Taxes and Government Spending

Chapter 14

Essential Questions

UNIT 6:
What is the proper role of government in the economy?

CHAPTER 14:
How can taxation meet the needs of government and the people?

Introduce the Chapter

ACTIVATE PRIOR KNOWLEDGE
In this chapter, students will learn about taxes and government spending policies. Tell students to complete the warmup activity in their Essential Questions Journal.

DIFFERENTIATED INSTRUCTION KEY

- LS Special Needs
- LA Basic to Average includes
  - ELL English Language Learners
  - LPR Less Proficient Readers
- LA All Students
- LA Advanced Students


- The Wall Street Journal Classroom Edition Video presents a current topic related to federal taxes.
- Yearly Update Worksheet provides an annual update, including a new worksheet and lesson on this topic.
- On the Go resources can be downloaded so students and teachers can connect with economics anytime, anywhere.

NGSSS

Next Generation Sunshine State Standards

Section 1: LA.1112.1.6, MA.912.A.2.2, SS.912.E.2.8, SS.912.E.3.5
Section 2: SS.912.E.2.8, SS.912.E.2.9
Section 3: LA.1112.1.6, SS.912.E.1.10, SS.912.E.2.3, SS.912.E.2.9
Section 4: LA.1112.1.6, MA.912.A.2.2, SS.912.E.1.10

Block Scheduling

BLOCK 1 Teach Sections 1 and 2 lessons, omitting the Bellringer activity and Extend options.

BLOCK 2 Use the Section 3 Bellringer and How the Economy Works feature to teach Section 3 and teach the Section 4 lesson.

Pressed for Time

Summarizing Organize the class into four groups, assigning each group one of the sections. Use the Jigsaw strategy to have one student from each group learn about and brief three other students—one from each of the other groups—on his or her section.
Focus on the Basics

Students should come away with the following understandings:

**FACTS:** • The government has the need, authority, and power to levy taxes. • Taxes are categorized on the basis of their structure and the tax base. • Taxes are evaluated as good or bad based on their simplicity, efficiency, certainty, and equity and on who bears the burden of the tax.

**GENERALIZATION:** Governments try to devise tax systems that can be considered good and fair, although people disagree about what those terms mean.
**Bellringer**

Write the following quotes on the board. Ask students to choose one and write what they think it means.

*Taxes are what we pay for civilized society.* (Oliver Wendell Holmes, Jr., U.S. Supreme Court Justice)

*The power to tax is the power to destroy.* (John Marshall, U.S. Supreme Court Chief Justice)

*The power of taxing people and their property is essential to the very essence of government.* (James Madison, U.S. President)

**Teach**

**Economics**

To present this topic using digital resources, use the lecture notes on www.PearsonSchool.com/PHecon.

**ELL LPR Differentiate** For students struggling with comprehension, assign the Vocabulary worksheet (Unit 6 All-in-One, p. 14).

**Discuss**

Call on students to offer their answers to the Bellringer activity. Discuss why taxation is a topic on which everyone has an opinion. Remind students of the rallying cry of the American Revolution, *No taxation without representation.* Ask *Why were the colonists protesting against taxes imposed on them by the British Parliament?* (They had no representation in Parliament.) Ask *Why do you think the British felt that the colonists should pay taxes?* (The British felt they were providing services, like defense, that the colonists would not have had otherwise.)

Ask *Who determines what taxes Americans will pay?* (the U.S. Congress, state legislatures, and local governing bodies) *Who elects congressional, state, and local representatives?* (voters) *How is this different from the situation of the American colonists?* (Americans today elect their representatives, who enact taxes. The colonists did not have representation in the British Parliament.)

Finally, ask students *Where does the federal government get the power to tax?* (from the people and the Constitution)

(lesson continued on p. 366)

**Answer**

**Checkpoint** to have money so it can provide goods and services

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**Differentiated Resources**

**ELL LPR Guided Reading and Review** (Unit 6 All-in-One, p. 16)

**Vocabulary worksheet** (Unit 6 All-in-One, p. 14)

**A Good Tax?** (Unit 6 All-in-One, p. 18)

**The Flat Tax** (Unit 6 All-in-One, p. 19)
**Teach Visual Glossary**

**Review Key Terms**
Pair students and have them write the definitions of the key terms related to the understanding of progressive taxes.

- **economic growth** – a steady, long-term increase in real GDP
- **tax** – a required payment to a local, state, or national government
- **revenue** – income received by a government from taxes and other sources

**Compare Graphs**
Direct students’ attention to the three bar graphs. Ask **How are the three graphs similar?** (At each income level, the first $25,000 in earnings is taxed at the same rate, 15 percent.) **How are they different?** (The two higher incomes have the remainder of their incomes taxed at higher rates.) Have students connect these similarities and differences to the definition of a progressive tax.

**Differentiate**
- Suggest that students draw a series of three steps in their notebooks, labeling the bottom step 15%, the second step 25%, and the third step 30%. Have them use the steps as a reminder of the idea that progressive taxes increase as income increases.
- Ask mathematical learners **What is the overall tax rate for each of the three income levels?** (found by dividing total amount of taxes by total income: $25,000—15 percent; $75,000—21.7 percent; $100,000—23.75 percent)

**Answers**
- **Graph Caption** $13,750 ($3,750 on first $25,000 and $10,000 on next $40,000)
- **Cartoon** Possible response: The millionaire is complaining about being taxed at a higher rate than the worker.
Display the “Progressive and Regressive Taxes” transparency (Color Transparencies, 14.a). Explain to students that the graph estimates the proportion of income that households at three income levels would pay in taxes in the state of Indiana. Make sure students understand that the percentages show a proportion of income, not tax rates. Ask How does the proportion of income paid for state income tax differ for these three households? (3 percent for the lowest-income household, just under 4 percent for the middle-level household, just over 4 percent for the highest-income household) What is the structure of this income tax? Why? (It is progressive because the percentage of income paid goes up as income goes up.)

Ask What percentage of income goes to the state sales tax? (The percentage falls from a high of about 3.3 percent for the lowest-income household to a low of about 1.4 percent for the highest-income household.) What structure does that tax have? (It is regressive because the percentage of income paid for this tax decreases as income increases.)

Ask What is the structure of the gasoline tax? Why? (It is also regressive because the proportion declines as income increases.) Ask Why does the incidence of a tax on gasoline fall most heavily on the consumer? (Demand for gasoline is relatively inelastic in the short run.)

Have students review the Action Graph animation for a step-by-step look at Elasticities of Demand and Tax Effects.

Differentiate Explain to students that some states institute tax holidays, during which no sales tax is charged for certain goods, at particular times of the year. Ask students to research the sales tax rates in their community, county, and state, and show which items are or are not subject to sales tax, and the existence of any sales tax holidays. Students should prepare a chart for distribution. Note that some states do not have a sales tax.

Background Note

Sales Tax Exemptions Several state governments have tried to lessen the regressive nature of sales taxes by exempting goods that are judged to be essential from the general sales tax. Eleven states and the District of Columbia do not levy sales tax on food or medicines, either prescription or over the counter. More than twenty others exempt food and prescription drugs, though not over-the-counter medications. Some states retain the sales tax on such goods but at a lower rate. In Illinois, the 6.25% sales tax is cut to only 1% on food and medicines.
different set of answers. Graph A represents the effect of a gasoline tax when demand is inelastic. Graph B reflects elastic demand.

Both graphs 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 every price level.

Before the tax, the market was in equilibrium, and consumers bought gas at $1.00 per gallon. This is shown as point i on both graphs. 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” a portion of 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.

**CHECKPOINT Who bears the greater burden of a tax when demand is inelastic?**

### Characteristics of a Good Tax

Although 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** Tax laws should be simple and easily understood. Taxpayers and businesses should be able to keep the necessary records and pay the taxes on a predictable schedule.
- **Efficiency** Government administrators should be able to assess and collect taxes without spending too much time or money. Similarly, taxpayers should be able to pay taxes without giving up too much time or paying too much money in fees.

### Taxes Around the World

<table>
<thead>
<tr>
<th>Country</th>
<th>Percent of Earnings Paid in Income and Social Security Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>5%</td>
</tr>
<tr>
<td>Korea</td>
<td>10.6%</td>
</tr>
<tr>
<td>Ireland</td>
<td>14.8%</td>
</tr>
<tr>
<td>Japan</td>
<td>19.5%</td>
</tr>
<tr>
<td>United States</td>
<td>23.4%</td>
</tr>
<tr>
<td>Canada</td>
<td>24.2%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>26.8%</td>
</tr>
<tr>
<td>Sweden</td>
<td>31.1%</td>
</tr>
<tr>
<td>Denmark</td>
<td>40.9%</td>
</tr>
<tr>
<td>Germany</td>
<td>42.7%</td>
</tr>
</tbody>
</table>

*Source: OECD, Economic Outlook No. 79, June 2006*

In this activity, students will work in small groups to predict the outcome of various situations.

**LESSON TITLE** | **CAN TAXES BE INCENTIVES?**
---|---
Type of Activity | Small group
Complexity | Low
Time | 60 minutes
NCEE Standards | 4, 16

**VIRTUAL ECONOMICS**

**L3** **Differentiate** Predicting How Taxes Affect People Use the following lesson from the NCEE Virtual Economics CD-ROM to explore how taxes can be incentives. Click on Browse Economics Lessons, specify grades 9–12, and use the key words taxes be incentives.

**SS.912.E.3.35** Compare the current U.S. economy with other developed nations.

### Global Impact

**ASSIGNMENT** Distribute the worksheet “A Good Tax?” (Unit 6 All-in-One, p. 17). Review with students the four criteria described in the text for determining if a tax is a good tax. Encourage students to describe each of the four criteria in their own words. Then have students study and analyze the cartoon and answer the questions.

**EXTEND**

Have students return to the three quotes in the Bellringer. Have them choose one and write a paragraph in which they agree or disagree with the view and explain why.

**L4** **Differentiate** Distribute the worksheet “The Flat Tax” (Unit 6 All-in-One, p. 19). Have students read the pros and cons of a proportional or flat tax, answer the questions, and state their own views.

**GUIDING QUESTION WRAP UP**

Have students return to the section Guiding Question. Review the completed graphic organizer. Have a discussion about the features of a tax system.

**ASSESS AND REMEDIATE**

**L3** **L2** **L4** Collect the “A Good Tax?” and “The Flat Tax” worksheets and assess student understanding of tax systems.

**L3** Assign the Section 1 Assessment questions.

**L3** Give Section Quiz A (Unit 6 All-in-One, p. 20).

**L2** Give Section Quiz B (Unit 6 All-in-One, p. 21).

( Assess and RemEDIATE continued on p. 368)

**ANSWERS**

**Checkpoint**

**Global Impact** different tax bases, different government services
Have students complete the Self-Test Online and continue their work in the Essential Questions Journal.

**REMEDICATION AND SUGGESTIONS**

Use the chart below to help students who are struggling with content.

<table>
<thead>
<tr>
<th>WEAKNESS</th>
<th>REMEDIATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying key terms (Questions 3, 4, 5, 6, 7)</td>
<td>Have students use the interactive Economic Dictionary Online.</td>
</tr>
<tr>
<td>Describing tax bases and structures (Questions 6, 7, 9, 10)</td>
<td>Have students identify every tax that they are aware of that they or members of their families pay. Have them discuss and identify the tax base and tax structure for each.</td>
</tr>
<tr>
<td>Identifying who bears the burden of a tax (Question 10)</td>
<td>Reteach the concept using the Action Graph online.</td>
</tr>
</tbody>
</table>

**Checkpoint**

Only those who use gas pay the tax.

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**Answers**

**Caption** Only those who use gas pay the tax.

**Checkpoint** simplicity, efficiency, certainty, equity

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**Assessment Answers**

1. Possible response: They have regressive, progressive, proportional structures; taxes evaluated for simplicity, equity, efficiency, and certainty.

2. Possible responses: income tax, sales tax from the people and the Constitution money collected from taxes and other sources

3. Where does the U.S. government get the power to impose taxes today?

4. What is a government’s revenue?

5. Federal taxes must be for the common good and the same in every state.

6. goods and services that are sold

7. They would both pay the same percentage.

8. (a) Taxes are collected in short time at low cost. (b) Efficiency reduces waste, allowing more revenue to be spent on goods and services rather than on collecting the tax itself.

9. With a progressive tax, people with a higher income pay a higher percentage of their income in tax. By contrast, with a regressive tax, the percentage of income paid in taxes goes down as income increases.

10. Possible responses: (a) consumers (b) because demand is inelastic—people need toothpaste.

11. $41.04 ($38 + $3.04)
**Focus on the Basics**

Students should come away with the following understandings:

**FACTS:**  
- The largest source of federal revenue is individual income taxes.  
- Corporations also pay income tax, but those taxes contribute a small share of federal revenue.  
- Social insurance taxes that fund Social Security and Medicare are another major source of federal revenue.

**GENERALIZATION:** Changes in income and social taxes would greatly affect federal revenues.

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**What taxes does the federal government collect?**

**Get Started**

Copy this table and fill it in as you read.

<table>
<thead>
<tr>
<th>Type of Tax</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income</td>
<td>On business earnings. Difficult to calculate due to deductions. Progressive.</td>
</tr>
<tr>
<td>Excise</td>
<td>On goods such as gas, cigarettes, cable TV</td>
</tr>
<tr>
<td>Import</td>
<td>Tariffs on imported goods.</td>
</tr>
</tbody>
</table>

**GRAPH SKILLS**

The main sources of federal revenue are the taxes shown on this graph.

1. What are the largest sources of federal revenue shown on the graph?
2. What percentage of federal revenues does not come from individual and corporate income taxes?

**SOURCE:** The Internal Revenue Service, U.S. Department of Treasury

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**NGSSS**

- SS.912.E.2.8 Differentiate between direct and indirect taxes.
- SS.912.E.2.9 Analyze how changes in federal spending affect budget deficits, surpluses, and the national debt.
Chapter 14 • Section 2

BELLRINGER

Have students review the sample earnings statement on page PF 45 and identify three taxes collected by the federal government. Calculate what percentage of the gross pay is withheld for taxes that go to the federal government.

Teach

Economics To present this topic using digital resources, use the lecture notes on www.PearsonSchool.com/PHecon.

DISCUSS BELLRINGER

Call on volunteers to give their Bellringer responses. Ask students to determine what percentage of their pay they see in their paycheck. (average for teens is between 50 and 75 percent) Discuss how mandatory withholding (established by law in 1943) makes it easier for the federal government to collect taxes and reduce taxpayer resistance.

L1 L2 Differentiate Assign each of several students a wage rate of $100 a week. Tell them they will be paid their weekly wage minus the amount withheld to pay taxes. Have them subtract each of the following percentages from their $100 wage: Federal income tax, 10%, Social Security tax, 6.2%, and Medicare tax, 1.45%. Call on the students to state how much will be withheld from their pay ($17.65) and how much take-home pay they will receive ($82.35).

PERSONAL FINANCE ACTIVITY

This would be a good time to use the Personal Finance Handbook lesson on paying taxes (pp. PF46–47) and complete the worksheet (Personal Finance All-in-One, pp. 111–112). Students will have a hands-on opportunity to complete a W-4 form and complete a 1040EZ based on a W-2 form. (lesson continued on p. 372)

Answers

Table Skills 1. $4,481.25 plus 25 percent of the amount over $32,550 = $11,865 ($8,962.50 plus $2,475 [25 percent of $9,900, the amount of income over $65,100]).

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 most of their income tax throughout the calendar year as they earn income. They have until mid-April of the following year to pay any additional income taxes they owe.

Tax Brackets

The federal income tax is a progressive tax. In other words, the tax rate rises with the amount of taxable income. The 2008 tax rate schedules shown in Figure 14.3 both have six rates, defined in the column headed “the tax is.” Each applies 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 $16,050 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 $357,700. Each year, the IRS publishes new tax rate schedules that reflect any changes in the federal tax code.

Tax Withholding

Employers are responsible in part for carrying out the system of 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.

Filing a Tax Return

After the calendar year ends, employers give their employees a report stating how much income tax has already been withheld and sent to the government. The employer uses that information to complete 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 how much of that income is taxable.

Differentiated Resources

L1 L2 Guided Reading and Review (Unit 6 All-in-One, p. 23)

L2 Comparing Tax Situations (Unit 6 All-in-One, p. 26)

L4 Calculating Federal Income Tax (Unit 6 All-in-One, p. 24)
The Price of Being Rich

TAXATION

The IRS uses audits to crack down on people who may not be paying all the taxes they’re supposed to. Now, a lot of high-income earners are feeling the heat.

By Tom Herman
The Wall Street Journal

The Internal Revenue Service is turning up the heat on high-income taxpayers, especially those who work for themselves.

Internal Revenue Service officials say audits of taxpayers making $100,000 or more rose 14% in 2007 from 2006. Recent IRS data also show a 29% increase in audits of people making $200,000 or more—and an 84% surge in audits of those with incomes of $1 million or more.

The push comes as the agency faces heavy pressure from Congress to raise additional revenue and shrink the nation’s $290 billion “tax gap,” or the difference between what’s collected and what should be collected each year. IRS research indicates much of the tax-noncompliance is committed by self-employed workers, such as consultants and small-business owners, whose taxes aren’t withheld from their paychecks and whose income isn’t reported separately to the government. By contrast, compliance is much higher among people whose pay is reported by their employers and whose taxes are withheld from their pay.

It’s not just Americans who face the IRS’s intensified crackdown. IRS officials say they have uncovered “significant noncompliance” among foreign athletes, such as golf and tennis stars, and foreign musicians who perform in the U.S., says Barry Shott, an IRS deputy commissioner.

IRS officials won’t divulge any names of foreign athletes or entertainers under scrutiny. But Mr. Shott says the cases involve not only taxation of prize money won by athletes competing in U.S. events but also product-endorsement money.

The IRS relies on numerous techniques to choose which returns are audited. Many returns are selected on the basis of a secret computerized-scoring system. Computer programs assign each tax return a score that evaluates the potential for inaccuracies, based on the IRS’s experience with similar returns.

Many returns are picked because of “mismatches”—something a taxpayer reported doesn’t match what was reported separately to the IRS by employers, banks or other financial institutions. Some returns get selected because of a tip from confidential informants, such as former business partners, ex-spouses or an angry neighbor.

Answer

Applying Economic Principles costs: auditor salaries, cost of collecting debts; benefits: increased revenue, increased tax compliance.
Comparing and Contrast

Distribute the “Comparing Tax Situations” worksheet (Unit 6 All-in-One, p. 25). Explain to students that people with identical incomes often pay different amounts of federal income tax based on their circumstances. The worksheet presents four people with the same income and the federal income tax they pay after adjustments.

Have students complete the worksheet to see the different impact of these adjustments to taxes.

Differentiate

- Distribute the “Comparing Tax Situations” worksheet (Unit 6 All-in-One, p. 26). Have students answer the questions.
- Distribute the “Calculating Federal Income Tax” worksheet (Unit 6 All-in-One, p. 24). Have students calculate federal income tax and answer questions about withholding allowances.

Answers

Caption Gross income, personal exemptions, tax exemptions, taxable income, any tax credits, amount withheld, and whether there is a tax due or a refund to be received.

Checkpoint Personal exemptions are available to all taxpayers for each taxpayer and any dependents he or she supports. Tax deductions are available only to those taxpayers who have the expenses that can be deducted.

Checkpoint Businesses can take many deductions, which affects their taxable income.

Virtual Economics

Differentiate

- Estimating Tax Revenue Use the following lesson from the NCEE Virtual Economics CD-ROM to examine the categories of federal taxes. Click on Browse Economics Lessons, specify grades 6–8, and use the key words federal taxes.

In this activity, students will estimate the level of taxes in various situations and analyze the sources of government revenue.

<table>
<thead>
<tr>
<th>LESSON TITLE</th>
<th>WHERE DOES THE MONEY COME FROM?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Activity</td>
<td>Using statistics</td>
</tr>
<tr>
<td>Complexity</td>
<td>Moderate</td>
</tr>
<tr>
<td>Time</td>
<td>100 minutes</td>
</tr>
<tr>
<td>NCEE Standards</td>
<td>16</td>
</tr>
</tbody>
</table>
From the start, Social Security provided old-age pensions and unemployment insurance 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 2008, the cap was $102,000. 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 healthcare 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 there is 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.

CHECKPOINT What is the Medicare program?

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.

As of 2008, if the total value of an estate is $2 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 $3 million estate.

Gift Taxes
The gift tax is a tax on the 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 large amounts each year. Under current law, a person can give up to $12,000 a year tax-free to each of several different people.

Import Taxes
Taxes on imported goods (foreign goods brought into the country) are called import taxes. These goods are charged duties, or fees, by the United States government. The duties are intended to protect American industries and to promote the sale of domestic products.

Social Insurance Tax Contributions
Individuals pay taxes into the Social Security and Medicare funds. Those payments are matched by employers, which pay at the same rate. Thus, every dollar collected in taxes from a worker is equaled by a dollar collected from that worker’s employer. Self-employed workers—those who work for themselves—pay twice the tax rate of employees, but that rate is equal to the combined employee-employer rate. These individuals can take some tax credits on their Social Security tax to lessen the overall tax burden.

Background Note
Social Insurance Tax Contributions
Individuals pay taxes into the Social Security and Medicare funds. Those payments are matched by employers, which pay at the same rate. Thus, every dollar collected in taxes from a worker is equaled by a dollar collected from that worker’s employer. Self-employed workers—those who work for themselves—pay twice the tax rate of employees, but that rate is equal to the combined employee-employer rate. These individuals can take some tax credits on their Social Security tax to lessen the overall tax burden.

CHECK UNDERSTANDING
Remind students that income taxes are not the government’s only source of revenue. Ask How do excise, estate, gift, and import taxes differ from these two taxes? (excise, import taxes: paid only by consumers who purchase certain goods; estate, gift taxes: paid only by people who dispose of wealth in certain ways and above certain amounts.)

DIFFERENTIATE Suggest that students use a two-column graphic organizer to take notes on the different types of taxes. They should put the name of the tax in the first column and the definition in the second.

EXTEND
Explain that some critics say estate taxes are unfair because they punish people who have had success. Others favor an estate tax as a limit on the accumulation of wealth in the hands of a few families. Have students research the topic and write an essay in which they express their views.

DIFFERENTIATE Have students explain how the federal government uses taxes and tax credits to try to encourage or discourage certain kinds of behavior.

GUIDING QUESTION WRAP UP
Have students return to the section Guiding Question. Review the completed graphic organizer and clarify any misunderstandings. Have a wrap up discussion about taxes.

Assess and RemEDIATE
Collect the “Comparing Tax Situations” worksheets and assess student understanding of the U.S. tax structure.

Collect the “Calculating Federal Income Tax” worksheet and assess student understanding of tax rates.

Assign the Section 2 Assessment questions.

Give Section Quiz A (Unit 6 All-in-One, p. 27).

Give Section Quiz B (Unit 6 All-in-One, p. 28).

Background Note
Social Insurance Tax Contributions
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Give Section Quiz A (Unit 6 All-in-One, p. 27).

Give Section Quiz B (Unit 6 All-in-One, p. 28).

Answers
Checkpoint a national health insurance program that pays for healthcare for people over age 65

Cartoon through taxes collected from employers
Have students complete the Self-Test Online and continue their work in the Essential Questions Journal.

REMEDIAUTION AND SUGGESTIONS
Use the chart below to help students who are struggling with content.

<table>
<thead>
<tr>
<th>WEAKNESS</th>
<th>REMEDIATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying key terms (Questions 5, 6)</td>
<td>Have students use the interactive Economic Dictionary Online.</td>
</tr>
<tr>
<td>Describing income taxes (Questions 3, 4, 7, 9)</td>
<td>Have pairs of students quiz each other on the individual income tax.</td>
</tr>
<tr>
<td>Explaining Social Security (Question 8)</td>
<td>Have students draw flow chart diagrams showing how Social Security works.</td>
</tr>
</tbody>
</table>

Critical Thinking
7. Predict (a) Explain how “pay-as-you-earn” taxation works. (b) Why is this system important? (c) What might happen if the government did not use this system to collect income taxes?
8. Contrast (a) How are the systems for collecting Social Security and Medicare taxes similar? (b) List one way they are different. (c) Which system of collecting do you think makes more sense?
9. Extend Contributions to charitable organizations such as the American Cancer Society are tax deductible. (a) What does this mean? (b) Explain the reason for this tax policy. (c) What is your opinion of this tax deduction?

Quick Write
10. Based on what you have read in this section about tax incentives, write a short essay answering the following question. What kind of behavior do you think the government should encourage or discourage in its tax policy? How can the government do this through its tax policy?

Answers
Checkpoint excise taxes
Caption tax credits for energy conservation

Assessment Answers
1. individual and corporate income taxes; social insurance, excise, estate, gift, and import taxes
2. Possible responses: Tax credit would convince me to save more; tax on chocolate would force me to buy less chocolate.
3. tax return
4. no; because federal income tax is progressive
5. if you give someone more than $12,000
6. use of tax laws to encourage or discourage certain behaviors
7. (a) Tax payments are withheld from wages. (b) It keeps money flowing into the federal treasury on a regular basis. (c) Government would have to borrow more money to operate.
8. (a) Both are based on and withheld from earnings. (b) Social Security tax has an income cap; Medicare does not. (c) Possible response: Having a cap is a bad idea; all people should pay the same rate.
9. (a) They are taken off gross income, which lowers taxable income. (b) Possible response: It encourages donations to charity. (c) Possible response: It is wise because many charities effectively do needed work.
10. Possible response: The government should encourage people to use less energy by giving tax incentives for conserving fuel.
**Guiding Question**

How does the federal government spend its income?

---

**Federal Spending**

### Mandatory and Discretionary Spending

In reality, when the government receives the $2.8 trillion in the form of taxes, most of it is already accounted for. After the government fulfills all its legal obligations, only about a third of the money remains to be spent.

The graph in Figure 14.4 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 Congress is mandated, or required, by existing law to spend on certain programs or to use for interest payments on the national debt. Other categories, such as defense and education, are discretionary. **Discretionary spending** is spending about which Congress is free to make choices.

**GRAPH SKILLS**

The federal government spends the funds it collects from taxes and other sources on a variety of programs:

1. Which are the three largest categories of expenditures in the federal budget?
2. On which area(s) does the federal government spend more: military and homeland security or dealing with the needs of elderly and retired citizens?

**ECONOMIC DICTIONARY**

As you read the section, look for the definitions of these Key Terms:
- mandatory spending
- discretionary spending
- entitlement

**Focus on the Basics**

Students should come away with the following understandings:

**FACTS:**
- Congress cannot control all the money spent by the federal government; some expenditures are required by law.
- The percentage of mandatory spending has increased over the years while the share of discretionary spending—which Congress can control—has dropped.

**GENERALIZATION:**
Since mandatory spending takes so much of the federal budget, it is difficult for Congress to cut spending or to devote large amounts of money to new programs.

**LESSON GOALS**

Students will:
- Know the Key Terms.
- Distinguish mandatory from discretionary spending.
- Compare and contrast entitlement programs.
- Debate possible solutions to the Social Security financing problem.
- Discuss the impact of rising mandatory spending on discretionary spending.

**BEFORE CLASS**

Have students complete the graphic organizer in the Section Opener or the Guided Reading and Review worksheet (Unit 6 All-in-One, p. 29).

**ELL LPR Differentiate**

Have students complete the Guided Reading and Review worksheet (Unit 6 All-in-One, p. 30).

**Answers**

Graph Skills
1. military, Social Security, Medicare
2. military and homeland security (35%)
BELLRINGER
Have students write a list of every way that they or someone they know benefits from federal spending. Students could review the federal spending chart on page 375 for help.

Teach
Economics
To present this topic using digital resources, use the lecture notes on www.PearsonSchool.com/PHecon.

CATEGORIZE
Call on students to offer their answers to the Bellringer activity. List them on the chalkboard. Then ask Which of these spending areas are mandatory and which are discretionary? (Circle the mandatory spending.)

COMPARE
Direct students’ attention to Figure 14.4 on page 375. Ask What is the total percentage of federal spending that goes to entitlement programs? (53%) Then ask What do Social Security, Medicare, and military and federal employee retirement programs have in common? (All are entitlement programs; all are mandatory spending.)

How do they differ? (Medicare is means-tested; Social Security and military and employee retirement programs are not.) Have students review the How the Economy Works feature on pp. 378–379 to understand more about these programs.

DIFFERENTIATE
Encourage students to create a concept web for each entitlement program. The center shape should have the name of the program, such as Social Security. The outer shapes should contain basic information, such as purpose, covered individuals, whether the program is means-tested or not, and special issues.

FL
SS.912.E.2.3 Research the contributions of key individuals of various backgrounds in the development of the U.S.

Answers
Checkpoint mandatory
Critical Thinking Possible response: By providing payments to the unemployed, elderly, or disabled, the government gives them resources they can use to buy goods, which helps fuel the economy; it is very expensive.

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” benefit from if they meet certain eligibility requirements, such as being at a particular 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. 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 makes up a huge portion of all federal spending. About 50 million Americans receive monthly benefits from the Social Security Administration. Of those beneficiaries, some are disabled workers, but the great majority are retired workers. Many of those retirees rely solely on their Social Security checks to support themselves.

The Social Security system faces an uncertain future today. To understand the
people are “entitled” to Social Security.

Critical Thinking:

Why did Perkins believe that Social Security was a vital need?

The large majority of our citizens need protection against the uncertainties of sickness and old age, and the government has a moral and legal obligation to provide that protection. The government has always provided some kind of insurance to meet these needs, in the form of public assistance. Social Security is a type of insurance and a way of providing that assistance. It is based on the principle that the people who worked hardest in our society should not have to suffer in their old age. Social Security was designed by Perkins to provide a basic income for workers who have already retired.

The system may not reach crisis levels for several decades. But unless something is done, today’s high school students might receive only limited benefits from Social Security when they retire.

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 healthcare bills for people who suffer from certain disabilities and diseases.

Like Social Security, 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 help pay for the program.

Medicare costs have been growing rapidly, partly as a result of expensive technology, but also because people are living longer. The basic problem facing Medicare is the same as that facing Social Security. 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.

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.
DISCUSS
Tell students that while a large part of federal mandatory spending is for healthcare, millions of Americans have gone without health insurance coverage. Have each student bring in a newspaper article about healthcare in America. Have students read the headlines of their articles aloud in class. Ask What aspects of healthcare are people concerned about? How have recent laws changed healthcare in the U.S.? Use the Opinion Line strategy (p. T28) to have students show their opinions about healthcare reform before and after the discussion.

The Deductions

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 and child nutrition. The federal government also pays retirement benefits and insurance for federal workers, as well as veterans’ pensions and unemployment insurance. Some members of Congress have pushed for additional government programs related to healthcare. One reason is that healthcare costs have increased at more than twice the rate of inflation over the last few decades. The average expenditure for healthcare rose from $891 per person in 1960 to $5,670 in 2003. To keep pace, health insurance costs have also skyrocketed. As a result, some 50 million Americans had no health insurance in 2009.

To resolve this problem, leaders have called for either a single-payer system organized by the government, or healthcare tax credits. Others have insisted we rely on market forces. President Obama signed legislation in 2010 that would require uninsured Americans to purchase health insurance through competitive private exchanges in their state. Some low-income families would get government subsidies.

CHECKPOINT What entitlement program costs the federal government the most money?

Defensive Spending
Spending on defense accounts for about half of the federal government’s discretionary spending. The remaining funds available for

Virtual Economics

Differentiate
Comparing Federal Spending Use the following lesson from the NCEE Virtual Economics CD-ROM to help students analyze government spending and the relationship between taxes and political freedom. Click on Browse Economics Lessons, specify grades 9–12, and use the key words scope and size. In this activity, students will use statistics to compare government spending in two periods of U.S. history and compare to other countries.

<table>
<thead>
<tr>
<th>Lesson Title</th>
<th>The Scope and Size of Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Activity</td>
<td>Using statistics</td>
</tr>
<tr>
<td>Complexity</td>
<td>High</td>
</tr>
<tr>
<td>Time</td>
<td>100 minutes</td>
</tr>
<tr>
<td>NCEE Standards</td>
<td>16, 18</td>
</tr>
</tbody>
</table>
discretionary spending are divided among a wide variety of programs.

**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 14.4, defense spending consumes about 19 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. Defense spending, of course, also buys weapons, missiles, battleships, tanks, airplanes, and ammunition equipment.

**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 and training
- scientific research
- student loans
- law enforcement
- environmental cleanup
- disaster aid
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 park rangers, FBI agents, file clerks, senators and members of Congress, geologists, CIA agents, Cabinet secretaries, meat inspectors, and many others.

**CHECKPOINT** Approximately how much of the federal government’s discretionary spending goes toward defense?

---

**Background Note**

**Federal Government Employment**
More than 2.7 million civilians work for the federal government. This total does not include military personnel. Only a small share—about 63,000 people—work for Congress and in federal courts. The vast majority work in the executive branch. Just over 1,700 people work in the Executive Office of the President, which includes the White House staff. Nearly 1.7 million work in the various cabinet departments. More than 945,000 work in the various independent agencies. The U.S. Postal Service, with 760,000, supplies the great majority of these workers, about four of every five.

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**Chapter 14 • Section 3**

**ANALYZE**
Display the “U.S. Projected Population by Age” transparency (Color Transparencies, 14.b). Ask What does the chart show about the age distribution of the U.S. population in the future? (A larger proportion will be older). Ask What implications does the aging of the population have for Medicare and Social Security costs? (Higher costs in the future) Remind students that Medicare and Social Security are forms of mandatory spending. Ask How are these rising costs likely to affect discretionary spending in the future? (There is likely to be less money for such spending.)

**EXTEND**
Have students write an essay on federal aid to states:
- Should aid be proportioned according to each state’s population? • Should the federal government give more to poorer states and less to wealthier ones?

**L4 Differentiate**
Distribute the “Federal Aid to State and Local Governments” worksheet (Unit 6 All-in-One, p. 33). Have students answer the questions.

**L2 LPR Differentiate**
Distribute the “Medicare and Social Security Funding” worksheet (Unit 6 All-in-One, p. 34).

**GUIDING QUESTION WRAP UP**
Have students return to the section Guiding Question. Review the completed graphic organizer and clarify any misunderstandings. Have a discussion about how the federal government spends its income.

**Assess and Remediate**

**L3 L2** Collect the “Problem Solving” skill worksheets and assess student understanding.

**L2 L4** Collect the “Federal Aid to State and Local Governments” worksheet and the “Medicare and Social Security Funding” worksheet and assess student understanding of government aid.

**L1** Assign the Section 3 Assessment questions.

**L3** Give Section Quiz A (Unit 6 All-in-One, p. 35).

**L2 L2** Give Section Quiz B (Unit 6 All-in-One, p. 36).

(Assess and Remediate continued on p. 380)

**Answers**

**Check Your Understanding**
1. to fund its operations 2. Defense, Social Security; Social Security, Medicare

**Checkpoint** about half
Have students complete the Self-Test Online and continue their work in the Essential Questions Journal.

### REMEDIATION AND SUGGESTIONS

Use the chart below to help students who are struggling with content.

<table>
<thead>
<tr>
<th>WEAKNESS</th>
<th>REMEDIATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying key terms (Questions 3, 4)</td>
<td>Have students use the interactive Economic Dictionary Online.</td>
</tr>
<tr>
<td>Mandatory and discretionary spending (Questions 1, 4, 8)</td>
<td>Have students create flash cards with a category of spending on one side and type of spending on the other. Have them test one another.</td>
</tr>
<tr>
<td>Entitlements (Questions 5, 6, 8, 9, 11)</td>
<td>Have students review related content in pairs.</td>
</tr>
</tbody>
</table>

### Answers

**Cartoon** The cartoonist suggests that states are dependent on the power of their representatives in Congress to gain funding.

**Checkpoint** They did not have the resources to deal with the widespread destruction.

### Assessment Answers

1. mainly on mandatory programs but also on discretionary programs
2. Possible response: We all depend on the government for defense and security. School students benefit from government aid to schools. In the future, I may need Social Security.
3. benefits programs in which people with higher income may receive lower benefits or none at all
4. Possible responses: spending on defense, homeland security, education, research
5. people now retired
6. healthcare; lower-income people who have no health insurance
7. Any three: Medicaid, unemployment compensation, other social programs, education, lower-income housing, highway building, mass-transit, healthcare, employment training
8. (a) Amounts spent on mandatory spending are fixed by law; discretionary spending can change from year to year. (b) by changing the law
9. Possible responses: Since benefits are fixed, Congress cannot cut them to control costs; members of Congress might fear that cutting benefits will cost them reelection.
10. (a) because 50 million Americans lack health insurance (b) Uninsured people will buy health insurance through state exchanges.
11. Possible response: Some students might suggest benefits ensuring college tuition or healthcare for all people; others might suggest changing Social Security. Students should offer explanations for the proposals.

### Other Text

Additional federal money goes to the states for education, lower-income housing, highway construction, mass-transit, healthcare, 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.

State and local governments rely on federal aid for a variety of needs. But nothing reveals that reliance as vividly as a disaster. For example, after Hurricane Katrina slammed into coastal Louisiana, Mississippi, and Alabama in 2005, those states did not have the resources to deal with the widespread destruction and human misery that the storm left behind. They looked to the federal government for help. Although critics denounced the federal relief agencies for their slow response, Congress appropriated $116 billion to help the states recover from the disaster.
Economics and You  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 pays part of the cost of running the state colleges. In fact, higher education is one of the largest areas of state government spending.

Principles in Action Because they are democracies, local governments manage their money in accordance with priorities set by elected local government officials. In this section, you will examine these priorities. For example, in the Economics & You feature, you will see that while school tax increases can be painful to the taxpayer, the programs they fund are sometimes essential to quality education and necessary to enriching the school experience.

State Budgets  Like families and individuals, governments must plan their spending ahead of time. That planning involves drawing up a budget. A budget is an estimate of future revenues and expenses. While the federal government has just one budget for planned revenue and expenses, states have two budgets: operating budgets and capital budgets.

Operating Budgets  A state puts together an operating budget to plan for its day-to-day spending needs. Those expenses include salaries of state employees, supplies such as computers and paper, and maintenance of state facilities, such as recreation areas and roadside parks.

Capital Budgets  A state also draws up a capital budget to plan for major capital, or investment, spending. If the state builds a new bridge, the money comes from this budget. Most of these expenses are met by long-term borrowing or the sale of bonds.

Focus on the Basics  Students should come away with the following understandings:

FACTS:  • State governments have operating budgets for ongoing expenses and capital budgets for major investments.  • States rely mainly on sales taxes and income taxes.  • Local governments use property taxes, income taxes, and other taxes to fund a variety of activities.

GENERALIZATION:  State and local governments must make careful decisions to balance spending and revenues.
To present this topic using digital resources, use the lecture notes on www.PearsonSchool.com/PHecon.

The states vary greatly in size, making it difficult to review their lists and volunteer their answers. Call on students to discuss the differences between operating and capital budgets. Then have them review their lists and volunteer their answers.

Differentiate Have students use a two-column graphic organizer to define and compare operating budget and capital budget. Remind them to include whether the budget type must be balanced.

The states vary greatly in size, making it difficult to compare state budgets. Point out that using charts is one way of determining how states compare. Distribute the “Comparing State Spending” worksheet (Unit 6 All-in-One, p. 39). Have students answer the questions.

Stress the importance of balancing budgets in which revenue and spending are equal.

Spending policies differ among the 50 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 14.5.

Every state spends taxpayer money to support 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 public elementary, middle, and high schools. The total amount of money spent per student varies among the states. The national average is $8,701 per student per year.

State police are a familiar sight along the nation’s highways. The state police enforce traffic laws and help 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.

Where Are State Taxes Spent?

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 have read, 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. Nature reserves and parks 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 legislative branch, and a court system. State tax revenues pay the salaries of all these and other state workers, including judges, maintenance crews in state parks, the governor, and professors in state universities.

Differentiated Resources

Guided Reading and Review (Unit 6 All-in-One, p. 38)

State and Local Education Spending (Unit 6 All-in-One, p. 40)

Taxes and Changing Circumstances (Simulation Activities, Chapter 14)
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? The pie chart on the left in Figure 14.5 shows you the major sources of state revenue.

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. Nonprofit organizations, religious groups, and charities are usually tax exempt; that is, they are not subject to taxes.

Sales Tax

Sales taxes are a main source of revenue for state governments. 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. Their sales tax rates range from 2.9 to 7.25 percent. Some local governments have their own, additional sales tax. In every state, some categories of products are exempt from sales tax. For example, many states do not charge sales tax on basic needs such as food and clothing.

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.

Individual Income Tax

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 14.5 shows that state individual income taxes contribute about 13 percent of state revenue.

Some states tax incomes at a flat rate (that is, as a proportional tax). Others use a progressive tax—either by creating their own progressive rate structure, or by taxing incomes at higher rates.

Background Note

State Income Tax Rates

Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—have no state income taxes. New Hampshire does not tax wage income but only the income from dividends and interest. Seven more states—Colorado, Illinois, Indiana, Maryland, Massachusetts, Pennsylvania, and Utah—have a flat state income tax rate: one rate applies to all levels of income. Some of these states, though not all, reduce the burden on some taxpayers by giving personal exemptions. The remaining states have variable income tax rates, with as few as two brackets (in Connecticut) to as many as ten (Missouri). The lowest tax rate is 0.36 percent in Iowa. The highest is California’s 9.3 percent (which becomes 10.3 percent on income over $1 million).

Answers

Graph Skills 1. Intergovernmental revenue, public welfare, education 2. 34.6 percent
ROLE-PLAY
Review the discussion of corporate income taxes. Ask Why would the heads of corporations prefer lower corporate tax rates? (Lower taxes mean higher profits.) Why might individual residents of the state prefer higher corporate tax rates? (Higher corporate income taxes might mean lower individual income tax rates.) What might small business owners think about this issue? (Possible response: They might prefer higher corporate tax rates, feeling that it would reduce their own tax burden and help them better compete with bigger companies.)

Divide the class into five groups. One group of seven students will take the role of members of the state legislature holding a hearing on whether to increase corporate tax rates from 3 percent to 5 percent. Assign the others to one of these groups: (1) representatives of a major corporation in the state or of a business association, such as bankers, minority-owned businesses, or farmers; (2) owners of small businesses; (3) people who work for groups that represent consumers, low-income individuals, community activists, or labor unions; (4) ordinary citizens. Have the members of each of these groups meet and prepare a five-minute presentation to the legislators. They should choose one or two speakers to deliver their views. Have the four groups take turns.

After the groups have made their presentations, have the seven legislators state their views on the issue and the reasons for them. They should refer to the arguments they have heard. Then have the legislators vote for or against the change in corporate tax.

When the role-playing exercise is complete, have the class discuss the implications of the decision for the state as a whole and for each of the groups.

**Differentiate** For additional practice with the concept of raising or lowering taxes, have students use the simulation “Taxes and Changing Circumstances” (Simulation Activities, Chapter 14). Students will participate in a role-playing game about taxes.

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**Answers**

**Economics & You** Students should check with the local school board or other government authority to answer the question.

**Checkpoint** Intergovernmental revenue and insurance trust revenue (based on Figure 14.5)

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**Virtual Economics**

**Differentiate**

**Exploring Local Government Spending** Use the following lesson from the NCEE Virtual Economics CD-ROM to evaluate how taxes are used on the local or state level. Click on Browse Economics Lessons, specify grades 6–8, and use the key words what taxes.

<table>
<thead>
<tr>
<th>Lesson Title</th>
<th>What Taxes Affect You?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Activity</td>
<td>Brainstorming</td>
</tr>
<tr>
<td>Complexity</td>
<td>Low</td>
</tr>
<tr>
<td>Time</td>
<td>50 minutes</td>
</tr>
<tr>
<td>NCEE Standards</td>
<td>16</td>
</tr>
</tbody>
</table>

In this activity, students will investigate what services are provided by different levels of government and how they are funded.
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. Today, there are more than 78,000 local government units in the United States. Together they collect about $484 billion in tax revenues.

The Jobs of Local Government
Local governments carry major responsibilities in many areas, such as public school systems, law enforcement (local police, county sheriff’s departments, park police), and fire protection. They manage public facilities (libraries, airports, public hospitals) and parks and recreational facilities (beaches, swimming pools, zoos). They monitor public health (restaurant inspection, water treatment, sewer systems), public transportation, elections (voter registration, ballot preparation, election supervision, vote counting), record keeping (birth/death certificates, wills, marriage licenses) and social services (food stamps, child-care and welfare).

Many of these responsibilities are reflected in the Local Revenue and Spending pie charts in Figure 14.6. In some towns and cities, separate commissions or private corporations carry out some of these jobs. You can see, though, that local governments touch our lives every day.

Property Tax
Property taxes are levied on property owners in local communities to offset the expense of services such as street construction and 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.

Assess and RemEDIATE

GIVE EXAMPLES
Direct students’ attention to the local spending pie graph in Figure 14.6. Say each category of local government spending and call on volunteers to give examples of local government spending in that area.

EXTEND
Explain that one controversial area of local spending is government funding for professional sports stadiums. Supporters say these facilities promote business and generate revenue through lease payments and taxes. Critics say that taxpayers foot the bill while teams realize vast profits. Tell students to take the role of the mayor of a city facing pressure to accept a large share of the cost of a new stadium. Tell them to write a brief speech on the issue.

GIVING QUESTION WRAP UP
Have students return to the section Guiding Question. Review the completed graphic organizer and clarify any misunderstandings. Have a wrap up discussion about how local governments manage their money.

Background Note
Assessments and Taxes While property taxes are based on the assessed value of a property, the assessed value is not necessarily equal to the market value. Considering the value of the home, then, the effective tax rate may actually be much lower than the nominal tax rate. In Philadelphia, for instance, the nominal tax rate in a recent year was $8.26 per $100 of assessed value. The assessed value was assumed to be only 32 percent of the home’s market value, however. As a result, the effective tax rate was only $2.64 per $100 of market value. That was still enough to rank Philadelphia seventh highest in effective tax rates. The highest was Indianapolis, Indiana, with a tax rate of $3.21 per $100 and an assumed assessment at 100 percent of market value.
Have students outline the subsection on local government revenue.

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 $230.25!

Three different taxes have been added—an occupancy tax, an 8.375 percent sales tax, and a hotel room tax. The purpose of each tax is to dampen the impact of congestion in the downtown area. Since the city is responding to the Essential Question—What types of organizations are taxed differently from the main tax sources of state revenue?—it has added these taxes in an attempt to reduce congestion. The city council would like you to find the answers to the following questions:

1. What is a balanced budget? How do local governments manage their money?
2. What kinds of organizations are tax exempt? Why do they differ from the main tax sources of state revenue?
3. What local government services do you use in your everyday life?
4. List at least four programs and services on which states spend their money.
5. What is the job of a tax assessor?
6. What is a real property tax?
7. What is a personal property tax?
8. What is a sales tax?
9. What is a state aid tax?
10. What is a state income tax?
11. Which source of local government revenue increased as a percentage of total revenue between 1995 and 2009?

Answers

Caption: Supporters say the tax would decrease congestion and cut greenhouse gas emissions. Critics say city businesses would be hurt.

Checkpoint: property tax

Assessment Answers

1. Possible response: They try to balance the revenues they take in with the spending they incur.
2. Possible responses: school, bus transportation, water and power
3. a budget in which spending equals revenues
4. any four categories from the bottom circle graph in Figure 14.5
5. nonprofit organizations, religious groups, charities; They do not have to pay taxes.
6. any three: corporate income taxes, licensing fees, corporate stock taxes, property taxes
7. determines the value of property subject to property tax
8. (a) raise taxes or cut spending (b) cut taxes or raise spending
9. (a) money transferred from other parts of the government; money earned from insurance trusts, sales and excise taxes, individual income taxes (b) Local governments rely much more on property taxes.
10. (a) Real property is permanent, such as land and buildings; personal property is movable, such as jewelry. (b) real property tax
11. (a) percentage of total revenue in 1995 (b) real property tax

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 ASSIGN THE ESSENTIAL QUESTIONS JOURNAL

After students have finished studying the chapter, they should return to the chapter’s essential question in the Essential Questions Journal and complete the activity.

Tell students to go back to the chapter opener and look at the image. Using the information they have gained from studying the chapter, ask How does this illustrate the main ideas of the chapter? (Possible response: A dam is an example of the kind of project a government would fund because no private company could make money building and running it.)

STUDY TIPS

Suggest that students work with partners, or even in groups, to review the section content and to practice applying the concepts to real-life situations.

ECONOMICS on the go Have students download the digital resources available on Economics on the Go for review and remediation.

Assessment at a Glance

TESTS AND QUIZZES

Section Assessments

Section Quizzes A and B, Unit 6 All-in-One
Self-Test Online

Chapter Assessments

Chapter Tests A and B, Unit 6 All-in-One
Economic Detective, Unit 6 All-in-One
Document-Based Assessment, p. 389
ExamView

AYP Monitoring Assessments

PERFORMANCE ASSESSMENT

Simulation Activities, Chapter 14
Virtual Economics on CD-ROM, pp. 367, 372, 378, 384

Essential Questions Journal, Chapter 14
Assessment Rubrics
Chapter Assessment

1. (a) the benefits-received principle and the ability-to-pay principle (b) Possible response: If a tax is used to supplement the income of poor people, they are clearly in the worst position to pay that tax even though they receive the benefits. (c) Possible response: The ability-to-pay principle is most important because only those who have money have the means to pay a tax.

2. (a) It would increase the store owner’s costs. (b) It would not affect wealthy consumers much because, unless they consumed huge quantities of milk, milk purchases would represent only a small percentage of their total spending. (c) No, because milk would take a larger share of their budget—unless they bought none.

3. (a) federal and any state or local income tax; Social Security and Medicare taxes (b) They will be collected on a “pay-as-you-go” basis from each paycheck. (c) Possible response: Yes, because all wage earners should pay some taxes to help provide the services we all use.

4. Any response is acceptable as long as students give three forms and valid reasons that support the choices.

5. (a) the cost of rent and utilities, taxes, prices, and wage rates in both locations (b) Possible response: That might make the city less attractive, but other factors, such as market size and income levels, would be very important too.

6. defense

7. Social Security—$37.2 billion; defense—$93.9 billion

8. Social Security—$615.51 billion; defense—$556.89 billion

9. (a) Responses should show understanding of the difference between spending and revenue, and use the correct numbers. (b) Responses should show understanding of the pros and cons of each alternative, including voter opposition to tax hikes and consequences of service cuts. (c) In budget and tax proposal, revenue and spending should be balanced. Budget should cover all anticipated needs.

10. (a) The removal will reduce the amount of money available for discretionary spending. (b) A new truck may benefit the community, but the cost will impact other safety needs. (c) Money will have to be taken from other parts of the budget.

Key Terms and Main Ideas

To make sure you understand the key terms and main ideas of this chapter, review the Checkpoint and Section Assessment questions and look at the Quick Study Guide on the preceding page.

Critical Thinking

1. Select (a) What are two principles that help determine the fairness of a tax? (b) How might these principles conflict with each other? (c) Which of these principles do you think is more important? Why?

2. Compare and Contrast (a) Suppose your state imposed a new tax on milk. How would this decision affect the owner of an ice cream store? (b) How would it affect healthy consumers? (c) Would it affect poor consumers the same way? Why or why not?

3. Evaluate (a) If you get a part-time job, what taxes will you probably pay on your earnings? (b) Briefly explain how the government will collect these taxes. (c) Do you think it is fair that you must pay these taxes? Why or why not?

4. Rank (a) Imagine that you are a member of Congress. What are the three most important forms of discretionary spending that you support? (b) Why did you select these categories?

5. Extend (a) You have the chance to open a restaurant in your community. The cost of the cleanup is $3 million. (b) A new tax on milk. How would this affect your decision? (c) Suppose the city announces that it will adopt congestion taxes. How will this affect your decision?

6. Which is greater: the amount spent on social security, health, and education in 1970 or the amount spent on defense?

7. About how much money was spent on social security in 1970? How much was spent on defense in 1970?

8. Social Security—$37.2 billion; defense—$93.9 billion

9. Complete this activity to answer the Essential Question: How can taxation meet the needs of government and the people? (a) You have the chance to open a restaurant in your community. The cost of the cleanup is $3 million. (b) A new tax on milk. How would this affect your decision? (c) Suppose the city announces that it will adopt congestion taxes. How will this affect your decision?

10. Modify Evaluate the impact of each of the following on your proposed budget. (a) Asbestos must be removed from two school buildings in your community. The cost of the cleanup is $3 million. (b) Your fire department wants to replace its outdated pump truck with a new one. The cost is $500,000. (c) You are having trouble hiring road maintenance workers because neighboring communities pay higher wages. In order to compete, you have to raise wages and benefits a total of $750,000.

Applying Your Math Skills

Using Pie Graphs to Understand Budgets

A pie graph is a useful way to present large amounts of information visually. The pie chart divides the information very much like a cherry pie into slices that represent the proportion of some whole number. In this case, the information being presented is federal spending in a particular year, 1970. Within each slice is a number that stands for the percent of each category of the total federal budget. By multiplying the total amount of spending in a year, in this case $1,956 billion, by the percentage of federal spending shown on the graph, you can find the amount of money actually spent for that category of spending in that year. Use your math skills and the pie graph to answer the questions below.

Visit PearsonSchool.com/PHecon for additional math help.

9. Complete this activity to answer the Essential Question: How can taxation meet the needs of government and the people? (a) Complete the table for total spending in 2006. (b) How many dollars were spent on defense in 2006? On health? On social security? (c) Complete the chart for spending in 2006. (d) Compare the two charts and write a paragraph relating these two budget categories.

10. Modify Evaluate the impact of each of the following on your proposed budget. (a) Asbestos must be removed from two school buildings in your community. The cost of the cleanup is $3 million. (b) Your fire department wants to replace its outdated pump truck with a new one. The cost is $500,000. (c) You are having trouble hiring road maintenance workers because neighboring communities pay higher wages. In order to compete, you have to raise wages and benefits a total of $750,000.

Essential Question Activity

To respond to the chapter Essential Question, go to your Essential Questions Journal.

WebQuest

The Economics WebQuest challenges students to use 21st century skills to answer the Essential Question.

SS.912.E.2.2 Use a decision-making model to analyze public policy issues in the student’s community.
Should entitlements be cut to help balance the budget?

Almost two-thirds of federal expenditures are entitlements such as Social Security, Medicare, and Medicaid. As these social welfare programs continue to grow, people debate about whether to limit their benefits in order to reduce the budget deficit.

Document A

America’s debt problem is mainly an entitlement spending problem. Serious entitlement reform would involve concentrating limited resources on the poor, eliminating subsidies for the rich, and moving support for the middle class from a system of defined benefits to defined contributions. . . . Properly understood, the budget battle is not between big spenders and budget hawks. It is between those who want to spend larger and larger portions of the budget on health care and transfers to the elderly, and those who want to use budget resources for anything else.

—“Federal Entitlements Will Crowd Out Other Spending in 25 Years,” www.sacbee.com, August 1, 2010

Document B

“I had another bad dream about Social Security.”

Document C

The recent financial crisis has certainly deepened the fiscal challenge. But it has done something else too. It has driven home that Social Security is, and must remain, the bedrock of retirement income security. There is simply no alternative. Private income sources cannot do what social insurance does—only social insurance provides absolute inflation protection, spreads risks over generations and across the whole population, provides wage insurance, and is immune to fluctuations in asset values. Yes, changes in economic and demographic conditions can force changes in social insurance. But those changes are gradual, not abrupt.


ANALYZING DOCUMENTS

Use your knowledge of entitlement programs and Documents A, B, and C to answer questions 1–3.

1. What is one reason the authors of Document A want to cut entitlement benefits?
   A. They use too much of the budget.
   B. The elderly do not deserve benefits.
   C. To free up funds for healthcare and the elderly
   D. The rich do not deserve benefits.

2. What problem does Document B address?
   A. Not everyone is entitled to Social Security.
   B. The government plans to replace Social Security.
   C. The future funding of Social Security is uncertain.
   D. Children benefit most from Social Security.

3. According to Document C, why should Social Security not be cut?
   A. It fluctuates easily when property values change.
   B. It is risky only to younger generations.
   C. It does not face changes when population figures change.
   D. It provides a steady supply of income security.

WRITING ABOUT ECONOMICS

To what extent entitlements can and should be limited is an ongoing issue. Use the documents on this page and resources on the Web site below to answer the question: Should entitlements be cut to help balance the budget?

Go Online to www.PearsonSchool.com/PHecon for a student rubric and extra documents.