Chapter 14

Taxes and Government Spending

Introducing the Chapter

In this chapter, students will learn about the taxes levied by federal, state, and local governments. This chapter discusses the types of taxes, how they are collected, and how they are used by governments to provide services for people.

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For additional links for *Economics: Principles in Action* provided by Prentice Hall and *The Wall Street Journal Classroom Edition,* visit the Social Studies area. Be sure to check out this month's **eTeach** online discussion with a Master Teacher.

Beyond the Lecture

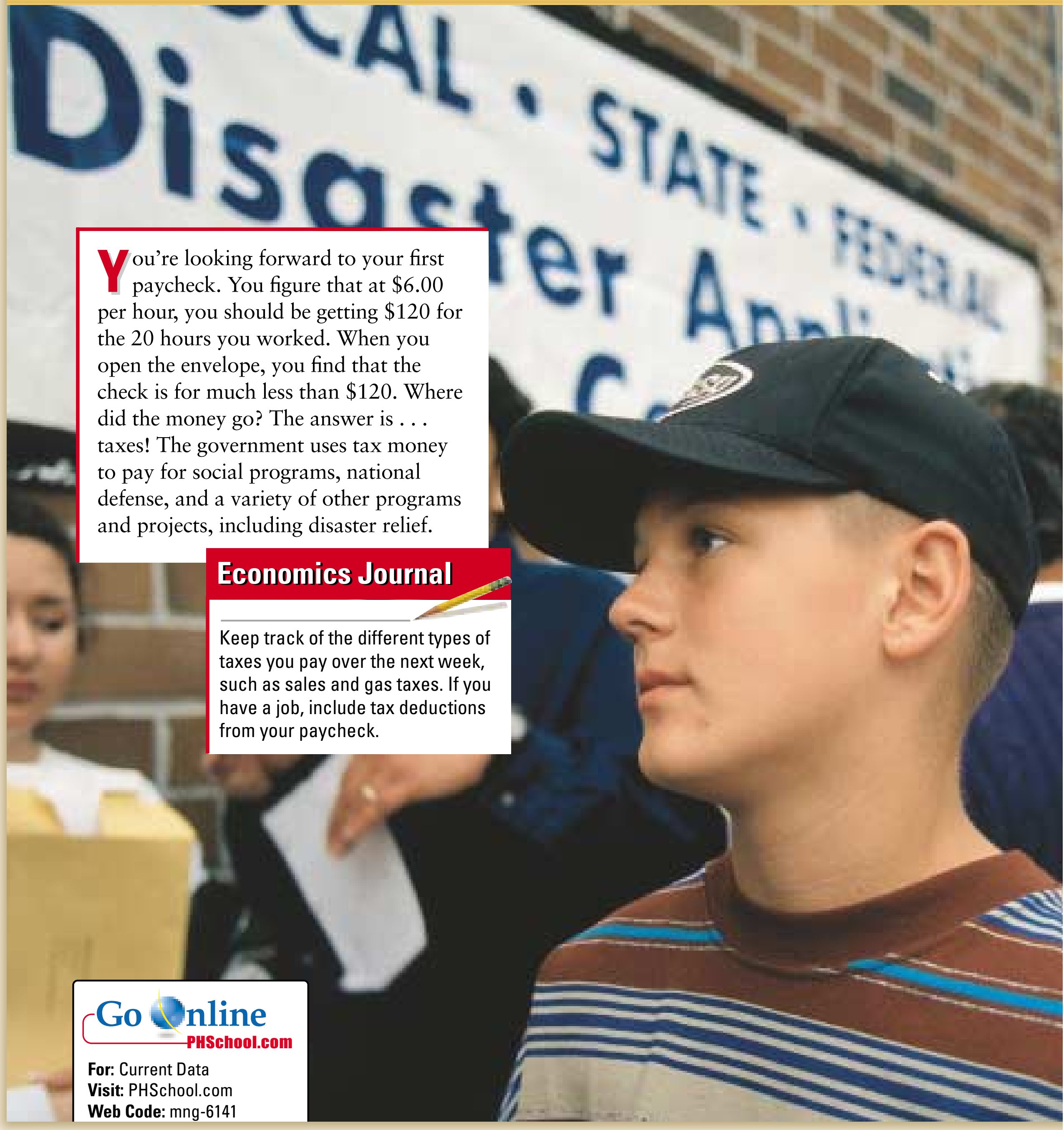
You may cover the concepts in Chapter 14 in an activity-based style by using the following materials:

- **Technology Resources** appropriate for use with this chapter are noted on pp. 361, 363, 366, 367, 368, 369, 373, 374, 379, 380, and 383.
- **Presentation Pro CD-ROM** with animated graphs gives you an alternative method for organizing and delivering chapter content.
- **Activities** designed to meet the needs of students of mixed abilities and learning styles are noted throughout the chapter in the side columns.
- **Learning Styles Lesson Plans** provide alternate lessons for diverse learning styles. See pp. 33–34 of the Learning Styles Lesson Plans folder located in the Teaching Resources.

Economics Journal

Instruct students to record the taxes they pay in their Economics Journals. Students may include completed journal entries in an Economics Portfolio.

Chapter 14 Taxes and Government Spending



You're looking forward to your first paycheck. You figure that at $6.00 per hour, you should be getting $120 for the 20 hours you worked. When you open the envelope, you find that the check is for much less than $120. Where did the money go? The answer is . . . taxes! The government uses tax money to pay for social programs, national defense, and a variety of other programs and projects, including disaster relief.

Economics Journal

Keep track of the different types of taxes you pay over the next week, such as sales and gas taxes. If you have a job, include tax deductions from your paycheck.

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For: Current Data
Visit: PHSchool.com
Web Code: mng-6141

NCEE
National Council on Economic Education

The following Voluntary National Content Standard in Economics is addressed in this chapter:

★ **Standard 16** Students will understand that: There is an economic role for government to play in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.

For more information about the standards, contact the National Council on Economic Education

1140 Avenue of the Americas
New York, NY 10036
1-800-338-1192

Section 1 What Are Taxes?

Preview

Objectives

After studying this section you will be able to:

1. **Understand** how the government uses taxes to fund programs.
2. **Identify** the roots of the concept of taxation in the United States Constitution.
3. **Describe** types of tax bases and tax structures.
4. **List** the characteristics of a good tax.
5. **Identify** who bears the burden of a tax.

Section Focus

Local, state, and national governments generate revenue by charging taxes. The Constitution spells out specific limits on governments' powers to tax. Taxation can take several different forms, and people disagree over which method of taxation is most fair.

Key Terms

tax
revenue
tax base
individual income tax
sales tax
property tax
corporate income tax
proportional tax
progressive tax
regressive tax
incidence of a tax

Looking at all of the taxes taken from your paycheck can be discouraging. It can feel like all of that money is being taken from you for someone else's use. Frustration over taxes is, after all, what led American colonists to go to war against Britain and declare independence. How, then, is anything different today?

Although money is taken from your paycheck, it is not done without your consent. As citizens of the United States, we authorize the government, through the Constitution and our elected representatives in Congress, to raise money in the form of taxes. Why?

Funding Government Programs

A **tax** is a required payment to a local, state, or national government. Taxation is the primary way that the government collects money. Taxes give the government the money it needs to operate.

The income received by a government from taxes and other nontax sources is called **revenue.** Without revenue from taxes, the government would not be able to provide the goods and services that we not only benefit from, but that we expect the government to provide. For example, we authorize the government to provide national defense, highways, education, and law enforcement. We also ask the government to provide help to people in need.

All of these goods and services cost money—in workers' salaries, in materials, in land and labor. All members of our society share these costs through the payment of taxes.

Taxes and the Constitution

Taxation is a powerful tool. The founders of the United States did not, without careful consideration, give their new government the power to tax. The Constitution they created spells out specific limits on the government's power to tax.

The Power to Tax

The Framers of the Constitution gave each branch of government certain powers and duties. The first power granted to Congress is the power to tax. This is Article 1, Section 8, Clause 1:

To lay and collect taxes, duties, imposts and excises, to pay the debts, and provide

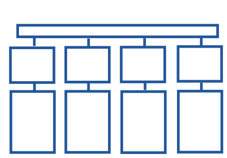
tax *a required payment to a local, state, or national government*

revenue *income received by a government from taxes and nontax sources*

Building Key Concepts: Graphing the Main Idea

Government To build understanding of how and why the **government** collects taxes, have students complete a tree map graphic organizer like the one at the right. Remind students that a tree map shows an outline for a main topic, main ideas, and supporting details. Encourage students to use the main heads and subheads in the section to organize their tree maps.

Section Reading Support Transparencies A template and the answers for this graphic organizer can be found in Chapter 14, Section 1 of the Section Reading Support Transparency System.



Section 1 What Are Taxes?

Objectives You may wish to call students' attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer Ask students to recall the colonists' cry of "No taxation without representation!" Have students explain what the colonists were angry about and why it is important that people who are taxed be represented in government. Then explain that this section will introduce them to types of taxes.

Vocabulary Builder Most of the key terms in this section have other meanings in other contexts. Ask students to choose three key terms and link their economic meaning to another meaning. For example, if they choose *progressive tax,* they may say that someone who is progressive is always moving ahead. A progressive tax rate "moves ahead" with income level.

Lesson Plan

Teaching the Main Concepts L3

1. Focus Governments levy taxes that pay for services provided. Ask students to identify examples of government services that are paid for by taxes.

2. Instruct Begin by explaining the purpose of taxation and the historical background that led to constitutional limits on this practice. Then introduce students to the three tax structures: proportional, progressive, and regressive. Discuss the four characteristics of a good tax. Finally, help students to understand how principles of supply and demand can affect the amount of tax they pay.

3. Close/Reteach Remind students that different tax structures distribute the tax burden among taxpayers in different ways. Ask them to distinguish among proportional, progressive, and regressive taxes, and have them create an organizer highlighting these differences.

Guided Reading and Review
Unit 6 folder, p. 2 asks students to identify the main ideas of the section and to define or identify key terms.

Differentiated Instruction L3

(Reteaching) Ask students to create two lists. The first list should include the limits that the Constitution places on the federal government's authority to create and collect taxes. The second list should include examples of how taxes are used to fund federal programs.

Background

Economics in History

Tax Freedom Day (TFD) has occurred later and later each year since the early years of the twentieth century. What is it?

Economists track the number of days average Americans must work to satisfy their federal, state, and local tax obligations. The day after the last day of working for the government is called Tax Freedom Day: the day when people begin working for themselves. In 1913 TFD came on January 30. By 1930 TFD had slipped all the way to February 13. Near the start of World War II, in 1940, Americans were working for the government until March 8.

TFD continued to fall later and later in the year until tax cuts and a recession reduced tax revenues. In 2000, TFD fell on April 30. By 2003, it had moved back to April 19. Because federal income taxes are progressive, most Americans enjoyed a personal Tax Freedom Day before this date.

Answer to . . .

Building Key Concepts Mary pays much higher taxes with a proportional or a progressive tax structure; her taxes are highest under a progressive tax structure. With a regressive structure she pays little more than Ron.

---

tax base *income, property, good, or service that is subject to a tax*

individual income tax *a tax on a person's earnings*

sales tax *a tax on the dollar value of a good or service being sold*

property tax *a tax on the value of a property*

corporate income tax *a tax on the value of a company's profits*

for the common defense and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States.

This clause is the basis for federal tax laws.

Limits on the Power to Tax

The Constitution specifically limits certain kinds of taxes. Two of those limits are in the taxation clause. First, the purpose of a tax must be for the "common defense and general welfare." A tax cannot bring in money that goes to individual interests. Second, federal taxes must be the same in every state. The federal gas tax, for example, cannot be $.04 a gallon in Maryland and $.10 a gallon in South Dakota.

Other provisions of the Constitution also limit the kinds of taxes Congress can impose. For example, Congress cannot tax church services because that would violate the freedom of religion promised by the First Amendment. Another clause of the Constitution prohibits taxing exports. The government can collect taxes only on imports—goods brought into the United States. (Congress can limit or prohibit the export of certain goods, however, such as technology or weaponry.)

Yet another clause of the Constitution (Article 1, Section 9, Clause 4) prohibits Congress from levying, or imposing, taxes unless they are divided among the states according to population. Because of this provision, it took the Sixteenth Amendment to legalize the income tax. This amendment was ratified in 1913.

Tax Bases and Tax Structures

Despite these limits, the government actually collects a wide variety of taxes. Economists describe these taxes in different ways. First, they describe a tax according to the value of the object taxed. Second, they describe how the tax is structured.

Tax Bases

A **tax base** is the income, property, good, or service that is subject to a tax. The tax base might be a person's earnings (**individual income tax**), the dollar value of a good or service being sold (**sales tax**), the value of a property (**property tax**), or the value of a company's profits (**corporate income tax**). When government policymakers create a

Figure 14.1 **Three Types of Tax Structures**

Type of Tax	Description	Example	Ron's taxes on $50,000 income	Mary's taxes on $150,000 income
Proportional	A constant percentage of income is taken in taxes as income increases	"Flat" tax	$7,500, or 15 percent of income	$22,500, or 15 percent of income
Progressive	A larger percentage of income is taken in taxes as income increases	Income tax	$5,000, or 10 percent of income	$45,000, or 30 percent of income
Regressive	A smaller percentage of income is taken in taxes as income increases	Sales tax	$2,000, or 5 percent of total purchases of $40,000; tax bill is 4 percent of income	$3,000, or 5 percent of total purchases of $60,000; tax bill is 2 percent of income

This chart shows how three different tax structures would affect a taxpayer named Ron with an income of $50,000 and a taxpayer named Mary with an income of $150,000.
Income **How does Mary's higher income affect the taxes she pays in each type of tax structure?**

Econ 101: Key Concepts Made Easy

Markets and Prices To help students understand the **incidence of a tax,** briefly review the principles of supply and demand, especially elasticity of demand, found in Chapter 5. Help them to see that if people will buy the same amount of a good even when the price rises—that is, if the demand is inelastic—the tax burden is likely to fall mainly on consumers. If, however, demand is elastic, so that people buy less of a good when the price rises, producers will bear the greater burden.

Ask students to make a list of goods that are (or might be) taxed. Then have students characterize the elasticity of demand for each good and the incidence of a tax on that item.

new tax, they first decide what the base will be for the tax: income, sales, property, profits, or some other category.

Next, the government decides how to structure the tax on that particular base. As shown in Figure 14.1, economists describe three different tax structures: proportional, progressive, and regressive.

Proportional Taxes

A **proportional tax** is a tax for which the percentage of income paid in taxes remains the same for all income levels. Leslie Wilson, a corporate executive, earns $350,000 a year. Tony Owens, a nurse, earns $50,000 a year. If a 6 percent proportional tax were levied on their incomes, Leslie would pay 6 percent of $350,000, or $21,000, in taxes. Tony would pay 6 percent of $50,000, or $3,000. With a proportional income tax, whether income goes up or down, the percentage of income paid in taxes stays the same.

Progressive Taxes

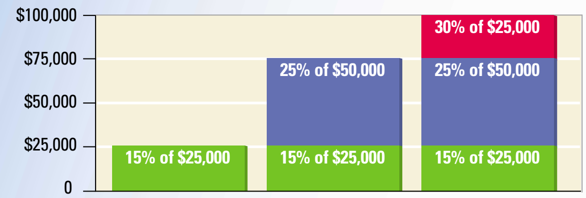
A **progressive tax** is a tax for which the percentage of income paid in taxes increases as income increases. As income rises, the percentage of income paid in taxes also rises. People with very small incomes might pay no tax at all.

The federal income tax is the clearest example of a progressive tax in the United States. A sample progressive income tax system is shown in Figure 14.2. Notice that the tax rate in this example rises from 15, to 25, and then to 30 percent as income rises. This is a progressive tax rate structure because as income rises, the percentage of income paid in taxes also rises.

Regressive Taxes

A **regressive tax** is a tax for which the percentage of income paid in taxes decreases as income increases. For example, although the sales tax rate remains constant, a sales tax is regressive. This is because higher-income households spend a lower proportion of their incomes on taxable goods and services. As a result, although they may pay more actual dollars in sales taxes, the proportion of their income spent on sales taxes is lower than that of lower-income households.

Figure 14.2 **Progressive Income Tax**



Total taxable income: $100,000

1. You would be taxed at a rate of 15 percent on the first $25,000 of your taxable income — 15% of $25,000 = $3,750
2. You would be taxed at a rate of 25 percent on your taxable income above $25,000 but below $75,000 ($50,000) — 25% of $50,000 = $12,500
3. You would be taxed at a rate of 30 percent on your taxable income above $75,000 ($25,000) — 30% of $25,000 = $7,500

Total tax = $23,750

In a progressive tax structure, the higher a taxpayer's income, the greater percentage he or she must pay in taxes. This chart shows a sample progressive income tax for a taxpayer with total taxable income of $100,000.
Income According to the chart, what would be the total tax on taxable income of $65,000?

proportional tax *a tax for which the percentage of income paid in taxes remains the same for all income levels*

progressive tax *a tax for which the percentage of income paid in taxes increases as income increases*

regressive tax *a tax for which the percentage of income paid in taxes decreases as income increases*

Characteristics of a Good Tax

Though it is sometimes difficult to decide whether a specific tax is proportional, progressive, or regressive, economists do generally agree on what makes a good tax. A good tax should have four characteristics: simplicity, efficiency, certainty, and equity, or fairness.

- *Simplicity* Tax laws should be simple and easily understood. Taxpayers and businesses should be able to keep the necessary records, prepare their own tax forms, and pay the taxes on a predictable schedule.
- *Efficiency* Government administrators should be able to collect taxes without spending too much time or money. Similarly, taxpayers should be able to pay taxes without giving up too much time. They should also not have to pay too much money in fees.

Differentiated Instruction L3

To assess student understanding of the types of tax structures, ask students to write an editorial in which they briefly define each type of tax structure and then explain why they feel that each type of tax is fair or unfair.

Learning Styles Activity

Learning Styles Lesson Plans folder, p. 33 asks pairs of students to create brochures supporting or criticizing the idea of a proportional tax structure for individual income tax.

Differentiated Instruction L2

Have students use the following method to take notes on the section. Tell them first to draw a line down the length of their paper, about one third of the way from the left side. Have them paraphrase important points from the section in the right column. Then, in the left column, tell them to write questions that can be answered by their notes. Tell them that they can use these notes for review by covering up the right column with a sheet of paper and answering the questions from the left column. LPR

Transparency Resource Package

Economics Concepts, 14A: Tax Structures

Economic Cartoon

Unit 6 folder, p. 14 gives students practice in interpreting cartoons about section content.

Block Scheduling Strategies

Consider these suggestions to take advantage of extended class time:

- Organize students into pairs. Have one student in each pair investigate the taxes that the British imposed on the American colonists and find out how those taxes were collected. Have the other student in the pair investigate why the colonists were opposed to the taxes and how they made their displeasure known. Then have each pair create a summary of its findings.
- Have groups of three to four students search through newspapers and magazines for letters to the editor, editorials, or cartoons about taxes. Then have each group make a presentation about what they have found, drawing conclusions about how people view taxes and are affected by them.

Answer to . . .

Building Key Concepts $13,750

Differentiated Instruction L3

(Enrichment) After students have read about the characteristics of good taxes, organize the class into several "taxing bodies." Explain that each taxing body must create a tax that satisfies the four characteristics of a good tax. Each group must also show how its tax satisfies the two principles of fairness. Finally, ask the class to determine which of the proposed taxes is the best tax and to explain why.

Differentiated Instruction L2

Ask students to look up the dictionary definitions of *simplicity, efficiency, certainty,* and *equity.* For each word they are likely to find several shades of meaning. Ask them to choose the meaning that they think is most appropriate in the context of taxes and then to explain their choices. ELL

Differentiated Instruction L3

Organize students into small groups. Assign each group a different type of manufactured product. (Choose goods that are common but that vary in their elasticity of demand.) Then explain to students that the government has just imposed a 10 percent tax on all manufactured goods. Ask each group to prepare a brief oral presentation explaining who bears the burden of this tax as it applies to their assigned product. Remind them to consider the elasticity of demand for their particular good.

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to the article.

▲ **This political cartoon makes fun of the saying, "The only sure things in life are death and taxes." Why are taxes necessary?**

- *Certainty* Certainty is also a characteristic of a good tax. It should be clear to the taxpayer when a tax is due, how much money is due, and how the tax should be paid.
- *Equity* The tax system should be fair, so that no one bears too much or too little of the tax burden.

Determining Fairness

Although everyone agrees that a tax system should be fair, people often disagree on what "fair" means. Over time, economists have proposed two different ideas about how to measure the fairness of a tax.

The first idea is called the benefits-received principle. According to this principle, a person should pay taxes based on the level of benefits he or she expects to receive. People who drive, for example, pay gasoline taxes that are used to build and maintain highways. In this way, the people who receive the most benefit from the roads also contribute the most to their upkeep.

The second idea about fairness is called the ability-to-pay principle. According to this principle, people should pay taxes according to their ability to pay. The ability-to-pay principle is the idea behind a progressive income tax: people who earn more income pay more taxes.

THE WALL STREET JOURNAL.
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In the News Read more about taxes in "Hard Habit to Break," an article in The Wall Street Journal Classroom Edition.

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For: Current Events
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Web Code: mnc-6141

Balancing Tax Revenues and Tax Rates

How much revenue does a good tax generate? The answer is "enough, but not too much." That is, enough so that citizens' needs are met, but not so much that the tax discourages production. For example, if a company has to pay $100,000 in taxes, it will not be able to use that $100,000 to expand production. If tax rates are lower, however, the company can use more of its income to stimulate production rather than to pay taxes. Ultimately, many people argue, the economy benefits from lower, rather than higher, tax rates.

Who Bears the Tax Burden?

To fully evaluate the fairness of a tax, it is important to think about who actually bears the burden of the tax. Taxes affect more than just the people who send in the checks to pay them. Why? The answer lies in supply and demand analysis.

Suppose that the government imposes a gasoline tax of $.50 per gallon and collects the tax from service stations. You may think that the burden of the tax falls only on the service stations, because they mail the checks to the government. Graphs A and B in Figure 14.3, however, provide a different set of answers.

Both Graphs A and B show two supply curves: an original supply line and a line showing the supply after the $.50 tax is imposed. When a tax is imposed on a good, the cost of supplying the good increases. The supply of the good then decreases at each and every price level. This shifts the supply curve to the left.

Before the tax, the market was in equilibrium, and consumers bought gas at $1.00

Preparing for Standardized Tests

Have students read the section titled "Characteristics of a Good Tax" and then answer the question below.

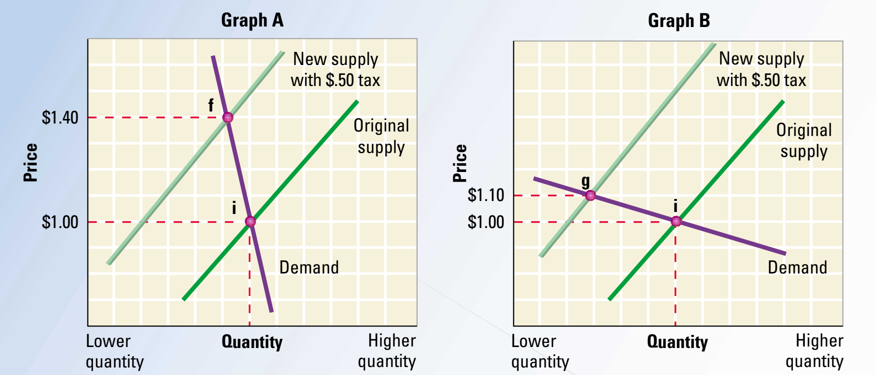
When taxpayers know when a tax is due, how much is due, and how it is to be paid, which requirement of a good tax is being fulfilled?

A equity
B simplicity
C certainty
D efficiency

Answer to . . .

Cartoon Caption Taxes are necessary to fund public goods and services and to fund the functions of government.

Figure 14.3 Elasticities of Demand and Tax Effects



If demand for a good is relatively inelastic (Graph A), a new tax will increase the price by a relatively large amount, and consumers will pay a large share of the tax.

Supply and Demand **Who bears the burden of a tax if demand is relatively elastic?**

per gallon. This is shown as point i on Graph A above. If demand for gas is relatively inelastic (that is, if consumers buy about the same amount no matter what the price), the tax will increase the price of each gallon by a relatively large amount. Consumers will bear a large share of the tax. This is shown in Graph A. Demand is inelastic, so the demand curve is relatively steep, and a $.50 tax increases the equilibrium price by $.40 (from $1.00 to $1.40 from point i to point f). In other words, consumers pay about four fifths of the tax.

In contrast, if demand is relatively elastic, the demand curve will be relatively flat, as in Graph B. Consumers will pay a relatively small part of the tax. As Graph B shows, a $.50 tax increases the equilibrium price by only $.10 (from $1.00 to $1.10 from point i to point g). In this case, consumers pay only one fifth of the tax. The service stations pay the other four fifths.

This example shows the **incidence of a tax**—that is, the final burden of a tax. When policymakers consider a new tax, they examine who will actually bear the burden. As in the example above, producers can "pass on" the burden to consumers. Generally, the more inelastic the demand, the more easily the seller can shift the tax to consumers. The more elastic the demand, the more the seller bears the burden.

incidence of a tax *the final burden of a tax*

Section 1 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-6145

Key Terms and Main Ideas

1. Why do governments impose taxes?
2. What is the difference between a **progressive tax** and a **regressive tax?**
3. What are the four characteristics of a good tax?
4. Describe the benefits-received principle. How does it differ from the ability-to-pay principle?

Applying Economic Concepts

5. ***Try This*** Suppose that your town decides to levy a tax to raise funds for construction, maintenance, and other expenses for local schools. Should the tax be proportional, progressive, or regressive? Explain your answer.
6. ***Critical Thinking*** Analyze the impact of the power to tax as expressed in the Constitution on tax policies today.

Go Online PHSchool.com
For: Discussion Activity
Visit: PHSchool.com
Web Code: mnd-6141

Progress Monitoring *Online*
For additional assessment, have students access Progress Monitoring Online at **Web Code:** mna-6145

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to detailed instructions for this activity.

Transparency Resource Package Economics Concepts, 14B: Economic Impact of Taxes

GTE Guide to the Essentials Chapter 14, Section 1, p. 58 provides support for students who need additional review of the section content. Spanish support is available in the Spanish edition of the guide on p. 58.

Quiz Unit 6 folder, p. 3 includes questions to check students' understanding of Section 1 content.

Presentation Pro CD-ROM Quiz provides multiple-choice questions to check students' understanding of Section 1 content.

Answers to . . .
Section 1 Assessment

1. To provide public goods and services and to fund the functions of government.
2. A progressive tax is a tax that causes the percentage of income paid in taxes to increase as income increases. A regressive tax is a tax in which the percentage of income paid in taxes goes down as income increases.
3. simplicity, efficiency, certainty, and equity
4. The benefits-received principle states that people should pay taxes based on the level of benefits they receive from the government. In contrast, the ability-to-pay principle states that people should pay taxes according to their ability to pay.
5. Possible answers: The tax should be proportional because the school is a public resource, so everyone should pay an equal portion of their income to fund it. The tax should be progressive because the ability to pay varies. The tax should be regressive because people who make the most money are already paying the most in taxes.
6. Although the Constitution grants Congress the power to tax, it also limits certain kinds of taxes; for example, a federal tax such as the gas tax must be the same rate in every state.

Answer to . . .
Building Key Concepts Producers or intermediaries bear the burden.

Section 2 Federal Taxes

Preview

Objectives

After studying this section you will be able to:

1. **Describe** the process of paying individual income taxes.
2. **Explain** the basic characteristics of corporate income taxes.
3. **Understand** the purpose of Social Security, Medicare, and unemployment taxes.
4. **Identify** other types of taxes.

Section Focus

The federal income taxes that households and families pay help to fund government programs. Other types of taxes are levied on specific items for specific purposes.

Key Terms

withholding
tax return
taxable income
personal exemption
deductions
FICA
Social Security
Medicare
estate tax
gift tax
tariff
tax incentive

During fiscal year 2004, the federal government took in about $1.88 trillion in taxes. If you divide up this federal tax revenue among all the people in the United States, it comes to about $6,300 per person. How does the government get all this money?

The federal government has six major sources of tax revenue. They are individual and corporate income taxes, social insurance taxes, excise taxes, estate and gift taxes, and taxes on imports.

Individual Income Taxes

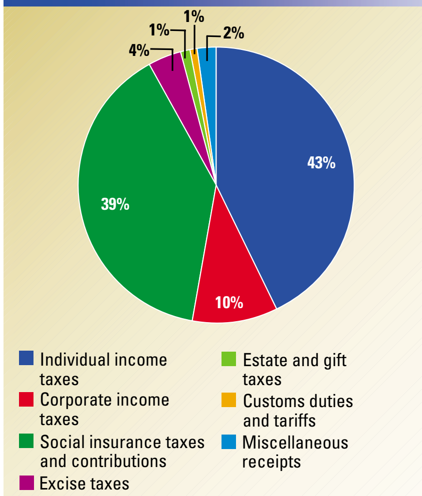
The federal government levies a tax on individuals' taxable income. As Figure 14.4 shows, individual income taxes make up the federal government's main source of revenue. About 45 percent of the federal government's revenues come from the payment of individual income taxes.

"Pay-As-You-Earn" Taxation

The amount of federal income tax a person owes is determined on an annual basis. In theory, the federal government could wait until the end of the tax year to collect individual income taxes. In reality, that would be a problem for both taxpayers and the government. Like other employers, the government has to pay regularly for rent, supplies, services, and employees' salaries. A single annual payment from all the nation's taxpayers at once would make meeting these expenses difficult.

Similarly, many people might have trouble paying their taxes in one large sum. For these reasons, federal income tax is collected in a "pay-as-you-earn" system. This means that individuals usually pay

Figure 14.4 Federal Revenue, 2004



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: U.S. Department of the Treasury

Building Key Concepts

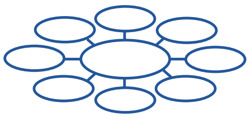
Sources of government revenue include the taxes shown on this graph.
Government Analyze the categories of revenue in the federal budget. What are the largest sources of federal revenue?

Go Online
PHSchool.com
Web Code: mng-6142

Graphing the Main Idea

Government To build understanding of the information on taxes collected by the **government,** ask students to complete two web graphic organizers. Tell them to make an organizer like the one at the right for income taxes and another for Social Security, Medicare, and unemployment taxes. Remind students that a web shows a main idea and its supporting details.

Section Reading Support Transparencies A template and the answers for this graphic organizer can be found in Chapter 14, Section 2 of the Section Reading Support Transparency System.



Section 2 Federal Taxes

Objectives You may wish to call students' attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer Ask students to consider why employees are required to fill out and submit tax returns on April 15 if employers send taxes to the federal government during the year. Explain that this section will answer that question and others about taxes and the federal government.

Vocabulary Builder Ask students to create a quiz of 11 fill-in-the-blank questions about the terms. Have students exchange quizzes, complete them, and return them to the authors for correction.

Lesson Plan

Teaching the Main Concepts (L3)

1. Focus The federal government collects six major types of taxes to keep the government running and to provide services for people who live in the United States. Ask students to list as many types of federal taxes as they can.

2. Instruct Begin by discussing individual income taxes—what they are and how they are collected. Then compare them with corporate income taxes. Go on to explain the other types of federal taxes that are withheld from an employee's paycheck and the tax paid by employers. Finally, compare and contrast excise, estate, gift, and import taxes.

3. Close/Reteach Remind students that the federal government collects taxes from individuals, corporations, and employers. Ask students to explain how each tax is collected.

Answer to . . .

Building Key Concepts The largest sources of federal revenue are individual income taxes and social insurance taxes and contributions.

Guided Reading and Review
Unit 6 folder, p. 4 asks students to identify the main ideas of the section and to define or identify key terms.

Transparency Resource Package
Economics Concepts, 14C: Major Sources of Federal Government Income

Differentiated Instruction L2
Before students read this section, ask them to list everything they know about federal taxes and also what they would like to know. Then instruct them to look for answers as they read the section. Have them create a study guide to show what they learn. Discuss with students anything they wanted to know that was not covered in the section. LPR

Differentiated Instruction L3
Ask students to create a flow chart that illustrates the process of paying income taxes. The flow chart should begin with a new employee filling out a W-4 form, declaring deductions, and so on, and end with the employee submitting a tax return.

HOURS AND EARNINGS		TAXES AND DEDUCTIONS	
Hours	Earnings	Description	Amount
20	200.00	FICA	15.20
		Federal	10.25
		State	5.10
		City	1.00
		Total Taxes	**31.55**
TOTAL			
Taxable Wages	**Less Taxes**		**Net Pay**
200.00	31.55		168.45

▲ **This young worker's pay stub shows that her employer, as required by law, has withheld part of her earnings for taxes. What percentage of this worker's pay was withheld for federal taxes? For total taxes?**

withholding *taking tax payments out of an employee's pay before he or she receives it*

tax return *form used to file income taxes*

taxable income *income on which tax must be paid; total income minus exemptions and deductions*

personal exemption *set amount that you subtract from your gross income for yourself, your spouse, and any dependents*

deductions *variable amounts that you can subtract, or deduct, from your gross income*

most of their income tax throughout the year as they earn income. In mid-April, they pay any additional income taxes they owe.

Tax Withholding

Employers are responsible in part for carrying out the system for collecting federal income taxes. They do so by **withholding,** or taking payments out of your pay before you receive it. The amount they withhold is based on an estimate of how much you will owe in federal income taxes for the entire year. After withholding the money, the employer forwards it to the federal government as an "installment payment" on your upcoming annual income tax bill. On the sample pay stub shown above, the employer has withheld $10.25 in federal income taxes from this employee's paycheck.

Filing a Tax Return

At the end of the year, employers give their employees a report showing how much income tax has already been withheld and sent to the government. The employee then completes a tax return. A **tax return** is a form used to file income taxes. On it you declare your income to the government and figure out your taxable income.

Taxable income is a person's gross (or total) income minus exemptions and deductions. Gross income includes earned income—salaries, wages, tips, and commissions. It also includes income from investments such as interest on savings accounts and dividends from stock.

Personal exemptions are set amounts that you subtract from your gross income for yourself, your spouse, and any dependents. **Deductions** are variable amounts that you can subtract, or deduct, from your gross income. Deductions include such items as interest on a mortgage, donations to charity, some medical expenses, and state and local tax payments.

Completing a tax return allows you to determine whether the amount of income taxes you have already paid was higher or lower than the actual amount of tax you owe. If you have paid more than you owe, the government sends you a refund. If you have paid less than you owe, you must pay the balance to the government. All federal income tax returns must be sent to the Internal Revenue Service, or IRS, by midnight on April 15 (or the next business day if April 15 falls on a weekend).

Econ 101: Key Concepts Made Easy

Trade To help students understand **tariffs,** explain that a tariff is a kind of economic ticket of admission to the United States for foreign goods. Paying the tariff gets products in the market door, so to speak, so that they can be sold. Be sure that students understand that American citizens also pay tariffs—called customs duties—when they return from a foreign country with goods they purchased in that country that exceed a certain value set by the U.S. government. Ask students who have traveled in foreign countries to describe the customs process. If no students have traveled abroad, invite faculty members who have done so to talk about their experiences.

Answer to . . .
Photo Caption roughly 13 percent (FICA and federal); 16 percent (total)

Tax Brackets

The federal income tax is a progressive tax. In other words, the tax rate rises with the amount of taxable income. The tax rate schedule in Figure 14.5 shows that in 2005, there were six rates. Each applied to a different range of income, or tax bracket. For example, married couples who filed a return together (a joint return) and had a taxable income of $14,600 or less paid 10 percent income tax. The highest rate—35 percent—was paid by high-income single people or married couples on the portion of their taxable incomes that exceeded $326,450. Each year, the IRS publishes new tax rate schedules that reflect any changes in the federal tax code.

Corporate Income Taxes

Like individuals, corporations must pay federal income tax on their taxable income. Corporate taxes made up less than 10 percent of federal revenues in recent years.

Determining a corporation's taxable income can be a challenge because businesses can take many deductions. That is, they can subtract many expenses from their income before they reach the amount of income that is subject to taxation. For example, companies deduct the cost of employees' health insurance. Many other costs of doing business can also be deducted.

Like individual income tax rates, corporate income tax rates are progressive. In 2005, rates began at 15 percent on the first $50,000 of taxable income. The highest corporate income tax rate was 35 percent on all taxable corporate income above $10,000,000.

Social Security, Medicare, and Unemployment Taxes

In addition to withholding money for income taxes, employers withhold money for taxes authorized under the Federal Insurance Contributions Act, or FICA. **FICA** taxes fund two large government programs, Social Security and Medicare. Employees and employers share FICA payments.

Social Security Taxes

Most of the FICA taxes you pay go to the Social Security Administration to fund Old-Age, Survivors, and Disability Insurance (OASDI), or **Social Security**. Social Security was established in 1935 to ease the hardships of the Great Depression.

FICA *taxes that fund Social Security and Medicare*

Social Security *Old-Age, Survivors, and Disability Insurance (OASDI)*

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Figure 14.5 **Federal Income Tax Rates, 2005**

Schedule	If your taxable income is over–	but not over–	the tax is	of the amount over–
Schedule X– use if your filing status is **single**	$0	$7,300	.... 10%	$0
	$7,300	$29,700	$730.00 plus 15%	$7,300
	$29,700	$71,950	$4,090.00 plus 25%	$29,700
	$71,950	$150,150	$14,652.40 plus 28%	$71,950
	$150,150	$326,450	$36,548.50 plus 33%	$150,150
	$326,450	....	$94,727.50 plus 35%	$326,450
Schedule Y– use if your filing status is **married filing jointly**	$0	$14,600	.... 10%	$0
	$14,600	$59,400	$1,460.00 plus 15%	$14,600
	$59,400	$119,950	$8,180.00 plus 25%	$59,400
	$119,950	$182,800	$23,317.50 plus 28%	$119,950
	$182,800	$326,450	$40,915.50 plus 33%	$182,800
	$326,450	....	$88,320.00 plus 35%	$326,450

BUILDING KEY CONCEPTS

According to these sample individual income tax tables, a single individual with $5,000 of taxable income would pay $5,000 X .10, or $500 in taxes.
Income What would be the tax for a married couple filing jointly with $75,000 in taxable income?

Transparency Resource Package
Economics Concepts, 14D: Federal Taxes

Differentiated Instruction L3

(Reteaching) Ask students to create a Venn diagram to review how individual income taxes and corporate income taxes are alike and how they are different. Have them conclude the activity by discussing what they included in each circle (for example, withholding by employers in the "personal income taxes" area, deductions for the costs of doing business in the "corporate income taxes" area, and progressive taxes in the common area).

Differentiated Instruction L3

Organize the class into three groups—a Social Security group, a Medicare group, and an unemployment compensation group. Tell each group that it is responsible for researching the purpose of its assigned program and preparing and delivering an illustrated five-minute oral presentation on it. The presentation should include at least one chart or graph.

Block Scheduling Strategies

Consider these suggestions to take advantage of extended class time:

- Bring in multiple blank copies of federal tax return forms. Distribute the forms to groups of students. Then go through the form line by line with the students, having them explain the information requested on each line and clarifying such information for them where necessary.
- Extend the Learning Styles Activity on this page by having students do additional research, using the Simulations and Data Graphing CD-ROM to create several graphs for their group's presentation. Provide extra time for each presentation, and work with the class to display the graphs on a class bulletin board.
- Have students use the Internet to find examples of cartoons about taxes. Links can be found within *Economics: Principles in Action* in the Social Studies area of the Prentice Hall Web site: **www.phschool.com**

Answer to . . .
Building Key Concepts $12,080

Differentiated Instruction L3

(Reteaching) Organize students into groups of three or four. Have them look in recent almanacs for information on U.S. budget receipts by source. They should collect data on the most recent year for which figures are available. First have students figure out what percentage of the total revenue came from individual income taxes, corporate income taxes, social insurance taxes (such as Social Security), excise taxes, and other types of taxes each year. Then have each group use the Simulations and Data Graphing CD-ROM to create a circle graph similar to the one in Figure 14.4 on page 365 that displays this information. (Their graphs will be for a more recent year, however.) Have them accompany their graphs with a brief glossary that defines each of the types of taxes mentioned in the section.

Simulations and Data Graphing CD-ROM offers data graphing tools so that students can practice creating and interpreting graphs.

Transparency Resource Package Economics Concepts, 14E: Value-Added Tax

Answer to . . .

Global Connections Answers will vary. Some students may favor a VAT as a way to collect revenue. Others will recommend against it so as to limit taxes.

Global Connections

Value-Added Tax Individual income taxes and sales taxes play a smaller role in generating government revenue in many European nations than they do in the United States. Instead, in much of Europe, a value-added tax, or VAT, has been implemented. A VAT taxes the increase in value that a good gains in each step of its production. For example, in the United States, consumers usually pay taxes when they buy a car. Under a VAT system, the price of a car already includes the tax paid by the mine that extracts the iron ore used to make the car. It also includes the tax the steel mill paid based on the value added to the iron ore when it was turned into steel. Similarly, the car's price includes the tax the car manufacturer paid on the value the steel gained when it was made into a car. In this way, the consumer doesn't directly pay the tax. Rather, the total price of the car already includes the tax. **Would you recommend a VAT for the United States? Why or why not?**

Medicare *a national health insurance program that helps pay for health care for people over age 65 or with certain disabilities*

estate tax *a tax on the estate, or total value of the money and property, of a person who has died*

gift tax *a tax on money or property that one living person gives to another*

Originally, Social Security was simply a retirement fund to provide old-age pensions to workers. Today, it also provides benefits to surviving family members of wage earners and to people whose disabilities keep them from working.

Each year the government establishes an income cap for Social Security taxes. In 2005, the cap was $90,000. No Social Security taxes could be withheld from a taxpayer's wages and salaries above that amount.

Medicare Taxes

FICA taxes also fund Medicare. The **Medicare** program is a national health insurance program that helps pay for health care for people over age 65. It also covers people with certain disabilities.

Both employees and self-employed people pay the Medicare tax on all their earnings. There is no ceiling as for Social Security payments.

Unemployment Taxes

The federal government also collects an unemployment tax, which is paid by employers. In effect, the tax pays for an insurance policy for workers. If workers are laid off from their jobs through no fault of their own, they can file an "unemployment compensation" claim and collect benefits for a fixed number of weeks. In order to collect unemployment benefits, an unemployed person usually must show that he or she is actively looking for another job. The unemployment program is financed by both state and federal unemployment taxes.

Other Types of Taxes

What are the taxes on gasoline and cable television service called? If you inherit money from your great aunt, will you have to pay a tax? Why are some imported products so expensive? To answer these questions, you need to look at excise, estate, gift, and import taxes.

Excise Taxes

As you read in Chapter 5, an excise tax is a general revenue tax on the sale or manufacture of a good. Federal excise taxes apply to gasoline, cigarettes, alcoholic beverages, telephone services, cable television, and other items.

Estate Taxes

An **estate tax** is a tax on the estate, or total value of the money and property, of a person who has died. It is paid out of the person's estate before the heirs receive their share. A person's estate includes not only money, but also real estate, cars, furniture, investments, jewelry, paintings, and insurance.

In 2005, if the total value of the estate is $1.5 million or less, there is no federal estate tax. Because an estate tax is a progressive tax, the rate rises with increasing value. That is, a $5 million estate will be taxed by the federal government at a higher rate than a $2 million estate.

Gift Taxes

The **gift tax** is a tax on money or property that one living person gives to another. The goal of the gift tax, established in 1924, was to keep people from avoiding estate taxes by giving away their money before they died. The tax law sets limits on gifts, but still allows the tax-free transfer of fairly

Preparing for Standardized Tests

Have students read the section titled "Other Types of Taxes" and then answer the question below.

Which of the following taxes is likely to show up on a telephone bill?

A excise tax
B FICA tax
C estate tax
D gift tax

large amounts each year. Under current law, a person can give up to $11,000 a year tax-free to each of several different people.

Import Taxes

Taxes on imported goods (foreign goods brought into the country) are called **tariffs.** Today, most tariffs are intended to protect American farmers and industries from foreign competitors rather than to raise revenue. Tariffs raise the price of foreign items and help keep the price of American products competitive. You will read more about tariffs in Chapter 17.

Taxes That Affect Behavior

The basic goal of taxation is to create revenue. However, governments sometimes use tax policies to discourage the public from buying harmful products. Taxes are also used to encourage certain types of behavior. The use of taxation to encourage or discourage behavior is called a **tax incentive.**

Federal taxes on tobacco products and alcoholic beverages are examples of so-called sin taxes. While they do bring in revenue, their main purpose is to discourage people from buying and using tobacco and alcohol.

▲ **The owner of this house is installing solar panels. He or she may be able to take advantage of tax incentives designed to encourage energy conservation.**

Taxes have also been imposed on the purchase of vehicles that get low gas mileage. The goal of these taxes is to encourage people to purchase more fuel-efficient cars. Similarly, certain tax deductions encourage energy conservation. Homeowners and businesses may deduct some of the cost of certain improvements, such as adding solar heating, from their taxable income.

tariff *a tax on imported goods*

tax incentive *the use of taxation to encourage or discourage certain behavior*

Section 2 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-6146

Key Terms and Main Ideas

1. Explain "pay-as-you-earn" taxation.
2. Describe **withholding** and explain how it would affect a student with a part-time job.
3. What is the purpose of **FICA?**

Applying Economic Concepts

4. ***Critical Thinking*** The founders of the United States wanted to avoid establishing a permanent aristocracy, or group of wealthy families who could control a great deal of the nation's wealth. How is this idea related to estate and gift taxes?
5. ***Try This*** Contributions to organizations such as the American Cancer Society are tax deductible (that is, they can be deducted from taxable income). Explain the reason for this tax policy.
6. ***Using the Databank*** Study the bar graph showing Government Receipts by Source on page 543 of the Databank. Approximately how much money (in billions of dollars) do the top three sources of government income generate?

Go Online PHSchool.com
For: Research Activity
Visit: PHSchool.com
Web Code: mnd-6142

GTE Guide to the Essentials
Chapter 14, Section 2, p. 59 provides support for students who need additional review of the section content. Spanish support is available in the Spanish edition of the guide on p. 59.

Quiz Unit 6 folder, p. 5 includes questions to check students' understanding of Section 2 content.

Presentation Pro CD-ROM
Quiz provides multiple-choice questions to check students' understanding of Section 2 content.

Answers to . . .

Section 2 Assessment

1. Pay-as-you-earn taxation means that individuals usually pay most of what they owe over the year as they earn income.
2. Withholding is a portion of income taken out of an employee's paycheck. It is forwarded to the federal government as an installment payment on the person's annual tax. A student with a part-time job would have a portion of salary withheld.
3. FICA taxes fund two large government programs—Social Security and Medicare.
4. Estate and gift taxes tax money that transferred from one individual to another. If large sums are given or inherited, some of that amount is taxed and paid to the government. Therefore, no inheritance can be passed along among a few individuals or families without losing some of its value.
5. Donations are deductible in order to encourage people to give to worthy organizations. The money is donated to a nonprofit organization, which furthers the public good.
6. approximately $1,700 billion

Progress Monitoring *Online*
For additional assessment, have students access Progress Monitoring Online at **Web Code:** mna-6146

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to detailed instructions for this activity.

Section 3 Federal Spending

Preview

Objectives

After studying this section you will be able to:

1. **Distinguish** between mandatory and discretionary spending.
2. **Describe** major entitlement programs.
3. **Identify** categories of discretionary spending.
4. **Explain** the impact of federal aid to state and local governments.

Section Focus

Although the federal budget is extremely large, about three quarters of the government's spending is required by current laws. Major categories of government spending include Social Security, defense, interest on the national debt, Medicare, and health care.

Key Terms

mandatory spending
discretionary spending
entitlement
Medicaid

Suppose that each year you were given almost $1.9 trillion to spend. So much money! So many choices! In reality, when the federal government receives this amount of revenue in the form of taxes, most of it is already accounted for. That is, after the government fulfills all its legal obligations, only about 26 percent of the money remains. In this section you will look at the many items on which the federal government spends its tax revenues. In Chapter 15, you will read about how the federal government, as part of the budget process, plans for that spending.

Mandatory and Discretionary Spending

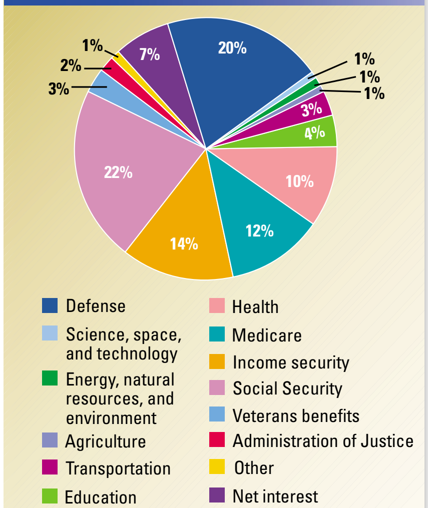
The graph in Figure 14.6 shows the major categories of federal spending. Some of these categories, such as Social Security and Medicare, are "mandatory." **Mandatory spending** refers to money that lawmakers are required by existing laws to spend on certain programs or to use for interest payments on the national debt. Others, such as defense and education, are "discretionary." **Discretionary spending** is spending about which government planners can make choices.

In general, the percentage of federal spending that is mandatory has grown in recent years. The percentage of discretionary spending has decreased. These trends worry many budget planners and politicians.

mandatory spending *spending on certain programs that is mandated, or required, by existing law*

discretionary spending *spending category about which government planners can make choices*

Figure 14.6 Federal Spending, 2004



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: Office of Management and Budget

Building Key Concepts

The federal government spends the funds it collects from taxes and other sources on a variety of programs. **Government Analyze the categories of expenditures in the federal budget. Which categories receive the most federal funds?**

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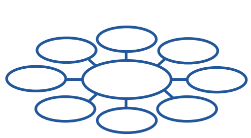
Building Key Concepts: Graphing the Main Idea

Government To help students understand mandatory spending and discretionary spending by the **government,** have them complete a web graphic organizer like the one at the right for each of the types of spending. Remind students that a web shows a main idea and its supporting details.

Section Reading Support Transparencies A template and the answers for this graphic organizer can be found in Chapter 14, Section 3 of the Section Reading Support Transparency System.



Section 3 Federal Spending

Objectives You may wish to call students' attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer Ask students to describe how they think most workers spent their most recent paychecks. Do they think that workers were able to choose freely how their money was spent, or did some of the money have to go toward required expenses? Explain that this section will detail how the government allocates its financial resources.

Vocabulary Builder Have students read through the section to discover the meaning of the key terms. Ask them to write each term and its definition in their Economics Journals.

Lesson Plan

Teaching the Main Concepts L3

1. Focus Explain to students that like the typical worker, the government is not free to spend its revenues however it wishes. Ask students to list necessities for which individuals must spend part of their earnings.

2. Instruct Begin by stating the differences between mandatory and discretionary spending. Then discuss each type of spending in depth, introducing students to the concept of entitlement programs. Finally, explain how federal tax dollars find their way back to the states and to local governments.

3. Close/Reteach After the federal government has funded its mandatory entitlement programs, it allocates its remaining financial resources as Congress and the executive branch see fit. Ask students to explain the purpose of entitlement programs.

Answer to . . .

Building Key Concepts Social Security, defense, income security, Medicare, health

Guided Reading and Review
Unit 6 folder, p. 6 asks students to identify the section's main ideas and to define or identify key terms.

Differentiated Instruction L2
Ask students to consult a dictionary to learn the pronunciation and meaning of the words *mandate* and *discretion.* Have them state each definition in their own words, and ask them to explain how those definitions help them to understand mandatory and discretionary spending. ELL

Differentiated Instruction L3
(Reteaching) Have students list everything they can remember spending money for over the past several weeks. Then ask them to divide their lists into two categories: mandatory spending and discretionary spending. Ask how they decided which category best described each expense. Finally, ask them to relate these categories to spending by the government and to list examples of government expenses that fall into each category.

Differentiated Instruction L3
Organize the class into six groups, and assign one of the following topics to each group: Social Security, Medicare, Medicaid, food stamps, Supplemental Security Income (SSI), and child nutrition. Ask each group to create a fact sheet about its topic that answers the following questions:
- Who benefits from the program?
- What benefits does the program offer?
- When was the program started?
- Why was the program initiated?
- How does the program work?

Photocopy and distribute the fact sheets so that everyone has information on all of these programs.

▲ **People who receive entitlement benefits such as Social Security, Medicare, and Medicaid include veterans, people with disabilities, and the elderly.**

entitlement *social welfare program that people are "entitled to" if they meet certain eligibility requirements*

Entitlement Programs

Except for interest on the national debt, most of the mandatory spending items in the federal budget are for entitlement programs. **Entitlements** are social welfare programs that people are "entitled to" if they meet certain eligibility requirements, such as being at a certain income level or age. The federal government guarantees assistance for all those who qualify. As the number of people who qualify rises, mandatory spending rises as well. As a result, managing costs has become a major concern.

Some, but not all, entitlements are "means-tested." In other words, people with higher incomes may receive lower benefits or no benefits at all. Medicaid, for instance, is means-tested, or dependent on income. Social Security is not. A retired person who has worked and paid Social Security taxes is entitled to certain benefits. Similarly, military veterans and retired federal employees are entitled to receive pensions from the government.

Entitlements are a largely unchanging part of government spending. Once Congress has set the requirements, it cannot control how many people become eligible for each kind of benefit. Congress can change the eligibility requirements or reduce the amount of the benefit in order to try to keep costs down. Such actions, however, require a change in the law.

Social Security

Social Security is the largest category of federal spending. More than 50 million retired or disabled people and their families and survivors receive monthly benefits. The Social Security Administration became an independent agency in 1995. Before that, its spending was part of the budget for the Health and Human Services Department.

Medicare

Medicare serves about 42 million people, most of them over 65 years old. The program pays for hospital care and for the costs of physicians and medical services. It also pays health care bills for people who suffer from certain disabilities and diseases.

Econ 101: Key Concepts Made Easy

Government Explain to students that the concept of **entitlement** entered the English language as recently as 1944. The word is derived from *entitle,* which itself comes from the Latin *intitulare,* meaning "give a title to." Someone bestowed with a title had certain rights and privileges. Thus, to be *entitled* means to have a right to something.

Ask students to examine the debate that has gone on for some time about whether individuals are actually "entitled" to programs that are called entitlements. Encourage students to see how the words that are used to talk about something can reveal a person's attitude toward it.

Medicare is funded by taxes withheld from people's paychecks. Monthly payments paid by people who make certain levels of taxable income and receive Medicare benefits also pay for the program.

Medicaid

Medicaid benefits low-income families, some people with disabilities, and elderly people in nursing homes. It is the largest source of funds for medical and health-related services for America's poorest people. The federal government shares the costs of Medicaid with state governments. The state share of the costs varies from 50 percent to 83 percent. In 2004, 54.6 million people were covered by Medicaid—about 18 percent of Americans.

Other Mandatory Spending Programs

Other means-tested entitlements benefit people and families whose incomes fall below a certain level. Requirements vary from program to program. Federal programs include food stamps, Supplemental Security Income (SSI), and child nutrition. The federal government also pays retirement benefits and insurance for federal workers, as well as veterans' pensions and unemployment insurance.

The Future of Entitlement Spending

Spending for both Social Security and Medicare has increased enormously in recent years and is expected to increase further in the next few decades. Social Security payments will rise as people in the large "baby boomer" generation, born between 1945 and 1964, start to retire. When the "baby boomers" reach 65, they will become eligible for Medicare as well.

Medicare costs have been growing rapidly, partly as a result of expensive technology, but also because people are living longer. Who will pay these costs? The following fact indicates the basic problem facing Medicare. In 1995, there were four people paying Medicare taxes for every Medicare recipient. By 2050, there will only be two people paying taxes for every recipient.

Discretionary Spending

Spending on defense accounts for about half of the federal government's discretionary spending. The remaining funds available for discretionary spending are divided among a wide variety of categories.

Defense Spending

Defense spending has dropped somewhat since the end of the cold war as a percentage of the total federal budget. As you can see from the graph in Figure 14.6, defense spending consumes about 20 percent of the federal budget.

The Department of Defense spends most of the defense budget. It pays the salaries of all the men and women in the army, navy, air force, and marines, as well as the department's civilian employees. There are about 1.4 million men and women in uniform, along with about 654,000 civilian workers, working for the armed forces.

Defense spending, of course, also buys weapons, missiles, battleships, tanks, airplanes, ammunition, and all the other equipment the military needs. The defense budget also includes funds for maintaining equipment and military bases.

Other Discretionary Spending

You may be surprised at how small a portion of federal spending goes into the category that could be labeled "everything else." Here are some of the many programs that this category of federal spending pays for.

- education
- training
- scientific research
- student loans
- technology
- national parks and monuments
- law enforcement
- environmental cleanup
- housing

THE WALL STREET JOURNAL.
CLASSROOM EDITION

In the News Read more about federal spending in "Rethinking the Digital Divide," an article in The Wall Street Journal Classroom Edition.

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For: Current Events
Visit: PHSchool.com
Web Code: mnc-6143

Medicaid *entitlement program that benefits low-income families, some people with disabilities, and elderly people in nursing homes*

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to the article.

Differentiated Instruction L3

(Enrichment) Assign each student one of the categories of discretionary spending discussed in this section. Instruct students to locate recent real-life examples of spending for their assigned categories. Then have each student compose a brief description of the example. You may want to have students also create "Dubious Discretionary Doings" lists to document strange or seemingly wasteful discretionary spending that they uncover in their research. Depending on the time available, have the information presented orally or in a class report and combined list.

Differentiated Instruction L4

You may wish to have students add the following to their portfolios. Ask them to read the part of this section titled "Federal Aid to State and Local Governments." Then have students research one type of federal aid to your state or local government to find out what kinds of restrictions come along with the funds. Have them write several paragraphs, first briefly describing the general impact of federal aid on state and local governments and then focusing on their research. GT

Economics Assessment Rubric
Economics Assessment Rubrics folder, pp. 6–7 provides sample evaluation materials for a writing assignment.

Transparency Resource Package
Economics Concepts, 14F: Federal Spending

Block Scheduling Strategies

Consider these suggestions to take advantage of extended class time:

- Distribute a table that details government spending. (Almanacs usually include this information, but it is also available from the Office of Management and Budget.) Then work with students to analyze the chart. First identify which spending is mandatory and which is discretionary. Then identify categories that get the most and the least spending. Finally, have students do research to analyze how spending in various categories has changed over time.
- Extend the second activity on this page by having students debate the following question: *Should the federal government fund state and local programs and projects without imposing any requirements or regulations?* After each side has presented its case, have the class decide which team made the most convincing arguments.

GTE Guide to the Essentials
Chapter 14, Section 3, p. 60 provides support for students who need additional review of the section content. Spanish support is available in the Spanish edition of the guide on p. 60.

Quiz Unit 6 folder, p. 7 includes questions to check students' understanding of Section 3 content.

Presentation Pro CD-ROM
Quiz provides multiple-choice questions to check students' understanding of Section 3 content.

Answers to . . .

Section 3 Assessment

1. Discretionary spending is spending about which government planners can make choices. Mandatory spending is spending that is required by existing law.
2. An entitlement program is a social welfare program that people are "entitled to" if they meet certain eligibility requirements.
3. Social Security costs are expected to increase as the "baby boomer" generation, a large segment of today's society, reaches retirement age.
4. Defense is the largest category of discretionary spending. Other examples may include education, training, scientific research, student loans, technology, national parks and monuments, law enforcement, environmental cleanup, housing, land management, transportation, disaster aid, foreign aid, farm subsidies, and salaries of civilian employees of the federal government.
5. (a–b) Answers will vary, but students should demonstrate an understanding of entitlement programs and be able to support their answers by suggesting needs that are not met (requiring added programs) or examples of waste or inefficiency (requiring modifying or cutting of programs).

▲ **As the federal government reduces its size, the burden of providing public assistance programs falls more heavily on the states. How does the cartoonist portray the ability of state governments to handle this responsibility?**

- land management
- transportation
- disaster aid
- foreign aid
- farm subsidies

This part of the federal budget also pays the salaries of the millions of people who work for the civilian branches of the federal government. They include members of Congress, Cabinet secretaries, park rangers, FBI agents, file clerks, geologists, CIA agents, meat inspectors, and many others.

Federal Aid to State and Local Governments

Some federal tax dollars find their way to state and local governments. In total, about $406 billion a year in federal monies is divided among the states. This is an average of about $1,400 per person.

As you have read, state and federal governments share the costs of some social programs, including Medicaid, unemployment compensation, and some of the programs that help children, families, refugees, and others. State and federal governments also share the costs of some highway construction. Additional federal money goes to the states for education, lower-income housing, mass-transit, health care, highway construction, employment training, and dozens of other programs.

Federal grants-in-aid are grants of federal money for certain closely defined purposes. States must use the federal funds only for the purpose specified and obey the federal guidelines for which aid is given. Beginning with the Reagan administration in the early 1980s, many grant-in-aid programs were converted to a block grant format. As you read in Chapter 13, block grants are lump sums of money intended to be used in a broadly defined area of public need, such as education or highways.

Section 3 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-6147

Key Terms and Main Ideas

1. How does **discretionary spending** differ from **mandatory spending?**
2. What is an **entitlement** program?
3. Why is the cost of the Social Security program expected to increase in the next decades?
4. What is the largest category of **discretionary spending?** Identify three additional examples of discretionary spending.

Applying Economic Concepts

5. ***Try This*** Suppose that you are running for political office. **(a)** Would you propose any new entitlement programs? If so, what would they be? **(b)** Would you propose eliminating or modifying any existing entitlement programs? Explain your answers.
6. ***You Decide*** Which categories of federal spending would you lower? Which would you raise? Give specific reasons for the changes you suggest.

Go Online
PHSchool.com
For: Debate Activity
Visit: PHSchool.com
Web Code: mnd-6143

6. Answers should demonstrate an understanding of federal spending and be well supported. For example, students may want to lower defense spending because the United States is the strongest world power, or they may want to spend more on environmental clean-up because many areas are damaged.

Progress Monitoring *Online*
For additional assessment, have students access Progress Monitoring Online at **Web Code:** mna-6147

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to detailed instructions for this activity.

Answer to . . .

Cartoon Caption State governments are portrayed as being low on funds and therefore unprepared.

Section 4

State and Local Taxes and Spending

Preview

Objectives

After studying this section you will be able to:

1. **Explain** how states use a budget to plan their spending.
2. **Identify** where state taxes are spent.
3. **List** the major sources of state tax revenue.
4. **Describe** local government spending and sources of revenue.

Section Focus

Like the federal government, state and local governments use the revenue from taxes to pay for a variety of programs and services. In general, states spend the largest amounts on grants to local governments, education, and public welfare.

Key Terms

operating budget
capital budget
balanced budget
tax exempt
real property
personal property
tax assessor

You and your family are thinking about colleges. Which one offers the courses you want? How much does it cost? During your research, you find that colleges within your state's university system are far less expensive than private schools. The reason is that your state government is paying part of the cost of running the state colleges. In fact, higher education is one of the largest areas of state government spending.

What else do states spend money on? In this section you will look at patterns of taxing and spending by state and local governments.

State Budgets

Like families and individuals, governments must plan their spending ahead of time. The federal government has just one budget for all kinds of spending. States have two budgets: operating budgets and capital budgets.

Operating Budgets

A state's **operating budget** pays for day-to-day expenses. Those include salaries of state employees, supplies such as computers or paper, and maintenance of state facilities, from the state capitol to recreation areas and roadside parks.

Capital Budgets

A state's **capital budget** pays for major capital, or investment, spending. If the state builds a new bridge or building, the money comes from this budget. Most of these expenses are met by long-term borrowing or the sale of bonds.

operating budget *budget for day-to-day expenses*

capital budget *budget for major capital, or investment, expenditures*

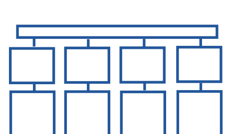
▲ **State colleges and universities, such as the University of Texas at Austin, receive state funding.**

Graphing the Main Idea

BUILDING KEY CONCEPTS

Government To build understanding of the ways in which state and local **governments** collect and spend taxes, ask students to complete a tree map graphic organizer like the one at the right. Remind students that a tree map shows the main topic, main ideas or divisions, and supporting details. They should place the title of the section in the top box and the main headings in the next row of boxes, followed by supporting details.

Section Reading Support Transparencies A template and the answers for this graphic organizer can be found in Chapter 14, Section 4 of the Section Reading Support Transparency System.



Section 4

State and Local Taxes and Spending

Objectives You may wish to call students' attention to the objectives in the Section Preview. The objectives are reflected in the main headings of the section.

Bellringer Ask students who purchased their economics textbooks or who provides the buses and trains that transport people around your community. (Adjust questions as needed to reflect state or local expenditures.) Explain that this section will discuss how state and local taxes are used.

Vocabulary Builder Ask students to review the meaning of each key term and to give a real-life example of the term or of a situation in which they would encounter an example of the term.

Lesson Plan

Teaching the Main Concepts L3

1. Focus Like the federal government, state and local governments collect taxes to finance the operations of the government and to provide services for their populations. Have students list services that their local taxes provide.

2. Instruct Begin by explaining the difference between an operating budget and a capital budget. Then discuss the various ways in which states spend their tax dollars. Next, talk about the kinds of taxes that states collect and how they are similar to and different from federal taxes. Finally, explain what is meant by local government, and discuss the taxation and spending policies of such governments.

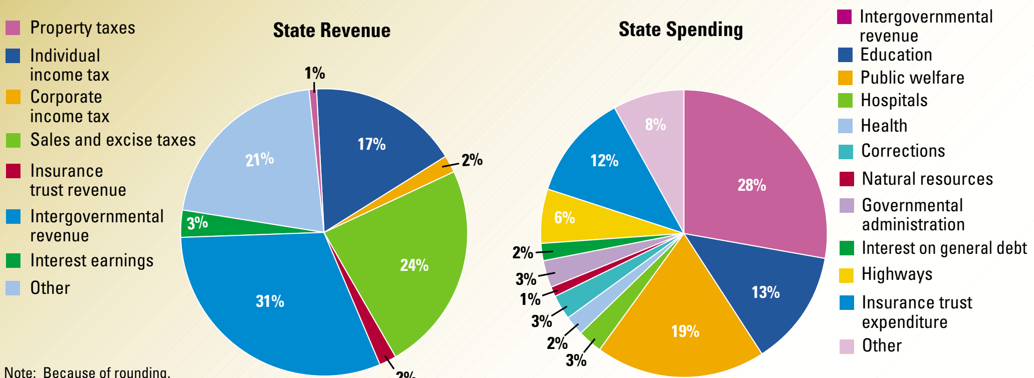
3. Close/Reteach In addition to funds distributed by the federal government, state budgets are supported by taxes levied at the state and local levels. Ask students to list the types of services that state and local governments offer.

Guided Reading and Review
Unit 6 folder, p. 8 asks students to identify the main ideas of the section and to define or identify key terms.

Differentiated Instruction L3
(Reteaching) Have students work in pairs to complete this activity. Ask them to create two lists: one titled "Operating Budget" and the other titled "Capital Budget." Have students include at least five expenses in each list. Expenses in the capital budget list should be based on actual capital improvements in your state. Ask pairs to review their lists, discuss why they placed each item in each list, and correct misplaced expenses.

Learning Styles Activity
Learning Styles Lesson Plans folder, p. 34 asks pairs of students to create circle graphs showing how a state allocates its revenue to its operating budget.

Figure 14.7 **State Revenue and Spending, 2002**



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: U.S. Census Bureau

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Web Code: mng-6145

Major sources of state revenue include individual income taxes, sales and other taxes, insurance premiums, and local and federal funds ("intergovernmental revenue").
Government **What are the major categories of state government spending?**

balanced budget *budget in which revenues are equal to spending*

Balancing State Budgets

In most states, the governor prepares the budget with the help of a budget agency. The legislature then discusses and eventually approves the budget.

Unlike the federal government, 49 states require **balanced budgets**—budgets in which revenues are equal to spending. These laws, however, apply only to the operating budget, not the capital budget. That makes it easier to balance state budgets than to balance the federal budget.

Some states can borrow money for several years. In other states, lawmakers must cut programs or raise taxes to balance the budget. In the early 2000s, deficits forced cuts and tax hikes in many states.

Where Are State Taxes Spent?

Spending policies differ among the fifty states. You are probably most familiar with state spending on education, highways, police protection, and state recreation areas. You can see other significant spending categories in Figure 14.7.

Education

Every state has at least one public state university. Some, such as California, have large systems with many campuses throughout the state. In many states, tax dollars also support agricultural and technical colleges, teacher's colleges, and two-year community colleges.

State governments also provide financial help to their local governments, which run elementary, middle, and high schools. Some states pay a larger share of local schools' costs than other states do. The amount of money that each state spends per student also varies. The national average is $7,920 per student per year.

Public Safety

State police are a familiar sight along the nation's highways. This police force enforces traffic laws and helps motorists in emergencies. State police also maintain crime labs that can assist local law-enforcement agencies.

State governments build and run corrections systems. These institutions house people convicted of state crimes.

Answer to . . .
Building Key Concepts
Intergovernmental revenue, insurance trust expenditure, education, and public welfare

Econ 101: Key Concepts Made Easy

Monetary and Fiscal Policy Help students understand **balanced budgets** by drawing an analogy to two common types of credit cards—one with revolving credit and one without. In the latter case, card holders are obligated to pay their monthly balances in full, so they can only spend as much as they are willing and able to pay at the end of each billing cycle. In other words their credit card budgets are in balance at the end of each month. A card that carries revolving credit, however, requires cardholders to pay only a portion of the monthly balance. In this case, the holders' credit card budgets may not be balanced—they may maintain a deficit.

Ask students why they think states are required to balance their operating budgets. Then ask how the existence of a deficit affects a governmental organization.

Highways and Transportation

Building and maintaining highway systems is another major state expense. State crews resurface roads and repair bridges. Some money for roads comes from the federal government. In turn, states contribute money to federal and interstate highway systems.

States pay at least some of the costs of other kinds of transportation facilities, such as waterways and airports. Money for such projects may also come from federal and local government budgets.

Public Welfare

States look after the health and welfare of the public in various ways. State funds support some public hospitals and clinics. State regulators inspect water supplies and test for pollution.

As you read in Section 2, states also help pay for many of the federal programs that assist individuals, such as unemployment compensation benefits. Because states determine their own benefits, they can meet local needs better than the federal government can. For example, during a local recession, they may decide to extend the number of weeks that people can claim benefits.

Arts and Recreation

If you've hiked in a state forest or picnicked in a state park, you've enjoyed another benefit of state tax dollars. Parks and nature reserves preserve scenic and historic places for people to visit and enjoy. States also run museums and help fund music and art programs.

Administration

Besides providing services, state governments need to spend money just to keep running. Like the federal government, state governments have an executive branch (the governor's office), a legislature, and a court system. State tax revenues pay the salaries of all these and other state workers, including maintenance crews in state parks, the governor, and state court judges.

State Tax Revenue

For every dollar a state spends, it must take in a dollar in revenue. Otherwise, it cannot maintain a balanced budget. The 50 states now take in more than $500 billion a year from taxes. Where does this money come from? Sales and individual income taxes provide the largest part of state revenues. The pie chart on the left in Figure 14.7 shows you other sources of state revenue.

Limits on State Taxation

Just as the United States Constitution limits the federal government's power to tax, it also puts limits on the states. Because trade and commerce are considered national enterprises, states cannot tax imports or exports. They also cannot tax goods sent between states.

State governments cannot tax federal property, such as military bases. Nonprofit organizations, religious groups, and charities are usually **tax exempt**; that is, they are not subject to taxes.

tax exempt *not subject to taxes*

◀ **Funds for plowing state highways are included in state budgets. Would you expect these funds to be included in a state's operating budget or capital budget?**

Differentiated Instruction L4

You may wish to have students add the following to their portfolios. In many communities education is funded primarily through property taxes. Some economists, however, believe that using this method of taxation to support education is unfair. Ask students to research the issue and write a position paper in which they define the issue, state the arguments, and then give an opinion. Remind students that their opinions should be backed by sound reasoning and by evidence such as statistics and judicial decisions. GT

Economics Assessment Rubric

Economics Assessment Rubrics folder, pp. 22–23 provides sample evaluation materials for a position paper.

Differentiated Instruction L3

Ask students to create a web graphic organizer that shows where state taxes are spent. They should use the categories listed in the section but also add at least two categories that reflect spending in their own state.

Block Scheduling Strategies

Consider these suggestions to take advantage of extended class time:

- Extend the second activity on this page by obtaining a summary of your state's most recent budget and analyzing it with students. (These are often available on-line at your state's Web site.) Ask questions such as: How much revenue did the state collect? How did the state allocate these resources? What changes might students like to see in the budget? Have students write a paragraph that summarizes their answers to these questions.
- Show the Economics Video Library segment "Private Prisons," about the trend toward privatizing prisons and its effect on state budgets. Have students investigate whether your state has privatized the prison system. If it has, have students research how well the system is working. If it has not, have them find articles on any relevant debate that may be occurring in your state.

Answer to . . .

Photo Caption These funds would be included in the operating budget because plowing keeps state-owned roads operating properly.

Meeting NCEE Standards

Use the following benchmark activity from the **Voluntary National Content Standards in Economics** to evaluate student understanding of Standard 16.

Explain why state and local governments use public money to pay for elementary education and why tobacco and gasoline are heavily taxed.

Differentiated Instruction L1

Have students research their own state's taxes. Use a search engine and key words such as "taxes," or "revenue" and your state name. Make a list of all the types of taxes that your state uses. What are the main sources of revenue? SN

real property *physical property such as land and buildings*

personal property *possessions such as jewelry, furniture, and boats*

Sales Tax

As Figure 14.7 shows, sales taxes are a main source of revenue for state governments. As you read in Section 1, a sales tax is a tax on goods and services. The tax—a percentage of the purchase price—is added on at the cash register and paid by the purchaser.

All but a few of the 50 states collect sales taxes. Sales tax rates range from 3 to 8 percent. Some local governments have their own, additional, sales tax.

In every state, some categories of products are exempt from sales tax. Many states do not charge sales tax on basic needs such as food and clothing. Some do not tax prescription medicines.

Even states without a sales tax impose excise taxes that apply to specific products and activities. Some are sin taxes—taxes that are intended to discourage harmful behavior—on products like alcoholic beverages and tobacco. Other taxes apply to hotel and motel rooms, automobiles, rental cars, and insurance policies. Many states also tax gasoline. This state gasoline tax is in addition to the federal tax.

State Income Taxes

Individual income taxes are another large contributor to many states' budgets. People pay this state income tax in addition to the federal income tax. Figure 14.7 shows that state individual income taxes contribute about 17 percent of state revenue.

Some states tax incomes at a flat percentage rate (that is, as a proportional tax). Some charge a percentage of a person's federal income tax. Others have progressive rates, with a tax structure like the federal income tax. A few states tax only interest and dividends from investments, not wages and salaries.

Corporate Income Tax

Most states collect corporate income taxes from companies that do business in the state. Some states levy taxes at a fixed, flat rate on business profits. A few charge progressive rates—that is, higher tax rates for businesses with higher profits.

As you can see from Figure 14.7, corporate income taxes contribute only a small percentage of state tax revenues—about 2 percent. Nevertheless, corporate income taxes can influence a state's economy.

Low corporate taxes, along with a well-educated work force and good public services, can make it easier to attract new businesses to a state. Politicians deciding on state corporate tax rates keep this fact in mind when they determine their state's policies.

Other State Taxes

Besides the corporate income tax, businesses pay a variety of other state taxes and fees. Do you want to be a hairdresser, a carpenter, or a building contractor? If so, you will have to pay a licensing fee. A licensing fee is a kind of tax that people pay to carry on different kinds of business within a state.

Some states charge a transfer tax when documents such as stock certificates are transferred and recorded. Other states tax the value of the stock shares that corporations issue.

Many states have rich natural resources, such as gold, oil, natural gas, fish, or lumber. Some states place a tax, called a severance tax, on companies that take (or "sever") these resources from the state's land and waters.

As you read in Section 2, the federal government taxes the estate of a person who has died. States, in turn, usually charge an inheritance tax on the value of the property that goes to each heir.

Some states also tax property. That includes **real property,** such as land and buildings, or "real estate." It also includes **personal property,** such as jewelry, furniture, and boats. Some states even tax intangible property, such as bank accounts, stocks, and bonds. Today, however, most property taxes, especially on real estate, are levied by local governments.

FAST FACT

New Hampshire legislators were faced with a dilemma: how to fund the state's education system, without placing undue hardship on low- and middle-income taxpayers. Their solution: establish an education trust fund. This fund created a uniform statewide education property tax with provisions for tax relief for certain qualified taxpayers. It also dedicated to education revenue from increases in the tobacco tax and from tobacco settlement funds, as well as from various tax increases on businesses.

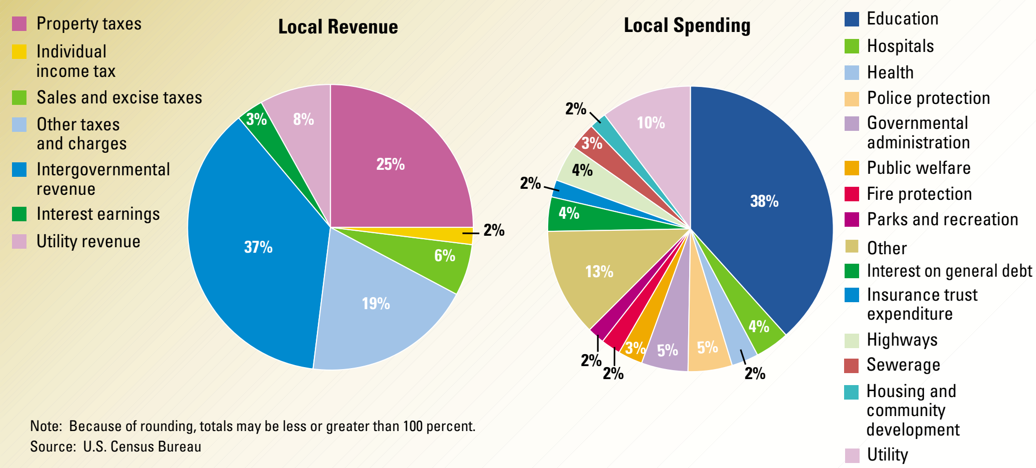
Preparing for Standardized Tests

Have students read the section titled "Limits on State Taxation," and then answer the question below.

Which of the following cannot be taxed by state governments?

A prescription medicines
B corporate income
C individual income
D federal property

Figure 14.8 Local Revenue and Spending, 2002



Note: Because of rounding, totals may be less or greater than 100 percent.
Source: U.S. Census Bureau

Major sources of local revenue include property taxes and state and federal funds ("intergovernmental revenue").
Government **What are the major categories of local government spending? How do they differ from the major categories of state government spending shown on page 376?**

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Local Government Spending and Revenue

Your local government plays a part in many aspects of everyday life, including public grade, middle, and high schools. Local governments hire police and firefighters. They build roads, libraries, hospitals, and jails. They pay teachers. Even though this is the level of government closest to you, it may be the one you know the least about.

Forms of Local Government

You probably think of "local government" as a town or city. There are other types as well, including townships, counties, and special districts, such as school districts. All units of local government are created by the state government. The state gives them their powers and authority.

Today, there are more than 87,000 local government units in the United States. Together they collect about $370 billion in tax revenues.

The Jobs of Local Government

Local governments carry major responsibilities in these areas:

- Public school systems
- Law enforcement (local police, county sheriff's departments, park police)
- Fire protection
- Public facilities such as libraries, airports, and public hospitals
- Parks and recreational facilities such as beaches, swimming pools, and zoos
- Public health (restaurant inspectors, water treatment plants, sewer systems)
- Public transportation
- Elections (voter registration, preparation of ballots, election supervision, vote counting)
- Record keeping (birth/death certificates, wills, marriage licenses, and the like)
- Social services (food stamps, child care and welfare, and similar programs)

Many of these responsibilities are reflected in the graph showing local spending (above right). In some towns and cities, separate commissions or private

Interdisciplinary Connections: Literature

Tax Protesters in Literature In 1819 Scottish writer Sir Walter Scott published *Ivanhoe*. The novel included a character named Locksley, based on the infamous English outlaw Robin Hood. According to legend, Robin Hood had his own ideas about unfair taxation. When the poor could not afford to pay the king's ever-increasing taxes, their property was often confiscated or destroyed—usually by the evil sheriff of Nottingham. Some stories portray Robin Hood as redistributing the country's wealth by stealing from the rich and sharing what he obtained with the poor. Whether or not such a person actually existed is still debated by scholars, but the figure of Robin Hood remains one of the most beloved tax protesters in western culture.

Making the Connection Have students find ballads, stories, or other sources that talk about the exploits of Robin Hood. Ask them to consider the legend of Robin Hood and provide examples of how federal, state, and local governments redistribute wealth.

Differentiated Instruction L3

Obtain a detailed map of the area covered by your local government (such as a county or township). Display it on a bulletin board or an easel. Then ask students to list your local government's sources of revenue. After you have compiled a list, ask students to think about how this money is spent locally. Have individual students point out areas on the map that show where local government revenues are spent (such as schools, fire stations, libraries, and parks).

Transparency Resource Package
Economics Concepts, 14G: State and Local Spending

Economic Detective Activity
Unit 6 folder, p. 12, "The Future of Centerville," provides an integrated application of chapter concepts.

Answer to . . .

Building Key Concepts Education and "other" are the major categories. Some categories that were important in state government spending (intergovernmental revenue, insurance trust expenditure) are much less significant for local government.

Guide to the Essentials
Chapter 14, Section 4, p. 61 provides support for students who need additional review of the section content. Spanish support is available in the Spanish edition of the guide on p. 61.

Quiz Unit 6 folder, p. 9 includes questions to check students' understanding of Section 4 content.

Presentation Pro CD-ROM
Quiz provides multiple-choice questions to check students' understanding of Section 4 content.

Answers to . . .

Section 4 Assessment

1. An operating budget covers day-to-day expenses. A capital budget covers major expenditures such as buildings and other permanent improvements.
2. A balanced budget is a budget in which revenues are equal to spending.
3. The main sources of state revenue are sales taxes and individual income taxes. Property taxes are the main source of local government revenue.
4. Real property is physical property, such as land and buildings. Personal property consists of possessions such as jewelry, furniture, and boats.
5. (a) federal income taxes (b) approximately $3,334
6. Students should submit a well-organized essay that demonstrates understanding of local expenditures. The essay should express agreement or disagreement with the expenditures, supporting this opinion with facts and logic.

▲ **Local taxes pay for city and town recreation areas like this playground.**

tax assessor *an official who determines the value of a property*

corporations carry out some of these jobs. You can see, though, that local governments touch our lives every day.

Property Taxes

Property taxes are levied on property owners in local communities to offset the expense of services such as street construction or maintenance. An official called a **tax assessor** determines the value of the property. Property taxes are usually figured as a fixed dollar amount per $1,000 of the assessed value. They are a main source of funding for public schools.

Other Local Taxes

Local taxes are similar to the types of taxes imposed by the states. Besides property taxes, local governments levy sales, excise, and income taxes. These taxes affect not only residents of a community but also visitors. In fact, many are designed specifically to raise revenue from nonresidents.

Suppose you've gone on a school trip to New York City. The room rate for your hotel is $200 a night. When you see the bill in the morning, however, it's $229.25! Three different taxes have been added—an 8.625 percent sales tax, a 5 percent city tax, and a $2 per room occupancy tax. Many other cities have taxes aimed at tourists and business travelers. They include sales taxes on hotel rooms and rental cars, airport taxes, and taxes on movie or theater tickets.

Some large cities collect income taxes as payroll taxes. In these cities, many workers are commuters who pay property taxes and sales taxes in the suburbs where they live. If the city did not take taxes from their paychecks, these workers would get a "free ride" on the city's services. They would be using police, street cleaning, and other services paid for only by the people who live in the city.

Section 4 Assessment

Progress Monitoring *Online*
For: Self-quiz with vocabulary practice
Web Code: mna-6148

Key Terms and Main Ideas

1. Describe the difference between a state's **operating budget** and its **capital budget.**
2. What is a **balanced budget?**
3. What are the main sources of state revenue? How do they differ from the main sources of local revenue?
4. Describe the difference between **real property** and **personal property.**

Applying Economic Concepts

5. ***Using the Databank*** Study the bar graph showing Income Taxes per Capita on page 542 of the Databank. **(a)** Which are higher, federal income taxes or state and local income taxes? **(b)** How much are total income taxes per capita?
6. ***You Decide*** Turn to Figure 14.8 and study the main categories of local spending. Write a brief essay stating whether you agree with the spending priorities shown on the graph.

Go Online PHSchool.com
For: Research Activity
Visit: PHSchool.com
Web Code: mnd-6144

Progress Monitoring *Online*
For additional assessment, have students access Progress Monitoring Online at **Web Code:** mna-6148

Go Online PHSchool.com Typing in the Web Code when prompted will bring students directly to detailed instructions for this activity.