. Individuals pay personal income taxes based on the money they earn each year. Corporations pay corporate income taxes based on their annual profits.

## Filing Tax Returns

The deadline for paying personal income tax is generally April 15 of each year. By that date, each taxpayer must submit a form called a **tax return** to the Internal Revenue Service, the government's tax collector. To fill out the tax return, taxpayers must first figure out exactly how much income they received during the past year. Each taxpayer then subtracts a certain amount of money called an **exemption**. In 1996 the exemption the federal government allowed was \$2,550 plus \$2,550 for each dependent, or person the taxpayer supported.

**Income Taxes** Most people must file their personal income tax returns by April 15.

*What is a corporate income tax?*

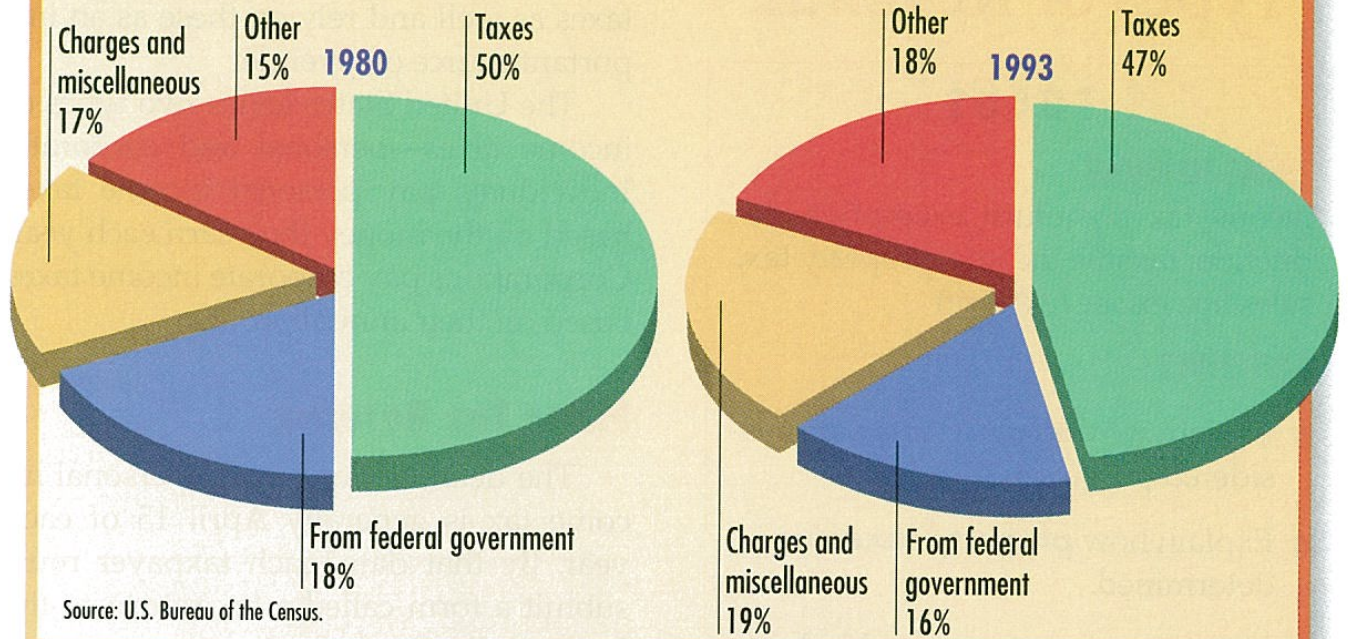






## GRAPH STUDY

**State and Local Government Revenue** The sources of state and local government revenue are changing. Which sources increased and which decreased between 1980 and 1993?



For example, a taxpayer with an unemployed spouse would claim an exemption of \$5,100.

A taxpayer may sometimes subtract additional amounts of money, called **deductions**, for such things as medical expenses and charitable contributions. The amount that remains after the taxpayer has subtracted all possible exemptions and deductions is called **taxable income**. The taxpayer must pay the government an income tax based on a certain portion of this taxable income.

### Withholding Taxes

To make the payment and collection of personal income taxes more convenient, the federal and state governments have set up a system of tax withholding. Under this system employers regularly subtract a certain portion of money from each employee's paycheck. This money is sent directly to the federal and state

governments. As a result most taxpayers owe only a small amount of income tax when they submit their tax returns. Some taxpayers may have too much money withheld from their paychecks. These taxpayers are entitled to a tax refund after submitting their tax returns.

The federal income tax and most state income taxes are progressive. People with higher incomes must pay a greater percentage in taxes. For example, in 1994 an unmarried taxpayer whose taxable income was less than \$22,750 had to pay 15 percent (or no more than \$3,412.50) to the federal government. An unmarried taxpayer whose taxable income was between \$22,751 and \$55,100 had to pay 15 percent on the first \$22,750 and 28 percent on the rest. People with higher incomes paid rates of 31, 36, and 39.6 percent. The reason for this system is that people with lower incomes must spend a larger percentage of their earnings on necessities such as food and housing. Peo-



ple with higher incomes generally have more money to spend on non-necessities. As a result they can afford to take on a bigger share of the tax burden.

## Property Taxes

A **property tax** is a tax based on the value of property. Governments usually define *property* to mean real estate, but personal items such as cars and jewelry may also be taxable. Property taxes are the primary source of revenue for local governments. Some state governments impose property taxes as well, as do many of the nation's school districts.

Before a government can collect property tax, it must send an assessor to examine a taxpayer's property. Using written reference material and past experience, the assessor decides what each piece of property is worth. Property tax is usually worked out as a percentage of the assessed value. The local government sets this tax rate according to the needs of the community. In one community it might be 4.5 percent (\$4,500 on a house assessed at \$100,000). In another it might

be only 2 percent (\$2,000 on a house assessed at \$100,000).

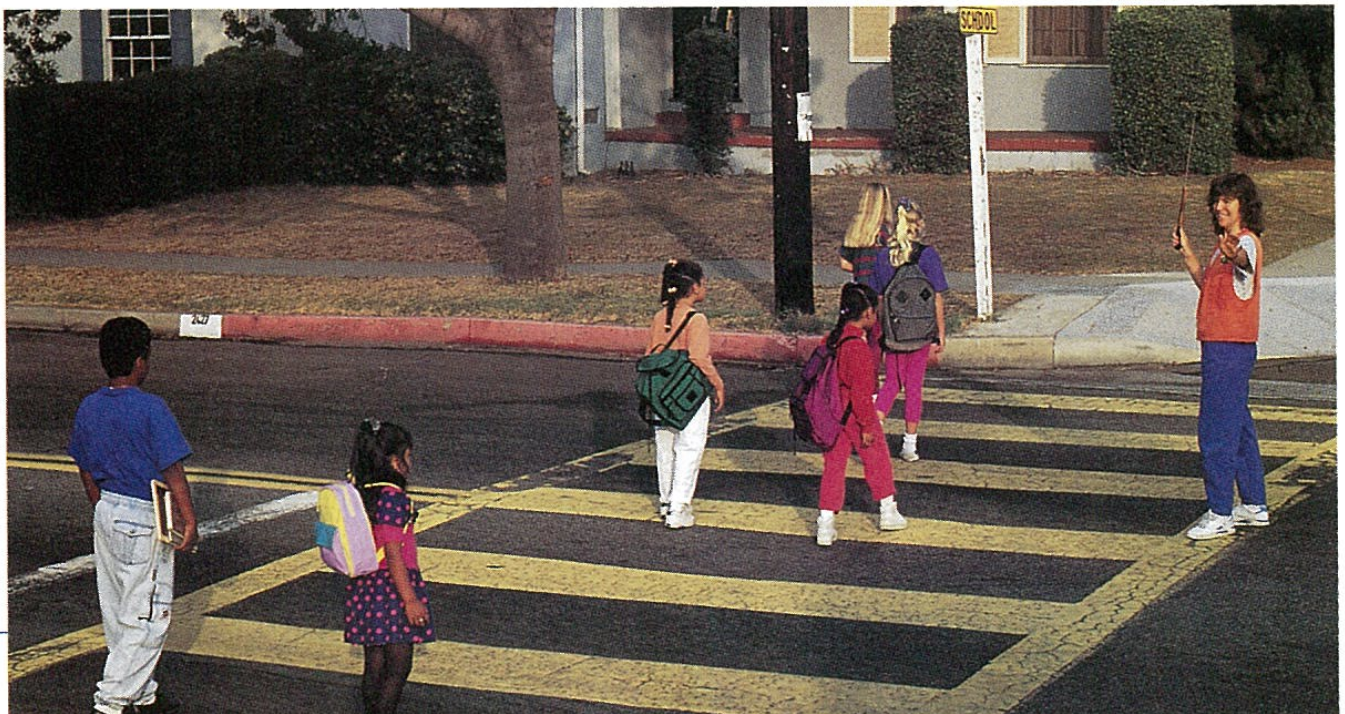
As the costs of government have increased, property owners have had to pay higher property taxes. Many property owners have objected to paying these high taxes. In 1978 California taxpayers voted to lower property taxes throughout the state. Since then, voters in a number of other states have followed with similar "taxpayer revolts." As a result of this pressure to lower property taxes or limit increases, many state and local governments have been forced to cut their spending drastically.

## Sales Taxes

A **sales tax** is a tax placed on the sale of various products. The purchaser pays this tax at the time of purchase. The seller collects the sales tax and sends the money to the government. Sales taxes are a popular way to raise revenue because they are so easy to collect. Almost every state government has some form of sales tax, as do many county and city governments.

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**Property Taxes** Many communities depend on property taxes to finance schools.  
*How are property taxes determined?*







**Sales Tax** Most states and many cities have some form of sales tax. *Why is a sales tax regressive?*

Sales taxes may be general or selective. A general sales tax is one collected on the sale of nearly any product. A selective sales tax, also called an **excise tax**, is one collected only on specific products. Every state, for example, places excise taxes on gasoline, cigarettes, and alcoholic beverages.

A sales tax is set as a percentage of the purchase price. This percentage rate varies from place to place. Among the states that have sales taxes, the rate varies from 3 to 7 percent. When local governments charge sales taxes, those taxes are added on to the state tax. For example, shoppers in New York City pay an 8.25 percent general sales tax. That rate includes 4 percent for the state, 4 percent for the city, and .25 percent for the Metropolitan Commuter Transportation District.

A sales tax is a regressive tax, because the tax rate is the same for everyone. Sales taxes hit people with low incomes hardest because they must spend nearly all of their earnings on

necessities. Higher-income people rarely spend everything they earn; they usually have money left over to save or invest. Therefore, wealthy people pay sales taxes on a smaller portion of their earnings.

To make sales taxes less regressive, many governments exclude certain basic, necessary items. In most states, for example, sales of groceries and medical supplies are not taxable. As a result poor people, who spend much of their incomes on these necessities, are able to pay a smaller share of taxes.

## Other Types of Taxes

The federal government and most state governments impose several other kinds of taxes in addition to income taxes, property taxes, and sales taxes. For example, when a person dies, the property and money left behind are known as that person's estate. If the estate is worth more than \$600,000, the federal government may claim a portion of its value as an estate tax. Most states also collect an estate tax or an inheritance tax.

To avoid paying an estate tax, some people try to give away their property before they die. This property, however, is subject to a gift tax. Under this tax, anyone who gives gifts of more than \$10,000 per year must pay the federal government a percentage of the total amount as a gift tax. State governments may also collect gift taxes.

## Social Security Tax

Several other kinds of taxes are collected only by the federal government. The best known of these is the social security tax. In 1935 the Social Security Act set up a federal fund to provide financial support for elderly people. A 15.3 per-



cent tax on wages and salaries, which employees and employers share, supports this fund.

## Tariffs

A **tariff** is a special kind of import tax. A tariff is designed to raise revenue as well as to protect American industries. Many products, such as clothing and electronics equipment, can be produced more cheaply in countries other than the United States. When those products are imported and sold in this country, people are more likely to buy them than to buy more expensive American products. American businesses may suffer as a result.

To help make American-made products more competitive, importers may be required to pay a tariff to the federal government. The importers must raise the selling price of their products to cover the cost of the tariff.

Tariffs are quite controversial. Some people feel that tariffs are necessary to protect American businesses from unfair competition. Others feel that tariffs hurt American consumers by forcing importers to raise the prices of products. One problem is clear to everyone: When the federal government places tariffs on foreign products, foreign governments respond by placing tariffs on American products. For this reason the federal government usually imposes tariffs only as a last resort.

## Nontax Revenue

Taxes are not the only way for the federal, state, and local governments to raise revenue. Governments may collect money from their citizens in a variety of other ways.

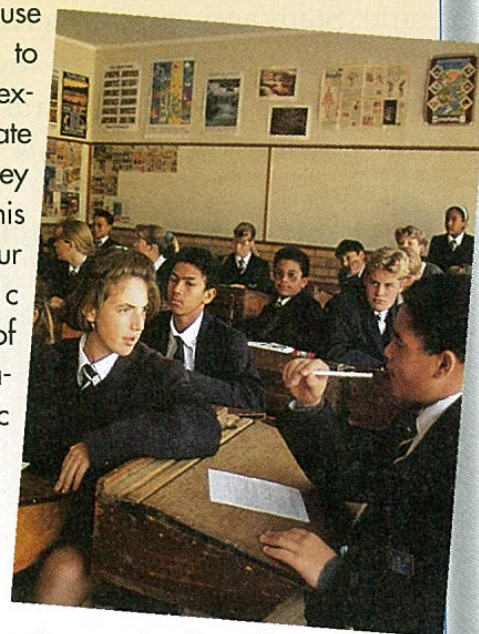
Many governments own land that they no longer need or cannot use. Occasionally, a government will sell unneeded property to private buyers. More often, however, the government will rent or lease the land. For example, the

### DID YOU KNOW?

#### Vouchers — A Way to Improve Schools?

A controversial idea for improving American education is the school voucher proposal. The government would give parents vouchers, or coupons, for a specific amount. These could be used to pay for a child's education at any school—public or private.

Supporters see voucher plans as providing parents with a greater choice in their children's education. They think the plan will force schools to compete for students, thus acting as an incentive for the schools to improve. Opponents argue that voucher plans violate the constitutional separation of church and state because parents can use public money to send their children to religious schools. They also point out that vouchers would allow well-to-do parents to use tax money to help pay for expensive private schools. They feel that this undercuts our democratic tradition of equal education in public schools.



**Private school students**





**Tolls** Motorists must pay tolls for the use of some highways, bridges, and tunnels. *What kind of revenue are tolls?*

federal government often leases the rights to dig mines or drill for oil on federal land. Renting or leasing is preferable to selling because it provides a steady source of income.

Tolls are another regular source of income. State and local governments often charge tolls for the use of highways and bridges. The federal government charges tolls for the use of canals the United States owns.

All governments also collect fees and fines. State governments, for example, require licenses for driving, getting married, hunting, and fishing. People who want to obtain such licenses must pay a fee to the government. The federal government charges fees for such services as registering copyrights, preparing passports, and providing copies of documents. In addition, governments collect fines from individuals and organizations. The fines might be for violating

traffic regulations or for failing to meet clean air and water standards.

In recent years an increasing number of states have begun to raise revenue through government-run lotteries. These games of chance, in which people buy numbered tickets, offer large amounts of cash as prizes for those whose numbers are drawn. Lotteries have proven to be very successful at raising revenue, and more than half the states now have them. Many people disapprove of lotteries, however, because they feel that states should not be encouraging gambling.

Many state and local governments get from 9 to 47 percent of their revenue from nontax sources such as rents, tolls, and fees. The federal government, however, gets less than 2 percent of its revenue from nontax sources.

## ★ SECTION 2 REVIEW ★

### UNDERSTANDING VOCABULARY

*Define* income tax, tax return, exemption, deduction, taxable income, property tax, sales tax, excise tax, tariff.

### REVIEWING OBJECTIVES

- 1 Why are income taxes considered progressive taxes?
- 2 How are property taxes determined?
- 3 What are two kinds of sales taxes, and how are they different?
- 4 What are three other types of taxes the federal government imposes?
- 5 What are three sources of nontax revenue?





## Using the Internet

**T**o learn more about almost anything, learn to use the Internet. The Internet is a global “network” that offers opportunities to explore exciting features such as electronic mail, games, on-line discussion groups, and even shopping. To enjoy the Internet and its services, you must have three things:

- 1) a computer,
- 2) a modem, to enable your computer to send and receive data over a telephone line, and
- 3) an Internet service provider, such as America Online or a local Internet service provider, that will grant you entry to the Internet.

### Learning the Skill

The easiest way to access sites and information on the Internet is to use a Web browser. This will allow you to view and explore information on the World Wide Web. The World Wide Web is made up of documents called Web pages. Each Web page has its own address, or URL, many URLs begin with `http://`. As you become familiar with the Internet and its various features, you will see how easy it is to locate information by using the proper Web site.

### Practicing the Skill

This chapter focuses on financing our governments. Follow these steps to learn more about government finances.

1. Log on to the Internet and access a World Wide Web search tool, such as Yahoo at  
<http://www.yahoo.com>

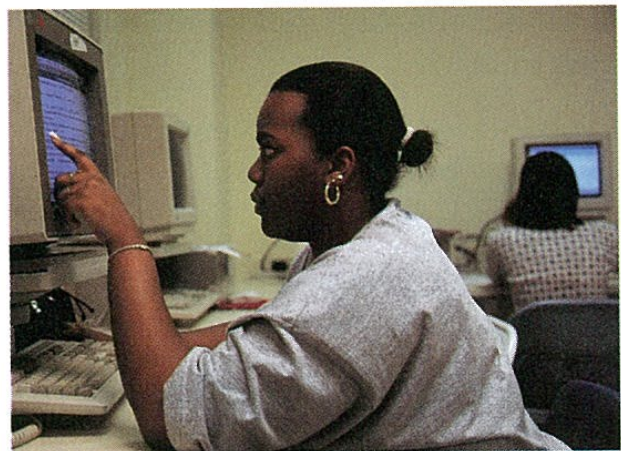
Lycos at

<http://www.lycos.com>

WebCrawler at

<http://www.webcrawler.com>

2. Search by selecting one of the listed categories or by typing in the category you want to find.
3. Continue your search by scrolling down the list that appears on your screen. When you select an entry, click on it to access the information. Sometimes, the information you first access will not be exactly what you need. If so, continue searching until you find the information that you want.



**Checking Out the Internet**

### APPLYING THE SKILL

**F**ollow this procedure to locate information about the budget of the federal government. Use the information you gather to create a chart or graph depicting how the government allocates its funds.





# How Governments Spend Their Money

## FOCUS

### TERMS TO KNOW

budget, expenditures, deficit, national debt, balanced budget, grant-in-aid

### OBJECTIVES

- Describe the steps in **the budget process** of the federal government.
- Identify the largest **expenditures** of the federal, state, and local governments.
- Explain some of the problems caused by **budget deficits**.
- Identify and describe the most common form of **intergovernmental revenue**.

**B**ecause governments have limited revenues, they must make choices. If more money is spent on one item, less money must be spent on another. Spending an extra \$1 billion on space exploration, for example, may result in less money for programs to feed the hungry. Making decisions like these is one of the most difficult duties of government.

To decide how best to spend its money, a government must set priorities. It must determine the importance of its

various goals and spend its money accordingly. The greatest amount of money will be spent on the most important items. Lesser amounts of money will be spent on less important items.

## The Budget Process

A government's spending priorities are presented in the form of a **budget**, a plan for managing and spending money. A budget always has two parts. The first part lists the government's revenues, or receipts, and indicates how much money is expected from each source. The second part lists the government's outlays, or **expenditures**—the items on which the government plans to spend money and the amount it plans to spend on each.

Budgets are almost always annual; they list revenues and expenditures for a one-year period. This one-year period is usually a fiscal year rather than a calen-

**NASA** The federal government has spent billions of dollars on the space program of the National Aeronautics and Space Administration. *How do governments decide how to spend their funds?*





dar year. While a calendar year always runs from January 1 to December 31, a fiscal year can begin at any time. For example, the federal government's fiscal year runs from October 1 of one calendar year to September 30 of the next. Most state and local governments also use those dates for their fiscal years.

## Preparing the Budget

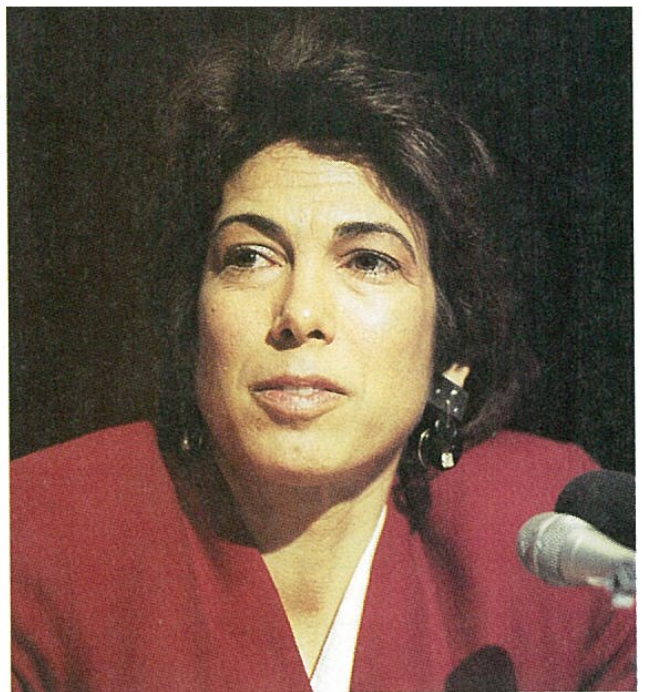
Because the federal government spends such an immense amount of money—more than \$1 trillion—the federal budget is a huge document. Preparing the budget requires the work of hundreds of people over several months.

The budget process begins each year in the Office of Management and Budget (OMB), a division of the Executive Office of the President. The head of the OMB, the budget director, asks every federal department and agency to estimate the amount of money it will need for the coming fiscal year. At the same time, members of the OMB staff estimate the amount of money the government can expect to take in during the same period.

With this information, the budget director meets with the President to discuss priorities. Based on recommendations of the President and the President's advisers, the budget director works out the first draft of the budget with the help of the OMB staff, who fill in the details. The completed budget is often more than 1,000 pages long.

## Passing the Budget

Once the President has approved the OMB's work, the budget is sent to Congress for approval. The President usually marks the occasion with a nationally televised speech, explaining and defending the spending priorities that have



**Budgets** Laura D'Andrea Tyson, head of the National Economic Council, is one of the officials involved in planning the budget. *Who else participates in preparing the budget?*

been established. Congress, however, almost never accepts the President's budget as it is. Many members of Congress have different priorities from those of the President. So, after weeks or months of congressional debate, the budget usually emerges with major changes.

By the time both houses of Congress pass the budget, it includes a great many compromises. Many federal agencies must accept less funding than they requested. The President may have to abandon some goals that were considered important. Members of Congress may have to give up programs that would benefit their constituents. As a result of these compromises, however, the federal budget is better able to meet the needs of the country as a whole.

## State Budgets

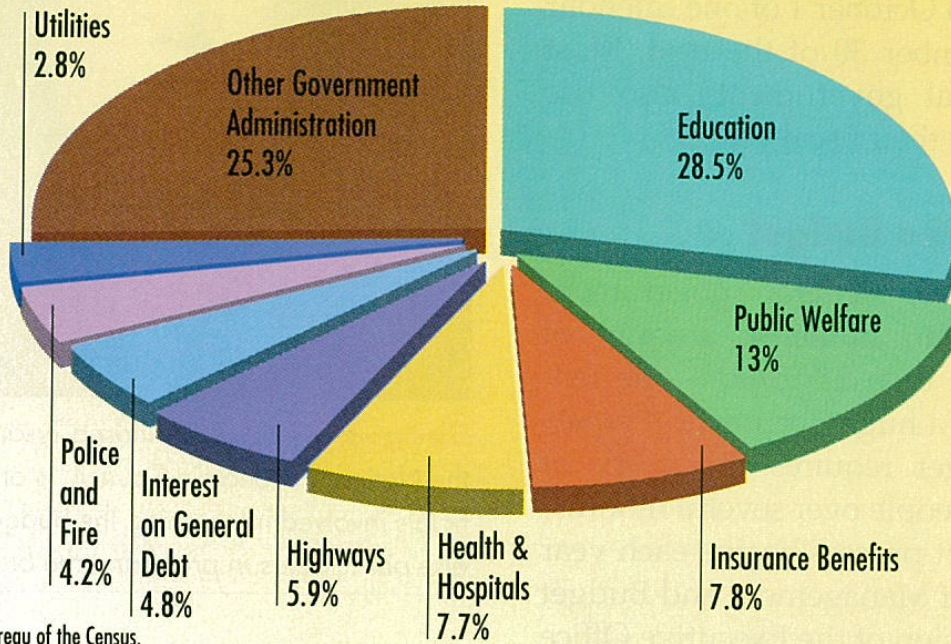
Most state and local governments follow a similar process in preparing their own budgets. Usually the leader of the executive branch, with the advice of





## GRAPH STUDY

**State and Local Government Spending** State and local governments spend close to 30 percent of their budgets on education. What percentage of spending goes toward administration?



Source: U.S. Bureau of the Census.

experts and political leaders, submits a budget to the legislature. The legislature then makes some changes and passes the revised version. Of course, no state or local budget requires as much work as the federal budget. In a small town, the budget process may take days rather than months. Nevertheless, the task of making choices and compromises is a difficult and often painful process at all levels of government.

## Expenditures

Each year's budget tends to be somewhat different from the one before. Some budgetary changes are due to outside events, such as world crises or natural disasters. More often, however, the changes are due to political developments, such as the election of new leaders who have new ideas and priorities.

During the early 1990s, the spending priorities of the federal government began to shift somewhat because of political changes in the country. However, the government did not radically change its pattern of spending. Each year the government spends the largest part of its budget on social security, medicare, national defense, and interest payments on loans.

The expenses in state and local budgets are much different from those of the federal budget. State governments do not have to pay for national defense, social security, or medicare. They also borrow much less money than the federal government does, so interest payments are not as great an expenditure.

The largest expense for nearly every state and local community is education. Educational spending accounts for more than one-third of the average state bud-



get. Among the other major expenses are social services (aid to needy people), transportation, and public safety.

## Budget Deficits

Governments often choose to spend more money than they take in. An excess of government expenses over government revenues is called a **deficit**. The federal government has had a deficit every year since 1970. In 1992 the deficit was at its peak—\$290 billion. Since then, the deficit has gone down significantly.

## Borrowing Money

To make up for a deficit, governments must borrow money to meet their expenses. Although some of the money is borrowed from banks, most of it comes from issuing bonds. A bond is a way for a government to borrow money from individuals. If you have ever bought a United States savings bond, you have lent money to the federal government. The government has promised to pay back what you paid for the bond plus interest.

Government deficits have occurred because American citizens ask more of their governments but are unwilling to pay higher taxes. Candidates who pledge to raise taxes almost always lose elections. As a result government leaders have been left with a difficult choice. They can either cut back on government programs or borrow more money. They have almost always decided to borrow more money.

## The National Debt

The huge federal deficit has caused a number of problems for the country. The most severe problem is the effect it has on the national debt. The **national debt** is the total amount the government owes



**Medicare** Social security and medicare are the two largest items in the federal budget. *What is the largest item in a state budget?*

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on money it has borrowed. Each year's deficit adds to this debt and increases the interest that must be paid on it. In 1996 that interest payment was more than \$345 billion. To pay this interest without cutting other expenses, the federal government has to continue borrowing money, which adds to the national debt.

Another problem is the deficit's effect on the economy. Only a limited amount of money is available for borrowing. If the federal government borrows much of that money, very little is left for individuals and businesses to borrow. This may result in higher interest rates—the "price" for borrowing money—which in turn discourages investment and slows economic growth.

## Balancing the Budget

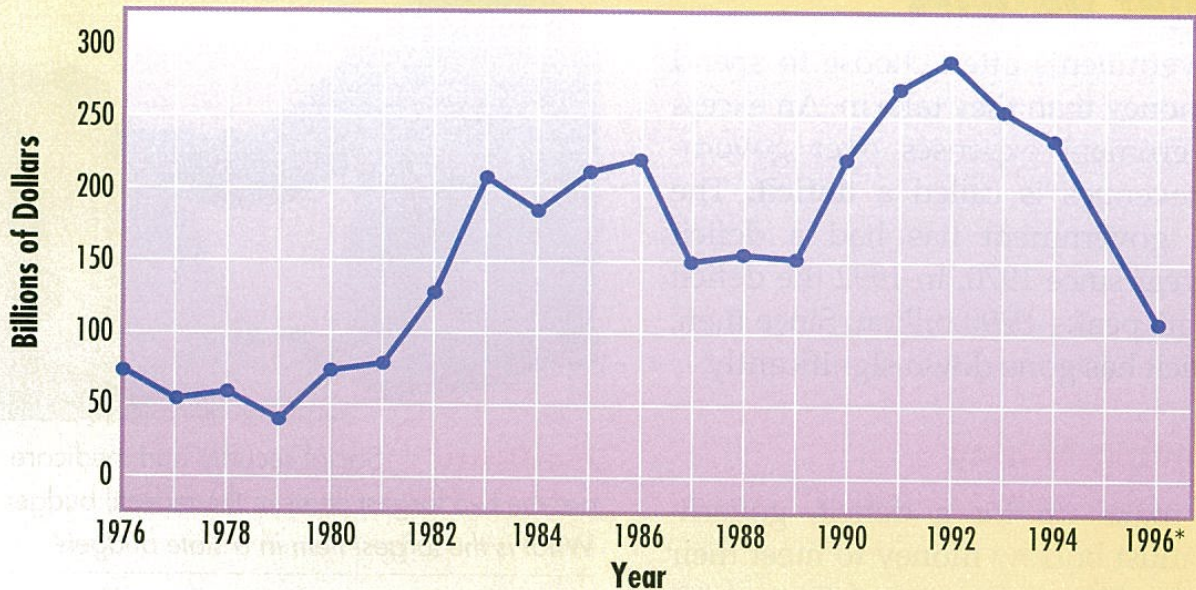
To overcome these problems, the federal government has been making great efforts to cut the federal deficit and "balance the budget." A **balanced budget** is a budget in which expenditures do not





## GRAPH STUDY

**Federal Budget Deficit, 1976–1996** The government reduced the federal deficit somewhat in 1996. *In what year was the deficit the largest?*



Source: U.S. Office of Management and Budget; U.S. Bureau of the Census; Budget of the United States Government.

\*estimated

exceed revenues—in other words, a budget with no deficit. An important step toward reducing the deficit came in 1985, when Congress passed the Gramm-Rudman-Hollings Act. This law required federal spending to be reduced by a certain amount each year. The Clinton administration made some progress toward reducing the deficit by cutting federal spending. In 1995, the Republican-controlled Congress tried to pass an amendment to the Constitution requiring a balanced budget by 2002. The amendment did not get the necessary votes in the Senate.

Most state constitutions require balanced budgets. When these governments cannot raise enough revenue to meet their expenses, they are not allowed, by law, to borrow money. Instead, they must cut services. In many communities, library hours have been cut and school activities have been limited in order to meet the restrictions of a balanced budget.

## Intergovernmental Revenue

When state and local governments are short of funds, they often turn to the federal government for help. Financial aid from the federal government may take several different forms.

### Federal Grants

By far the most common form of federal assistance is the grant-in-aid. A **grant-in-aid** is a sum of money given for a specific purpose, such as building highways or low-income housing. To receive a grant-in-aid, a state or local government must meet certain conditions. For example, it might have to agree to let minority-owned companies do a certain part of the work on the project.

A block grant is a combination of specific grants-in-aid. The federal government usually gives block grants for





**Special Education** Some federal funds go to special education programs. *What educational items do state grants pay for?*

general categories, such as transportation. A grant may be used for any purpose within that particular category.

## State Grants

States also provide grants to local governments. For education, a city or town may depend on assistance from both the state government and the federal government. In many schools, for example, state grants help pay for textbooks, while federal funds help pay for school lunch programs. Money for special programs, such as education for students with learning disabilities, may also come from federal grants.

## Debate Over Federal Grants

Many Americans criticize federal grants. They feel that the huge bureaucracy needed to manage these grants is too expensive. They also argue that state and local governments often waste money by requesting grants for projects they do not really need. Other people argue that federal grants enable communities to pro-

vide services they could not afford otherwise. In their view, while the federal government may not be completely efficient, it is the best way we have of providing help to people who need it.

In recent years, intergovernmental financing has moved in several directions. First, in its efforts to reduce the budget deficit, the federal government has made fewer and smaller grants to states than it did in the past. Second, there has been a trend to give states more freedom in deciding how to spend federal grants.

In 1995 Congress passed legislation in response to state complaints about the financial burdens of federal regulations. This legislation makes it harder for the federal government to impose new regulations, such as environmental laws, on states without putting up the money to pay for them. Such laws are known as unfunded mandates.

## ★ SECTION 3 REVIEW ★

### UNDERSTANDING VOCABULARY

*Define* budget, expenditures, deficit, national debt, balanced budget, grant-in-aid.

### REVIEWING OBJECTIVES

- 1 What are the main steps in the budget process of the federal government?
- 2 What are the largest expenditures of the federal, state, and local governments?
- 3 What are some of the problems caused by budget deficits?
- 4 What is the most common form of intergovernmental revenue?



## Identifying Key Terms

Choose the vocabulary term that best completes each of the sentences below. Write your answers on a separate sheet of paper.

revenue   progressive tax   deductions  
deficit   regressive tax   sales tax

1. For the last several years, the government had a \_\_\_\_\_ because its expenses exceeded its receipts.
2. More than half of the federal government's \_\_\_\_\_ comes from income taxes.
3. The tax was a \_\_\_\_\_ because the wealthy paid more than the middle class.
4. The state placed a 4 percent \_\_\_\_\_ on all products except food.
5. The \_\_\_\_\_ placed a heavier tax burden on the poor.
6. The family was able to claim several \_\_\_\_\_ on their income tax return.

## Reviewing the Main Ideas

### SECTION 1

1. Why is taxation such an important government power?
2. How does the Constitution limit the federal government's power to tax?

### SECTION 2

3. What is tax withholding, and what is its purpose?
4. How are property taxes determined?

### SECTION 3

5. In what ways is the federal budget a compromise document?
6. What choices do government leaders have when faced with a deficit?

7. What factors may contribute to annual changes in the federal budget?

## Critical Thinking

### SECTION 1

1. **Developing a Point of View** Do you think Americans would be willing to pay higher taxes in return for more services? Why or why not?

### SECTION 2

2. **Evaluating Information** What type of government revenue do you think is the most fair? Explain.

### SECTION 3

3. **Identifying Alternatives** What do you think the government's spending priorities should be? Give reasons for your answer.

## Reinforcing Citizenship Skills

In an almanac, find a table that shows some budget information, such as the interest paid on the national debt, over a period of time. Explain how you could show this information on a line graph or bar graph. Indicate which type of graph would be better.

## Cooperative Learning

In groups of four, survey family members, local businesspeople, and other adults on the subject of taxes. Ask for their ideas on how the taxation system might be changed. Also look for news reports in newspapers and magazines on tax increases or cuts at the local, state, and national levels.



## Changing Tax Rates

Income	Tax Bracket	Percent Decrease	Tax Decrease
\$25,000	15%	4%	\$150
\$50,000	28%	3%	\$420
\$75,000	31%	2%	\$465
more than \$100,000	36%	1%	\$360

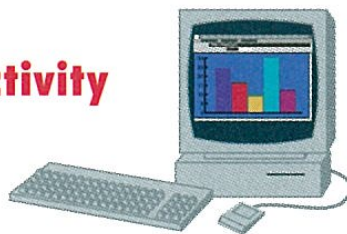
### Focusing on Your Community

The revenues and expenditures of every community are somewhat different, depending on the resources and needs of the community. Find out what your community's major expenditures and major sources of revenue are. What are local property tax rates and sales tax rates? What grants, if any, does the community receive from the state or federal government? Has the community had to cut services in recent years because of budget problems? If so, what services have been cut? Prepare a brief oral report for the class.

### Technology Activity

#### Using the Internet

Search the Internet to find information on this year's individual income tax forms. You might use the following key words to focus your search: **treasury, Internal Revenue Service, income tax**. Once you have located the information, calculate



your income tax if you were single, had no other dependents, claimed the standard deduction, and earned \$23,000 for the year.

### Analyzing Visuals

The federal government is constantly revising tax rules and rates in an effort to raise revenues without overtaxing its citizens. The table above shows how one proposed change would affect different levels of taxpayers. Study the table, then answer the following questions.

1. At which income level would people see the greatest percentage decrease in taxes?
2. At which income level would people see the smallest percentage decrease in taxes?
3. At which income level would people see the largest reduction in their tax bill?
4. Do you think this proposed tax plan would be fair? Explain why or why not.



# The Economy and the Individual

## CIVIC PARTICIPATION

**A**s a consumer, your economic decisions can have a far-reaching effect on other individuals and on your community and the country, as well as on yourself. Contact a local consumer league to learn about your rights as a consumer. What protections and what economic responsibilities do consumers have? Try to find out how the economic decisions of people

in your area have affected local businesses.

### Working in Your Community

After you have obtained the information, prepare a pamphlet on consumer rights. List the various rights consumers have, and provide the names, addresses, and phone numbers of consumer groups to contact with problems. Distribute this pamphlet to people in your neighborhood. ■

### Your Civics Journal

As you study this chapter, keep a list in your civics journal of the economic decisions you make each day. The list might include budgeting, purchasing items, and saving or borrowing money. Next to each entry, note the factors involved in your decision.

