

The VOTE Textbook

Student Notes

Chapter 18: The Federal Budget

Opening Story: Nikki and her dream to build guitars

The Federal Budget: It is a detailed plan for how the government spends its revenue every year—a line-by-line, itemized picture of our national priorities.

The Golden Moment

Shared Problem: Irresponsible budgeting and money management

Shared Goal: Financial freedom to invest in our future

The Budget Juggling Act:

- How to generate revenue
- What to spend it on
- Willingness to borrow

A personal budget is different from a federal budget because our country creates its own money, but individuals don't.

When you hear the word *budget*, think *fiscal*. It comes from the Latin for *purse* or *treasury*.

A fiscal year (FY) is the 12-month period covered in an annual budget. A fiscal year can start at any time.

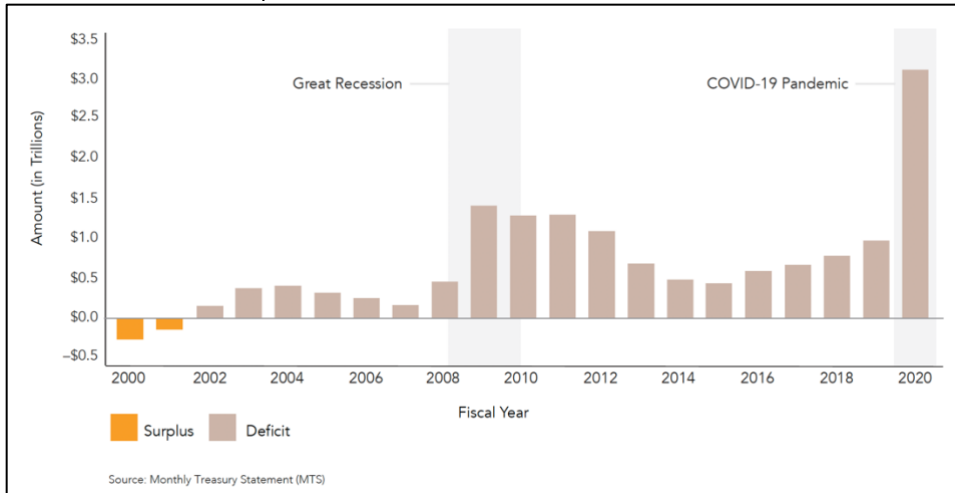
Balanced Budget: When government revenue equals government spending during a fiscal year.

Budget Deficit: When government revenue is less than government spending during a fiscal year.

Budget Surplus: When government revenue is greater than government spending during a fiscal year.

National Debt: The deficits accumulated from all previous fiscal years, minus any surpluses from all previous fiscal years.

Federal Deficits and Surpluses, 2000-2020



Principal is the amount of money that is borrowed. *Interest* is the cost of borrowing money. Paying back a loan means paying both the principal and the interest.

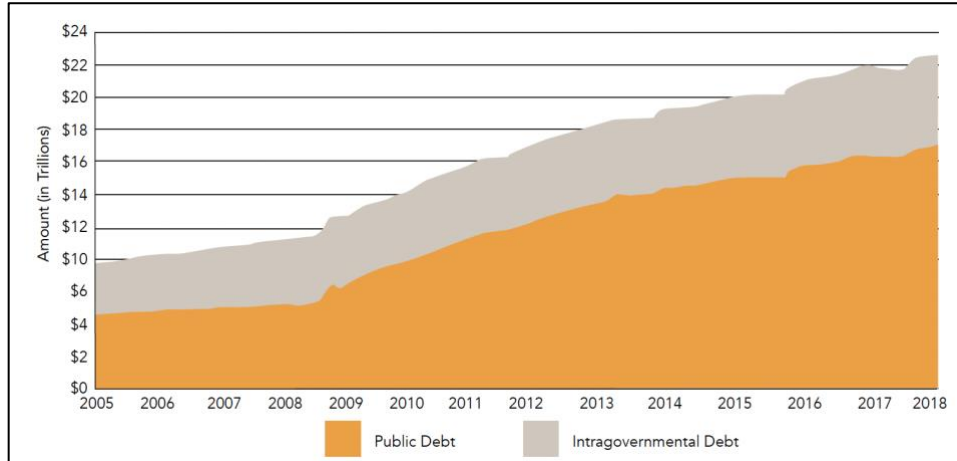
Compound Interest and Credit Cards
 Example: The credit card company charges 15% interest

January 1: Zero balance = \$0				
January 31: Spend \$1,000 and pay \$600 Owe \$400 plus interest = \$460	}	<table border="1" style="display: inline-table; vertical-align: middle;"> <tr><td>Simple Interest: \$60</td></tr> </table> <table border="1" style="display: inline-table; vertical-align: middle; margin-left: 20px;"> <tr><td>Compound Interest: \$0</td></tr> </table>	Simple Interest: \$60	Compound Interest: \$0
Simple Interest: \$60				
Compound Interest: \$0				
February: Spend \$1,000 and pay \$600 Owe \$860 plus interest = \$989	}	<table border="1" style="display: inline-table; vertical-align: middle;"> <tr><td>Simple Interest: \$120</td></tr> </table> <table border="1" style="display: inline-table; vertical-align: middle; margin-left: 20px;"> <tr><td>Compound Interest: \$69</td></tr> </table>	Simple Interest: \$120	Compound Interest: \$69
Simple Interest: \$120				
Compound Interest: \$69				
March: Spend \$1,000 and pay \$600 Owe \$1,389 plus interest = \$1,597.35	}	<table border="1" style="display: inline-table; vertical-align: middle;"> <tr><td>Simple Interest: \$180</td></tr> </table> <table border="1" style="display: inline-table; vertical-align: middle; margin-left: 20px;"> <tr><td>Compound Interest: \$217.35</td></tr> </table>	Simple Interest: \$180	Compound Interest: \$217.35
Simple Interest: \$180				
Compound Interest: \$217.35				
April: Spend \$1,000 and pay \$600 Owe \$1,997 plus interest = \$2,296.95	}	<table border="1" style="display: inline-table; vertical-align: middle;"> <tr><td>Simple Interest: \$240</td></tr> </table> <table border="1" style="display: inline-table; vertical-align: middle; margin-left: 20px;"> <tr><td>Compound Interest: \$456.95</td></tr> </table>	Simple Interest: \$240	Compound Interest: \$456.95
Simple Interest: \$240				
Compound Interest: \$456.95				
...				
This pattern continues through December. After 12 months, you owe \$13,340.77 (even though you only borrowed \$4,800)	}	<table border="1" style="display: inline-table; vertical-align: middle;"> <tr><td>Simple Interest: \$720</td></tr> </table> <table border="1" style="display: inline-table; vertical-align: middle; margin-left: 20px;"> <tr><td>Compound Interest: \$7820.77</td></tr> </table>	Simple Interest: \$720	Compound Interest: \$7820.77
Simple Interest: \$720				
Compound Interest: \$7820.77				

Compound Interest and the National Debt

If there came a point when the government couldn't make its interest payments, it might have to borrow to service its debt. At that point, the government might be in a position where it owes interest on its interest.

Two Types of National Debt



1. Intergovernmental debt: The government borrows from itself
2. Public debt: The government borrows from individuals, pension funds, insurance companies, investment firms, foreign entities, and others

Money is a claim on the goods and services that society generates.
Money is anything used for purposes of exchange and to repay a debt.

Three functions of money:

1. Medium of exchange
2. Unit of account
3. Store of value

The Gold Standard and Fiat Currency

Before the mid-1900s, there was a gold standard in the U.S., meaning that paper money represented gold.

After 1971, the U.S. officially switched to fiat currency. Now the dollar is solely backed by people's faith and confidence.

Cryptocurrency is digital money. Its role in the future is uncertain, but it is an example of how monetary systems can change over time.

The money supply is the amount of money in circulation on a given day. In the U.S., two major players are involved in managing the money supply:

1. The U.S. Department of the Treasury ("Treasury")
The Treasury collects taxes and enforces tax laws, prints bills, mints coins, prints postage stamps, manages all the government's accounts and debts, and more.
2. The Federal Reserve System ("the Fed")
The Fed is our nation's central bank. It is a private, nonprofit corporation with a government mandate to create the conditions for stable prices, full employment, and moderate long-term interest rates.

The 7-member Board of Governors (BOG) governs the Fed. Members are appointed, not elected, and are accountable to the government but not controlled by it.

The Federal Open Market Committee (FOMC) is the body that decides when and how to influence interest rates and the money supply.

Financing the Deficit

The Treasury borrows from individuals, pension funds, insurance companies, investment firms, foreign entities, and others by selling government securities to them (treasury bills, treasury notes, and treasury bonds).

- Radicals say this a just Band-Aid covering the deeper, systemic problem of profit-driven capitalism.

- Conservatives say this causes high interest rates and crowds out private firms, which hurts the economy.
- Liberals say this increases demand because government spending boosts the economy, so private firms crowd in.

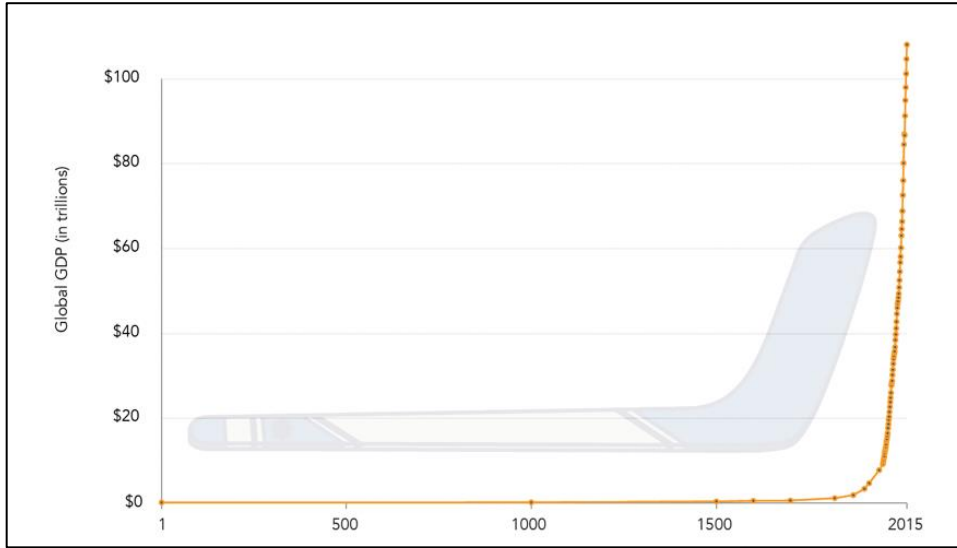
Why doesn't the Treasury just tell the Fed to increase the money supply so the government can use it to fund the deficit and pay off the national debt? This controversial idea is called *monetizing the debt*.

- Liberals say we need a firewall between the Fed and the Treasury so that the Fed isn't unduly pressured to increase the money supply and put the economy at risk of inflation.
- Conservatives say the firewall between the Fed and the Treasury is totally ineffective. They say the Fed still engages in manipulating the money supply, which is irresponsible and puts the economy in danger of extreme inflation.
- Radicals say the firewall between the Fed and the Treasury doesn't address the real problem, which is the privately owned Fed's mandate to keep the rotten system of capitalism afloat.

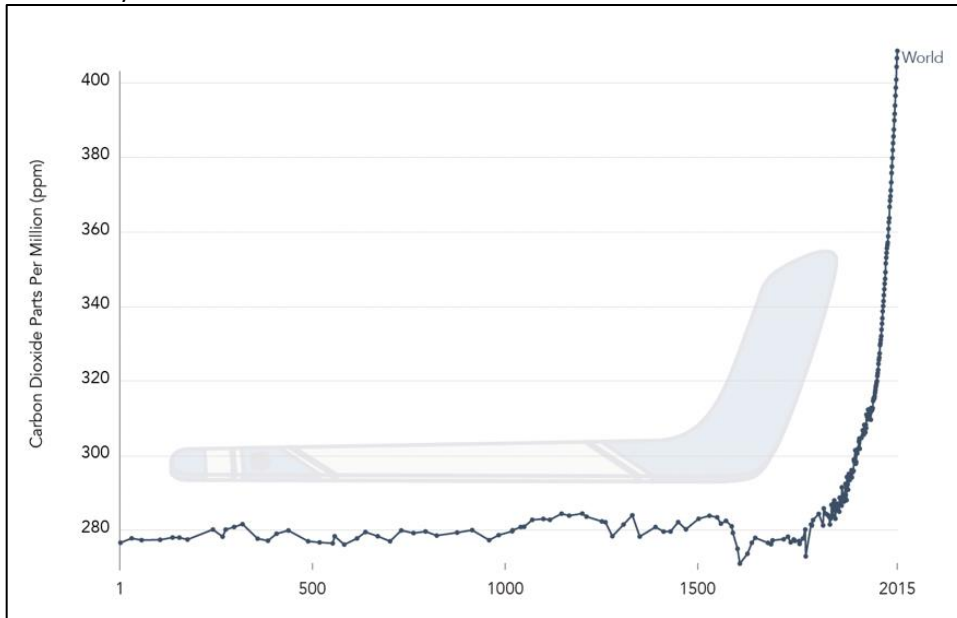
Shared Tools: Potential GDP and the Roles of Government

Potential GDP: Liberals, conservatives, and radicals all agree that at least some growth is vital to a healthy economy, and they all want the economy to be at its potential. But they don't agree on what level of growth is best or how to view our potential. It all starts with a hockey stick:

The Hockey Stick of Human Prosperity




The Hockey Stick of Global Carbon Emissions




The Roles of Government and Potential GDP


Each role of government uses society's resources. That's why more roles of government means lower growth and lower potential GDP.



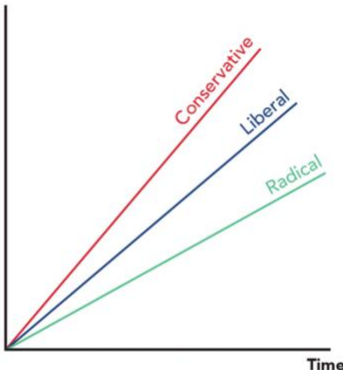
Conservatives, Liberals, and Radicals
National Security
Property Protection
Infrastructure



Liberals and Radicals
Transparency with Accountability
Stability
Equity



Radicals
Manage Public Ownership
Community Councils
Universal Benefits



Levels of Potential GDP and Economic Growth

Conservative: Limit roles of government to have **maximum prosperity for all.**

Liberal: Expand roles of government to have the **highest overall standard of living.**

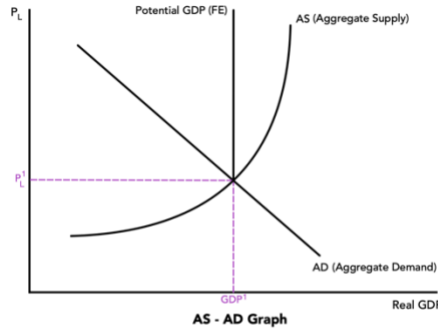
Radical: Increase roles of government to have the **best quality of life.**

THE BLAME GAME		
What causes public and private debt?		
<p>Conservative</p> <p>Too much government interference in capitalism</p> <p>We need free-market capitalism.</p>	<p>Liberal</p> <p>Not enough government intervention in capitalism</p> <p>We need fair-market capitalism.</p>	<p>Radical</p> <p>The drive for profit in capitalism</p> <p>We need democratic socialism.</p>

Conventional Tools: Aggregate Supply-Aggregate Demand (AS-AD) Graph

The goal is full employment and stable prices.

The Sweet Spot!



Actual GDP = Potential GDP = Full Employment

Underperformance and overperformance are both problems. The sweet spot tells us that we are living up to our economic potential as a nation.

Conservative, Part 1: Annual Balanced Budgets

Fiscal Actions:

- ↓ Marginal income tax rates
(Increase incentive to work)
- ↓ Corporate taxes
(Increase incentive to invest)
- ↓ Capital gains rates
(Increase incentive to save)

Revenues to be used for:

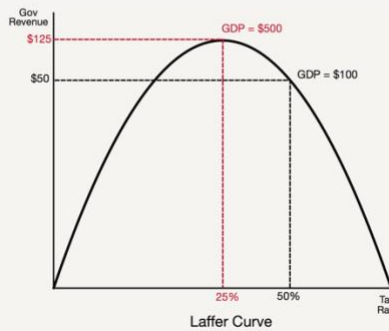
- National defense
- Protect private property
- Infrastructure

Otherwise,

"Starve the Beast"

Result: Zero debt

Arthur Laffer
"Supply-side economics"
The tax cuts will pay for themselves.



Conservative, Part 2: Constrained Money Supply

To counter problems of false interest rate signals and inflationary pressures ...

Monetary Action, Option I

"Austrian" F.A. Hayek

Eliminate the Fed and return to a gold standard or allow competing currencies, and then leave it alone.

Monetary Action, Option II

"Monetarist" Milton Friedman

Set the growth rate of the money supply, and then leave it alone.

Liberal, Part 1: Adaptable Balanced Budgets

1. Fiscal Actions at potential:

None

2. Fiscal Actions below potential:

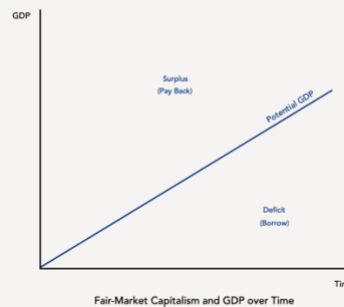
↓ Taxes on poor and middle class
↑ Government spending

3. Fiscal Actions above potential:

↑ Taxes on everyone
↓ Government spending

"Everyone's a liberal in a foxhole."

Overall result: Zero debt



1. Potential:

Balanced budget!

2. Below Potential

Deficit: Borrow!

3. Above Potential

Surplus: Pay Back!

Liberal, Part 2: Flexible Money Supply	
<p>When the economy overheats and we have inflation, it's challenging for elected officials to make the unpopular decision to raise taxes and cut government spending.</p> <p>That's where the Fed comes in. The Board of Governors is not elected so it can "take away the punch bowl the minute the party gets started," as people often say.</p>	<p>Monetary Actions, above potential:</p> <p>The Fed sets higher interest rates and then decreases the money supply as needed.</p>
	<p>Monetary Actions, below potential:</p> <p>The Fed sets lower interest rates and then increases the money supply as needed.</p>

The Federal Budget Policies	
Conservative	Liberal
<p>Annual balanced budgets and constrained money supply</p> <ul style="list-style-type: none"> • A debt-free nation 	<p>Adaptable balanced budgets and flexible money supply</p> <ul style="list-style-type: none"> • A debt-free nation


Radical Tools: Unsustainable Growth and Sustainable Development

Radicals use the six core points as tools to analyze economic issues.

- Ownership
- Governance
- Meeting people's basic material needs
- Production
- Sustainability
- Communities


Radicals select the core point that makes the most sense for a particular issue. For the federal budget, it is sustainability.

Drill down into sustainability in capitalism:

Workplace Exploitation + Capitalist Competition	}	The Pressure for Bad leads to The Visible Suffering
<p>... and is represented by the Six-Core Cube of capitalism, which can never be solved.</p> 		

The Unsolvable Six-Core Cube of Capitalism

1. Private Ownership
2. Top-Down Governance
3. Individuals at Risk
4. Production for Profit
5. Unsustainable Growth
6. Unhealthy Communities



Why unsolvable?
It is built around six core points that are rotten to the core!

Unsustainable Growth: Society uses up resources without considering how those decisions will affect people in the future.

Unsustainable Growth

- The focus is solely on short-term gains.
- Production continually expands, regardless of the costs to people and the planet.
- Future generations are burdened with the consequences of today's actions.



The Visible Suffering of Capitalism

- Hunger and malnourishment
- Harmful products
- Mass poverty
- Homelessness
- Extreme income inequality
- Pollution and climate crisis
- Inaccessible, low-quality health care
- Destructive market domination
- Impoverished elders
- **Exploding public and private debt**
- Damaging trade relationships
- High prices and no jobs

Drill down into sustainability in democratic socialism:

Workplace Justice
+
Coordination Among Competitors

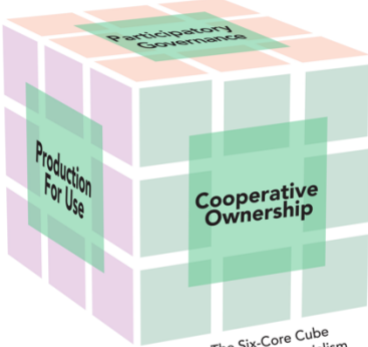
The Pressure for Good leads to The Invisible Synergy

...and is represented by the Six-Core Cube of democratic socialism, which can be solved.



The Solvable Six-Core Cube of Democratic Socialism

1. Cooperative Ownership
2. Participatory Governance
3. Social Safeguards
4. Production for Use
5. Sustainable Development
6. Healthy Communities



Why solvable?
It is built around six core points that are beneficial to the core!

Sustainable Development: Society uses resources wisely today and protects them for future generations.

Sustainable Development

- There is equal focus on short-term and long-term gains.
- Economic growth is in service to the well-being of people and the planet.
- Prosperity is assured for generations to come.



Radical Fiscal Actions: *Integrated Balanced Budgets*

Government Spending:

- National security
- Infrastructure
- Property protection
- Transparency with Accountability
- Stability
- Equity
- Manage public ownership
- Community councils
- Provide universal benefits

Participatory Budgeting:

A portion of revenues are available for local projects, which the community votes on directly.

Progressive Taxes:

- Fund benefits we can't afford on our own
- Higher quality of life

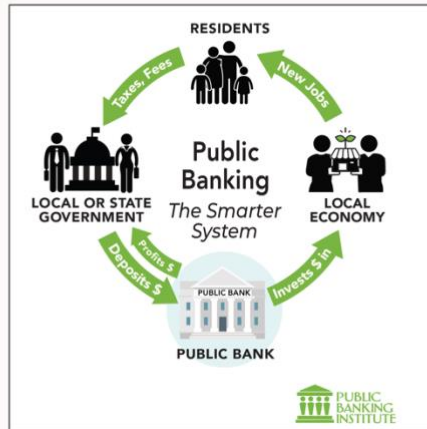
"Everyone pays their fair share and everyone benefits."

Result: Zero Debt



Radical Monetary Actions: *Public Banking*

Tax revenues are deposited into federal, state, county, and city public banks, where the funds can be used to make loans that develop the economy in a sustainable way.



Federal Budget Policies: *Radical*

Integrated balanced budgets and public banking

- A debt-free nation



Discussion Story: Burger King HQ moves to Canada

Understanding the Federal Budget

Four tax definitions:

1. Tax Revenue: The federal government raises money (revenue) to fund the annual budget by taxing individuals and businesses.
2. Tax loopholes: These are unintended provisions in the tax laws that are mistakes but make it legal to pay less in taxes.
3. Tax evasion: These are unlawful activities to get out of paying taxes.
4. Tax avoidance: These are legal ways to minimize the amount of taxes owed.

Tax Avoidance Examples:

Individual

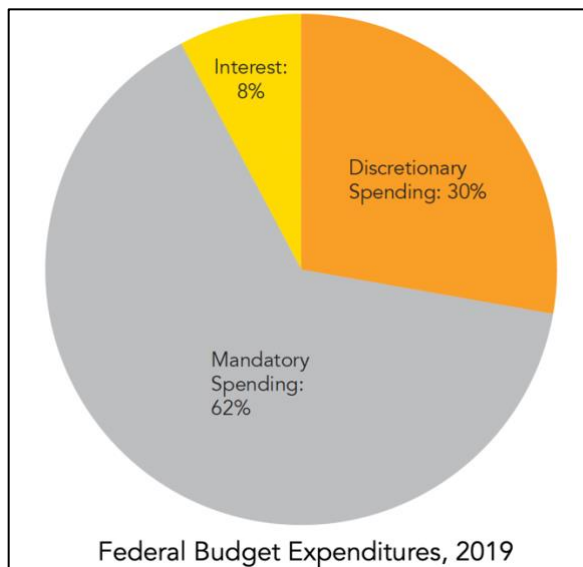
- Tax deductions
- Investments as collateral
- Trust funds
- Incorporation

Corporate

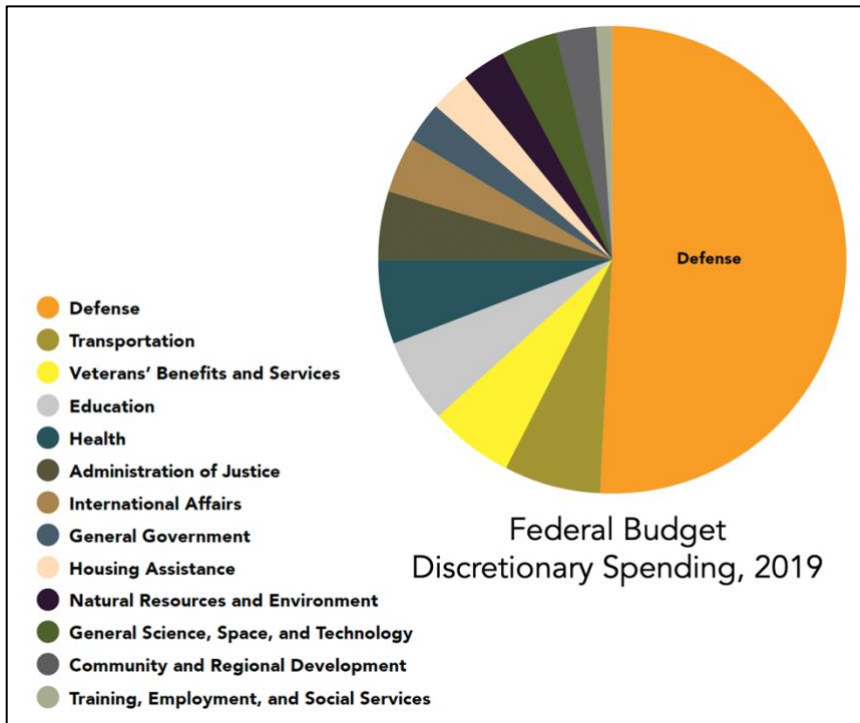
- Tax inversions
- Business tax credits and deductions
- Tax havens
- Accelerated depreciation

Three Types of Expenditures

1. **Mandatory:** Laws exist to protect funding for certain expenditures including Social Security, Medicare, SNAP, CHIP, and more.
2. **Discretionary:** Spending is not required by law. This includes defense, transportation, education, the environment, and more.
3. **Interest on the national debt:** Payments to those who redeem government securities they purchased.



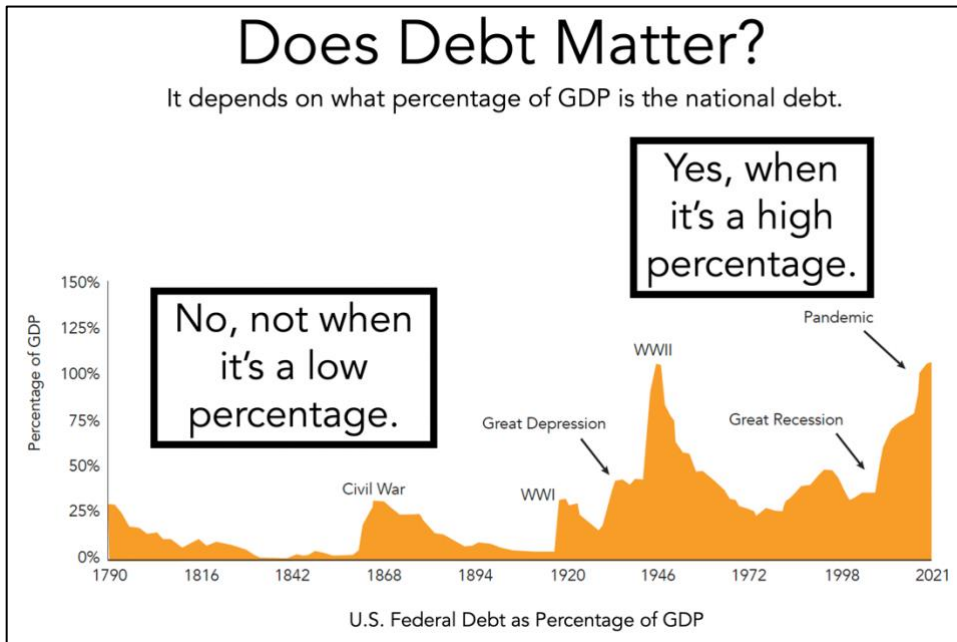
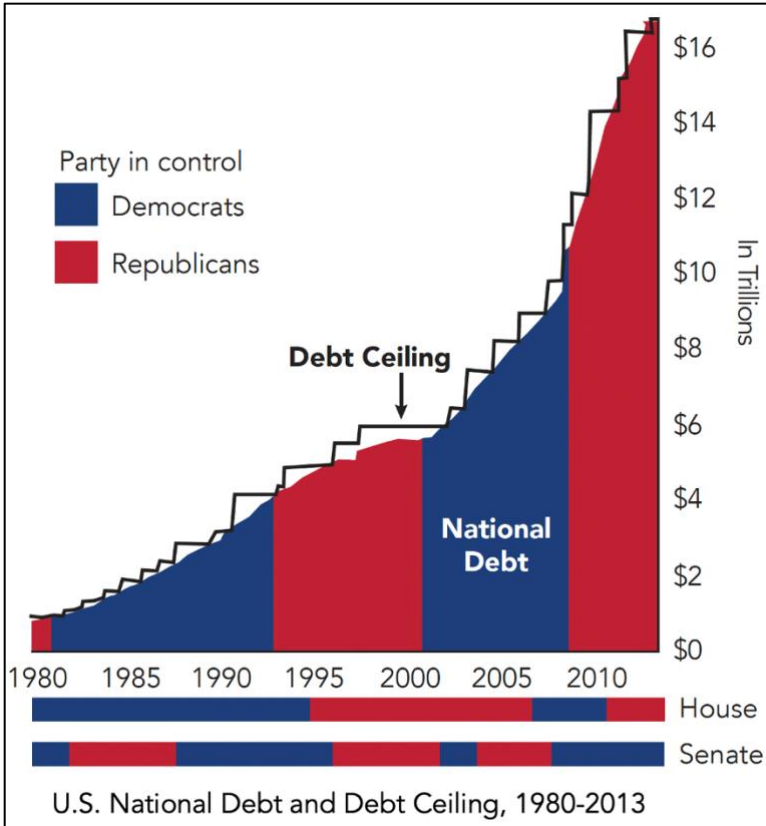
The Federal Budget Process

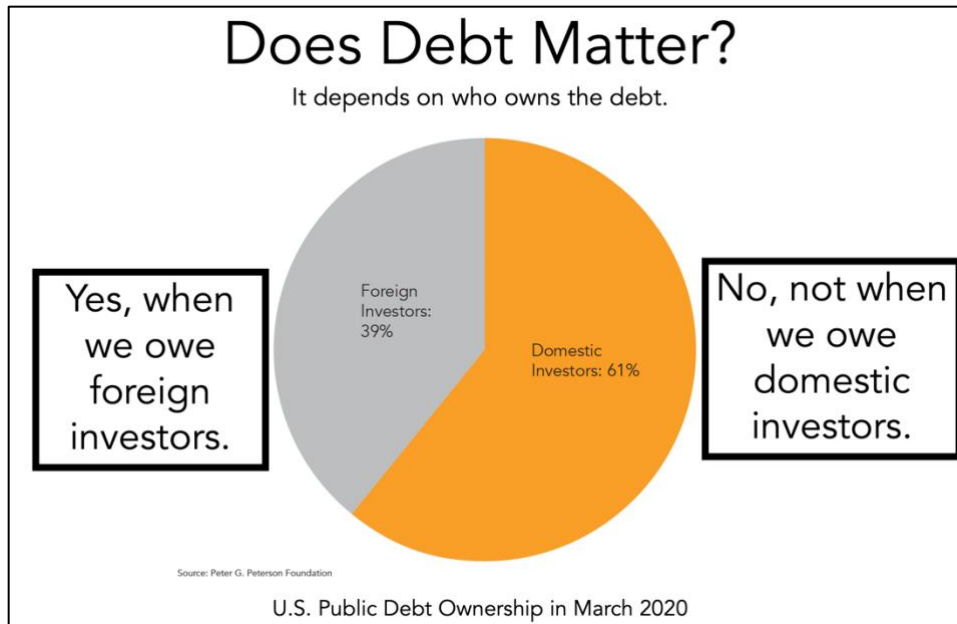


The Debt Ceiling

The U.S. debt ceiling is the legal limit on allowable debt for the federal government.

When we hit the ceiling, if Congress doesn't raise it, we are in danger of defaulting on our loans.





Does Debt Matter?

It depends on the interest rate (the *service on the debt*).

Example from *America the Broke* by Gerald Swanson:

At **low interest rates**, we can service our debt without sacrificing too many other government expenditures.

At **high interest rates**—and they can shoot up unexpectedly—servicing the debt could require such a high percentage of our revenues that we would be unable to fund anything else. The nation would become *insolvent*.

No, not when interest rates are low.

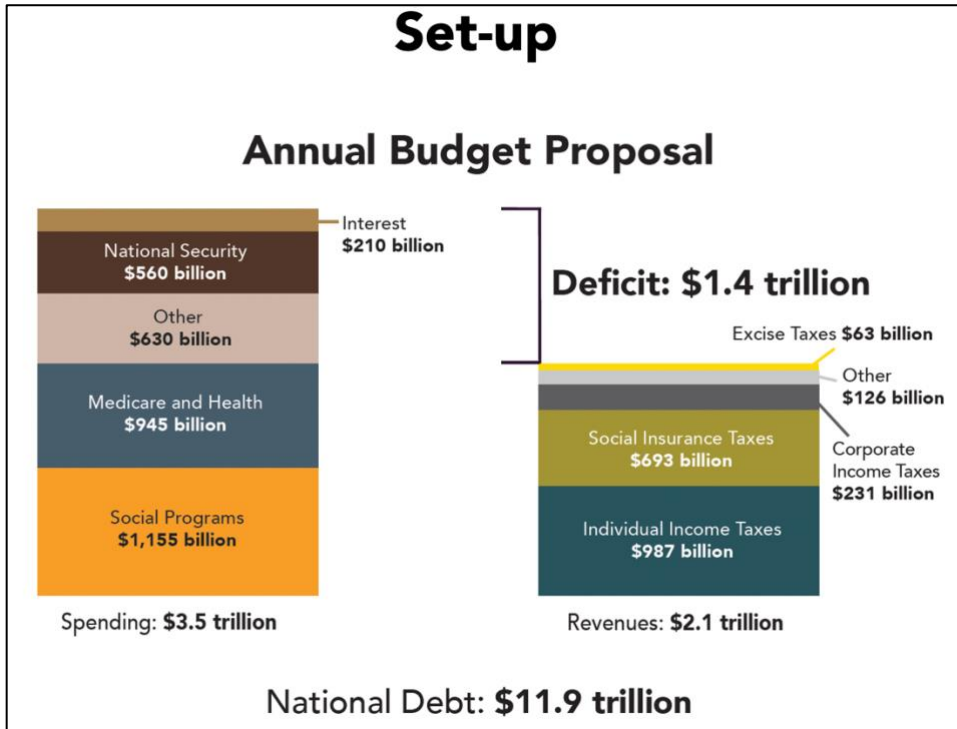
Yes, when interest rates are high.

Five ideas to address the national debt and why they haven't been adopted:

1. Use inflation to lessen the value of the dollar.
This would have devastating effects on the nation.
2. Default on our loans.
This would cause a global economic crisis.
3. Cut spending.
Liberals and radicals are unwilling to do so.

4. Increase taxes.
Conservatives are unwilling to do so.
5. Grow the economy.
There is no agreement on how or how much or the best possible way to do it.

Three-in-One Activity: "Reduce-the-Deficit Challenge"



Round I: Neutral

POLICY	Y/N
1. Close tax loopholes for individuals and corporations.	
2. Replace Social Security with private retirement accounts.	
3. Raise taxes for privately owned corporations.	
4. Create a single-payer health-care system.	
5. Eliminate all government-imposed trade barriers.	
6. Regulate the private banking industry.	
7. Require all firms to be worker-owned.	
8. Eliminate capital gains taxes.	
9. Use a minimum wage to combat poverty.	
10. Authorize community councils to set standards for product safety.	

Voices on The Federal Budget

Conservative

Response to discussion story: High U.S. corporate tax rates make it impossible for firms to compete profitably, and this injustice forces firms to pursue tax avoidance strategies.

Voice: Pages 898-902

Summary: Page 903

Talking Points: Page 904

Round II: Conservative		Free-Market Capitalism
POLICY	Y/N/NA*	IMPACT
1. Close tax loopholes for individuals and corporations.	Y	-\$100
2. Replace Social Security with private retirement accounts.	Y	-\$100
3. Raise taxes for privately owned corporations.	N	
4. Create a single-payer health-care system.	NA	
5. Eliminate all government-imposed trade barriers.	Y	-\$100
6. Regulate the private banking industry.	N	
7. Require all firms to be worker-owned.	NA	
8. Eliminate capital gains taxes.	Y	-\$100
9. Use a minimum wage to combat poverty.	N	
10. Empower community councils to set standards for product safety.	NA	
Total Reduction		\$400B

* Answer "Y" for Yes; "N" for No; and "NA" for Not Applicable

Round II: Conservative, cont'd

The results of free-market capitalism, expanded beyond these four policies:

- The entire deficit is eliminated.
- There are no future deficits because there are annual balanced budgets.
- The size of the national debt goes down relative to our increasingly robust GDP.

Radical

Response to discussion story: The drive for profit corners firms into using corporate inversions and other tax avoidance strategies just so they can survive in capitalism.

Voice: Pages 905-909

Summary: Page 910

Talking Points: Page 911

Round III: Radical <small>Democratic Socialism</small>		
POLICY	Y/N/NA*	IMPACT
1. Close tax loopholes for individuals and corporations.	Y	-\$100
2. Replace Social Security with private retirement accounts.	NA	
3. Raise taxes for privately owned corporations.	NA	
4. Create a single-payer health-care system.	Y	-\$100
5. Eliminate all government-imposed trade barriers.	N	
6. Regulate the private banking industry.	NA	
7. Require all firms to be worker-owned.	Y	-\$100
8. Eliminate capital gains taxes.	N	
9. Use a minimum wage to combat poverty.	N	
10. Empower community councils to set standards for product safety.	Y	-\$100
Total Reduction		\$400B

* Answer "Y" for Yes; "N" for No; and "NA" for Not Applicable

Round III: Radical, cont'd

The results of democratic socialism, expanded beyond these four policies:

- The entire deficit is eliminated.
- There are no future deficits because there are integrated balanced budgets.
- The size of the national debt goes down relative to our increasingly robust economic development.

Liberal

Response to discussion story: Tax inversion and other tax avoidance strategies are inevitable when government doesn't close loopholes, enforce the rules, or pass fair laws.

Voice: Pages 912-916

Summary: Page 917

Talking Points: Page 918

Round IV: Liberal		Fair-Market Capitalism
POLICY	Y/N/NA*	IMPACT
1. Close tax loopholes for individuals and corporations.	Y	-\$100
2. Replace Social Security with private retirement accounts.	N	
3. Raise taxes for privately owned corporations.	Y	-\$100
4. Create a single-payer health-care system.	NA	
5. Eliminate all government-imposed trade barriers.	N	
6. Regulate the private banking industry.	Y	-\$100
7. Require all firms to be worker-owned.	NA	
8. Eliminate capital gains taxes.	N	
9. Use a minimum wage to combat poverty.	Y	-\$100
10. Empower community councils to set standards for product safety.	NA	
Total Reduction		\$400B

* Answer "Y" for Yes; "N" for No; and "NA" for Not Applicable

Round IV: Liberal, cont'd

The results of fair-market capitalism,
expanded beyond these four policies:

- The entire deficit is eliminated.
- There are no future deficits because there are adaptable balanced budgets.
- The size of the national debt goes down relative to our growing GDP.

Shared Outcome: Financial freedom to invest in our future.