Chapter 16: Financing Government
Section 2
Lecture Notes

AMERICAN GOVERNMENT

PEARSON

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

Key Terms, cont.

- **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

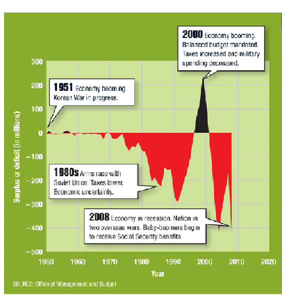
- What effect does borrowing have on the federal budget and the nation's economy?
  - Borrowing can be used to provide an economic stimulus for the nation and to pay off budget deficits in times of crisis or overspending.
  - However, such borrowing leads to future deficits and higher interest payments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

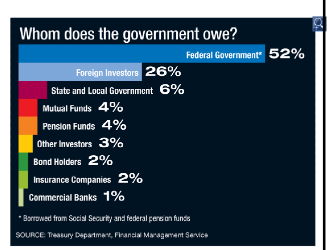
- Under President Reagan, the theory of supply-side economics took hold.
- This theory says that lowering taxes increases the supply of money in private hands and boosts the economy without higher government spending.
- In 2008, supply-side supporter George W. Bush approved both an economic stimulus 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?

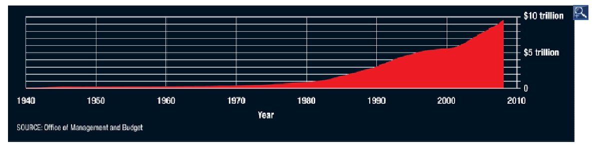


The Public Debt

- 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.

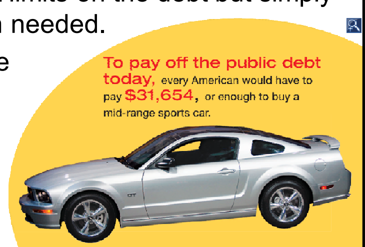
The Public Debt

- The public debt has exploded over the past 30 years, passing $1 trillion for the first time in 1981.
- About 1 in every 10 dollars spent by the U.S. government now goes to paying interest on the public debt.



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?