Chapter 15 Federal Budgets Questions & Answers

1. Which of the following is considered mandatory government spending?

a. Funding for the Environmental Protection Agency (EPA).
b. Payments to active military personnel.
c. Infrastructure maintenance spending.
d. International aid to poor countries.
e. <u>Payments to Social Security recipients.</u>

2. Mandatory outlays:

a. usually change during the budget process.
b. cannot be altered once they are made into law.
c. <u>require changes in existing laws if those outlays are to be altered.</u>
d. are a minor component of total outlays, and so are usually ignored.
e. are another name for discretionary outlays.

3 Which of the following is considered discretionary government spending?

a. Payments to Social Security recipients.
b. Payments to unemployment insurance recipients.
c. <u>Payments to government employees.</u>
d. Payments to food stamp recipients.
e. Payments to foreign bondholders.

4. Mandatory outlays are different than discretionary outlays because:

a. mandatory outlays usually change during the budget process, whereas discretionary outlays do not.
b. mandatory outlays have been decreasing as a percentage of the federal budget, whereas discretionary outlays have been increasing as a percentage of the federal budget.
c. <u>discretionary outlays can be changed during the annual budget process, whereas mandatory outlays cannot.</u>
d. discretionary outlays include entitlement programs (such as Social Security and Medicare), whereas mandatory outlays include important government programs (such as defense).
e. discretionary outlays comprise the vast majority of the total budget, whereas mandatory outlays make up only a minor fraction.

5. Assuming all of the following are in your personal monthly budget, your ________ payment is considered a discretionary outlay.

a. mortgage (or rent, if you do not own a home)
b. car loan
c. student loan
d. <u>food bill</u>
e. boat loan

6. Due to ________, government outlays have risen quickly since 2000.

a. less tax revenue
b. <u>an aging population</u>
c. rising inflation
d. economic expansion
e. lower interest payments on current government debt

7. Social Security and Medicare spending continue to grow and take up larger shares of the federal budget because life expectancy is ________, the number of people receiving benefits is ________ quickly, and the growth in the number of people paying into the programs is ________.

a. <u>increasing; increasing; decreasing</u>
b. decreasing; increasing; decreasing
c. increasing; decreasing; decreasing
d. increasing; increasing; increasing
e. decreasing; decreasing; increasing

8. Federal government spending jumped during 2008–2009 primarily because of:

a. <u>expansionary fiscal policy in response to the Great Recession.</u>
b. increased spending on bridge and road infrastructure.
c. increased foreign aid to disaster-stricken areas.
d. increased spending on the U.S. education system.
e. the bailout payments made to big banks.

9. Which of the following is NOT a revenue source for the U.S. federal government?

a. <u>State sales taxes.</u>
b. Federal gasoline taxes.
c. Federal income taxes.
d. Medicare taxes.
e. Admission fees for national parks.

10. The largest source of tax revenue for the government is ________ taxes.

a. <u>individual income</u>
b. corporate income
c. social insurance
d. estate
e. excise

11. During the Great Recession, as a percentage of gross domestic product (GDP), federal government outlays were ________, and government revenues were ________ their long-run averages over the period 1970–2017.

a. <u>above; below</u>
b. below; above
c. above; above
d. below; below
e. equal to; equal to

12. Why did tax revenues fall so sharply after 2007?

a. Tax rates were drastically lowered.
b. A slowdown in economic activity increased unemployment.
c. Many people moved out of the country because of increased tax rates.
d. A large increase in the number of retirees led to a decrease in the number of people paying taxes.
e. Congress approved tax cuts in the prior year.

13. Budget deficits tend to:

a. increase over time.
b. decrease over time.
c. increase during recessions.
d. increase during expansions.
e. grow as the economy grows and shrink as the economy shrinks.

14. If government outlays in 2018 were $3.5 trillion, including interest on debt, and government revenues were $2.8 trillion, the federal:

a. debt was unaffected.
b. debt decreased by $700 billion.
c. budget surplus was $700 billion.
d. budget deficit was $700 billion.
e. budget was balanced.

15. The obvious way to reduce or eliminate a budget deficit is to raise tax rates. What is the main problem with this solution?

a. Some people will find a way to avoid paying the higher tax.
b. Raising taxes across the board is unfair to the poor.
c. Higher taxes act as a damper on the economy.
d. Sometimes it is actually desirable to run a deficit.
e. Higher taxes introduce uncertainty that makes budget planning harder.

16. If government revenues in 2018 were $3.1 trillion and government outlays, including interest on debt, were $2.8 trillion, the federal:

a. debt was unaffected in that year.
b. debt decreased by $300 billion.
c. debt increased by $300 billion.
d. budget deficit was $300 billion.
e. budget was balanced.

17. The federal budget deficit has grown so quickly in the past 5–10 years because of:

a. increased tax revenue.
b. increased spending on entitlement programs.
c. lower income tax rates on the top 1% of households.
d. economic expansion.
e. higher interest payments on current government debt.

18. Why does the federal debt tend to increase during periods of recession?

a. **Economic activity decreases, which decreases revenues and increases outlays.**
b. Economic activity decreases, which decreases revenues and decreases outlays.
c. Economic activity increases, which increases revenues and increases outlays.
d. Economic activity increases, which increases revenues and decreases outlays.
e. Economic activity increases, which decreases revenues and increases outlays.

19. On the spending side, what is the main big-picture challenge for anyone trying to balance the federal budget?

a. The growth of discretionary spending as a percentage of the overall total.
b. **The growth of mandatory spending as a percentage of the overall total.**
c. The growth of interest on debt as a percentage of the overall total.
d. The uncertainty caused by frequent legislative changes in spending policy.
e. There is no big challenge on the spending side, just on the revenue side.

Use the following table to answer the next 2 questions, where GDP = gross domestic product.

Public Debt over Time

	2001		2011	
	Debt	GDP	Debt	GDP
Canada	\$0.6 trillion	\$1.0 trillion	\$0.7 trillion	\$1.5 trillion
France	\$0.9 trillion	\$1.5 trillion	\$1.8 trillion	\$2.0 trillion
Italy	\$1.5 trillion	\$1.2 trillion	\$1.7 trillion	\$1.6 trillion
Norway	\$0.1 trillion	\$0.2 trillion	\$0.1 trillion	\$0.3 trillion
Australia	\$0.2 trillion	\$0.7 trillion	\$0.4 trillion	\$1.4 trillion

20. According to the table, the country with the highest average yearly budget deficit over the time period is:

a. Canada.
b. **France.**
c. Italy.
d. Norway.
e. Australia.

21. According to the table, the country with the lowest average yearly budget deficit over the time period is:

a. Canada.
b. France.
c. Italy.
d. **Norway.**
e. Australia.

22. Which country faces the most severe fiscal challenges—in terms of debt-to-GDP (gross domestic product) ratio—according to the accompanying table?

Public Debt across the World		
	Total Public Debt	GDP
Canada	$0.7 trillion	$1.5 trillion
Italy	$2.9 trillion	$2.2 trillion
France	$2.3 trillion	$2.7 trillion
Jamaica	$0.3 trillion	$0.2 trillion
Cyprus	$0.2 trillion	$0.2 trillion

a. Canada
b. Italy
c. Jamaica
d. France
e. Cyprus

23. Discretionary spending is a shrinking part of the federal budget. What is a possible consequence of this development?

a. Politicians will have more control over spending, increasing favoritism and corruption in Congress.
b. Income assistance programs will eventually have revenue shortfalls and be unable to fulfill their obligations.
c. There will be more competition for public works and infrastructure projects.
d. The federal government will be forced to default on interest payments, reducing the overall creditworthiness of the United States.
e. State and local governments will automatically assume discretionary spending responsibilities.

24. Which component of the federal budget has accounted for a steadily increasing percentage of the total budget since the 1970s?

a. Interest on debt.
b. Income aid.
c. Social insurance.
d. Defense.
e. Miscellaneous discretionary outlays.

25. Many people are concerned about foreign ownership of U.S. debt. The concern stems from a fear that:

a. the interest paid on foreign debt is too high.
b. foreigners who own the debt have too much power over the country.
c. foreign-held debt will be impossible to pay off.
d. it would be hard to wage war against nations holding U.S. debt.
e. foreigners who own the debt do not pay taxes on the interest earned.

26. One of the main benefits of foreign ownership of U.S. debt is that:

a. it increases the supply of loanable funds in the United States.
b. It makes it harder for other nations to wage war against the United States.
c. It is kept out of the hands of private corporations in the United States.
d. foreign-held debt is easier to pay off than domestically-held debt.
e. interest is lower for foreign-held debt than for domestically-held debt.

27. If government revenues in 2010 were $2.1 trillion and government outlays, *not* including interest on debt, were $2.1 trillion, this means:

a. the federal debt was unaffected in that year.
b. <u>the federal debt increased.</u>
c. the federal debt decreased.
d. there was a budget surplus.
e. the federal budget was balanced.

28. If government revenues in 2019 were $2.7 trillion and government outlays, including interest on debt, were $3.1 trillion, the federal:

a. debt was unaffected in that year.
b. budget was balanced.
c. budget surplus was $400 billion.
d. debt decreased by $400 billion.
e. <u>debt increased by $400 billion.</u>

29. An aging population is cited as one of the reasons for fiscal concerns about Social Security and Medicare. How might this demographic shift impact future revenue generation and the national debt?

Answer: Many individuals who have reached retirement age are no longer working. Although that may not always be the case, a lower percentage of individuals beyond the retirement age earn job incomes than do those in other age groups. If the population continues to age, the government will not be able to sustain entitlement spending growth without an increase in taxes or an increased growth in deficit spending and debt.

30. What are transfer payments? What is their significance for the U.S. federal budget?

Answer: By definition, transfer payments are payments to groups or individuals where no good or service is received in return. In the context of the federal budget, transfer payments include Social Security checks, income assistance, and other payments made to people in need of financial support. These are all mandatory outlays (prescribed by law) to which the recipients are entitled, which is why these outlays are called entitlements. Transfer payments represent a growing share of the total budget, and, because they are mandatory, there is no easy way to rein them in. This means that the share of the budget available for outlays, where the government gets something of lasting value in return (new highways, etc.), is steadily shrinking, and there is nothing budget planners can do about it.

31. Explain the distinction between mandatory and discretionary spending. Why is this distinction important?

Answer: Mandatory spending is spending prescribed by law. In the U.S. federal budget, mandatory spending includes items like Social Security and Medicare. Discretionary spending is spending that can be adjusted annually as part of the federal budget planning process and includes defense spending and many smaller categories, such as spending on national parks. The distinction is important because of how the proportion of mandatory-to-discretionary spending has changed over the decades. In 1970, over half of all spending was discretionary, and so budget planners had room each year to move money around and make cuts as needed to balance the budget. Today, discretionary spending represents less than 30% of the total budget. This means that if a budget deficit is projected, there is less the budget planners can do about that. Politicians can talk about spending less on this or that discretionary program, but the fact is that balancing the budget is increasingly more difficult without action by Congress to change the laws that mandate spending on Social Security and so on.

32. What were the origins of the U.S. federal income tax? How has it evolved to the present day?

Answer: Prior to 1913 there was no income tax. Taxes on imports were the main source of government revenue. However, import taxes were projected to decline, and so the income tax was created. Right from the start, the income tax was progressive, meaning that high earners were taxed at higher rates than low earners, but, even in the highest tax bracket, the rate was only 6%. However, the need for more revenue soon pushed the rate of the top bracket above 70% and then, during World War II, above 90%. This latter rate was eventually judged to be too high, and so the rate came down in the Kennedy years and dropped further in the Reagan years. Since then, the top marginal rate has settled into the 35–40% range.

33. An aging population is cited as one of the reasons for future fiscal concerns for Social Security and Medicare. How might this demographic shift impact future revenue generation and the national debt?

Answer: By definition, individuals who have reached retirement are no longer working. That may not always be the case, but a lower percentage of individuals beyond the retirement age earn job income than do other age groups. If the population continues to age, the government will not be able to sustain spending growth without an increase in taxes or an increased growth in deficit spending and debt.