



# Test Yourself: Government Deficits

Lord, the money we do spend on government!  
And it's not one bit better than the government  
we got for one-third the money twenty years ago.

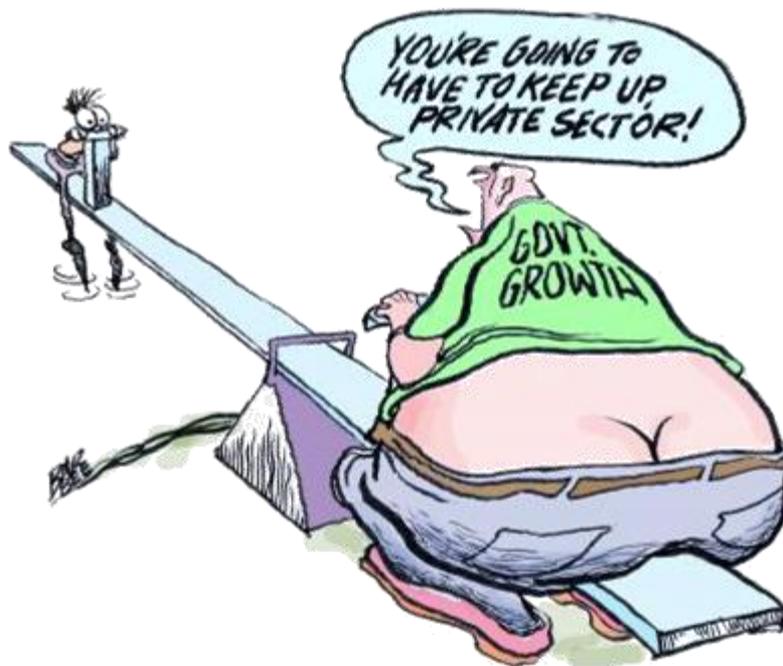
Will Rogers



How has the size of the US government changed?



Since the 1950s, US government expenditures have grown from about one-quarter to over one third of GDP.





How do taxes in the US compare to taxes in other countries?



US citizens are among the most lightly taxed people in the industrialized world.



What are two principles of  
taxation?



Two principles of taxation are:

- **Benefits Received Principle** - Those who benefit from government expenditures should pay the taxes that finance their benefits.
- **Ability to Pay Principle** - Those who have higher incomes can afford to pay a greater proportion of their income in taxes, regardless of the benefits.

The ability-to-pay principle dominates in the US.



What is a progressive tax?



A **progressive tax** is a tax that charges a higher percentage of taxation as income rises.



What is the average tax rate?



The **average tax rate** is the total tax due divided by the total taxable income.



What is the marginal tax rate?



The **marginal tax rate** is the change in taxes due divided by the change in taxable income.



What is a regressive tax?



A **regressive tax** is a tax that charges a lower percentage of taxation as income rises.

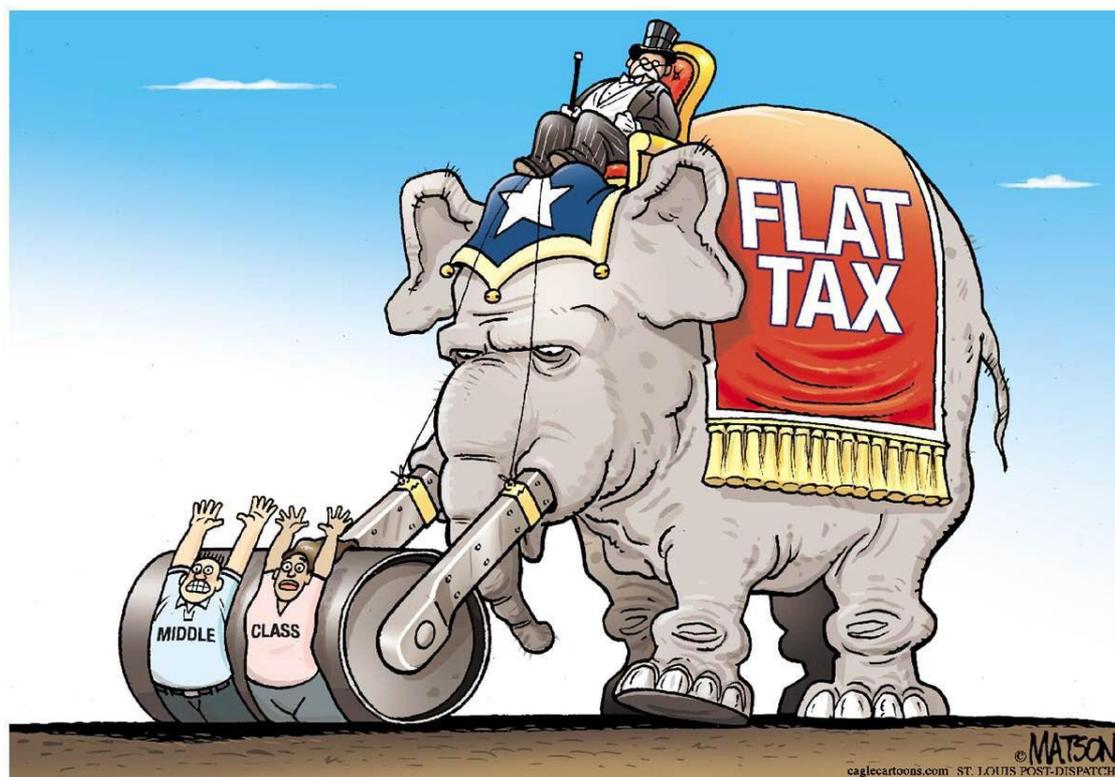




What is a proportional tax?



A **proportional tax** is a tax that charges the same percentage of taxation regardless of the size of income ... a flat tax.





# What is benefit - cost analysis?



**Benefit-cost analysis** is a comparison of the rewards and costs of an economic alternative.



Cost Benefit Analysis



What is the basic rule of benefit-cost analysis?



The basic rule of benefit-cost analysis is that *a firm will produce additional units as long as marginal benefit exceeds marginal cost.*

Why might government be inefficient in solving society's problems?





Government might be inefficient in solving society's problems because of:

- **the majority rule problem** - Voting can lead to a rejection of projects with marginal total benefits exceeding the marginal cost. Majority rule can lead to inefficient solutions because “one person one vote” cannot measure the *intensity* of voters' preferences as well as the market can.



Government might be inefficient in solving society's problems because of:

- **the interest group effect** - Interest groups can create government support for programs with costs out-weighting their benefits. Interest voting can be inefficient because a small group within the society can benefit while the whole society pays the costs.

Government might be inefficient in solving society's problems because of:



- **rational ignorance** - Voters choose to remain uninformed because the marginal cost of obtaining information is higher than the marginal benefit of knowing it.
- **bureaucratic inefficiency** - The bureaucracy may become more powerful than elected officials.
- **the shortsightedness effect** - Democracy has a bias toward programs offering clear benefits and hidden costs.



What are the four stages of the budget process?



The four **stages of the budget process** are:

- agency budget proposals
- president submits budget
- budget resolution
- budget passed



What is the federal fiscal year?



The **federal fiscal year** runs October 1<sup>st</sup>  
through September 30<sup>th</sup>.



What is the federal deficit?



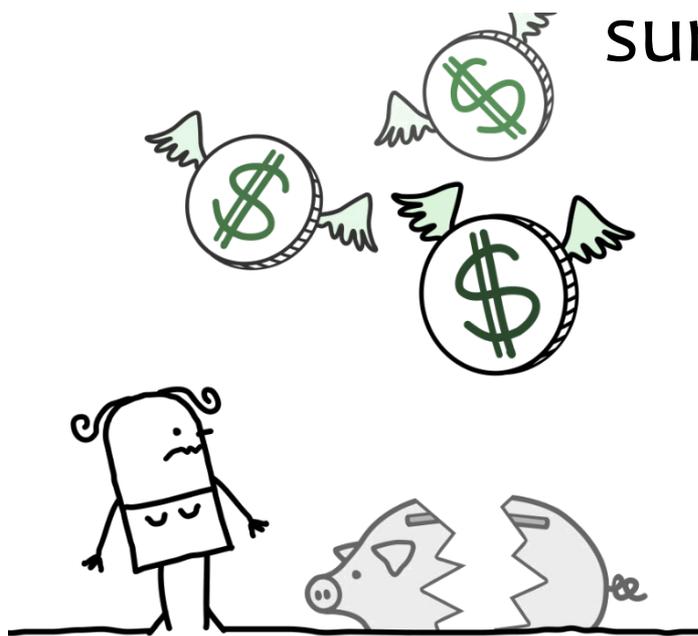
The **federal deficit** is how much money the government borrows in any given fiscal year to cover the difference between receipts and outlays.



What is the national debt?



The **national debt** is the amount owed by the federal government to owners of government securities and is an accumulation of annual deficits minus annual surpluses.





How does the US Treasury borrow money?



When the government borrows money, it "issues debt." That means the government sells Treasury *marketable securities* (Treasury bills, notes, bonds, securities, savings bonds, etc) to other federal government agencies, individuals, businesses, organizations, state and local governments, as well as people, businesses and governments from other countries.

Those are like IOUs, promising the government will pay back the loan with interest on a certain schedule or by a certain date.



What is the net public debt?



The **net public debt** is national debt minus all government inter-agency borrowing.



What has been done to curb the national debt?



Among those things we've tried to curb the national debt are:

- **tax increases** - In 1993, we raised the highest marginal tax rate from 31% to 36%. and increased the gasoline tax.
- **spending caps** - In 1993, we reduced military and entitlement spending.
- **debt ceilings** – These are legislated legal limits on the national debt, which Congress can raise to accommodate budget deficits anytime it wants.



What is the internal national debt?



The **internal national debt** is the portion of the national debt owed to a nation's own citizens.



What is the external national debt?



The **external national debt** is the portion of the national debt owed to foreign citizens.

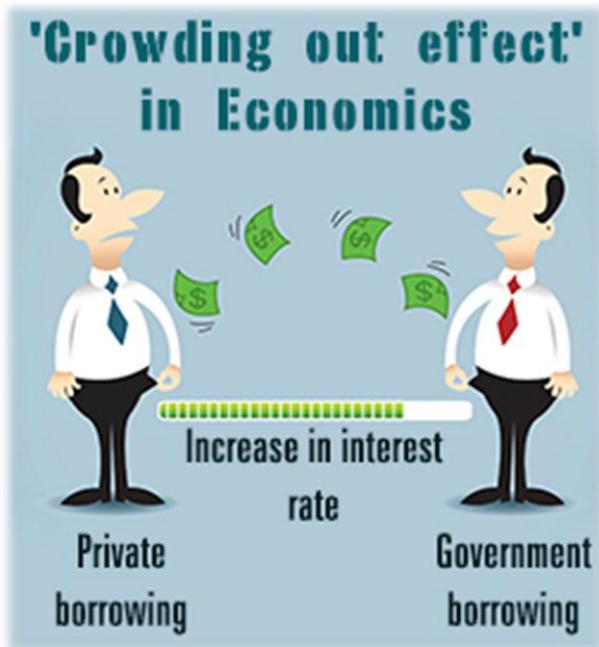




What is the crowding-out effect?



When federal government borrowing increases interest rates, the result is lower consumption and investments ... known as **the crowding-out effect.**





How did you do?! If you didn't do as well as you'd like, review the margin notes and presentations and test yourself again.

THE END  
THE END