

# 13

## The Budget: The Politics of Taxing and Spending

### □ Chapter Overview

As the popular saying “put your money where your mouth is” suggests, the federal budget process provides a powerful way to think about the priorities of the national government. In this chapter we examine the politics of the budget. We start by describing the sources of funding for the federal government and assess the consequences of tax expenditures and borrowing. Then we analyze federal expenditures and the growth of the budget, outline the budgetary process, and explain the role that politics plays. We conclude by assessing the impact of democratic politics on budgetary growth and of the budget on scope of government. By the end of the chapter, students should have a good understanding of the basic dynamics and controversies surrounding the federal budget.

### □ Study Outline

- 13.1** Learning Objective 13.1: Describe the sources of funding for the federal government and assess the consequences of tax expenditure and borrowing. (p. 446)

#### *Federal Revenue and Borrowing*

- **Income taxes:** A percentage of what a person earns goes directly to the government.

- The **Sixteenth Amendment** (1913) officially authorized Congress to collect income taxes.
- The **Internal Revenue Service (IRS)** collects income taxes, monitors people's payments through **audits**, and investigates and prosecutes cases of tax evasion.
- The income tax is **progressive**—people with higher incomes pay a greater percentage in taxes.
- Opponents suggest a flat tax in which everyone pays an equal rate; such a tax is considered **proportional**.
- Others propose a sales tax to replace the income tax; because poorer people pay a higher percentage of their income in sales tax—they spend much more of their income than they save or invest—such a tax is called **regressive**.
- Corporations also pay taxes on their income, but most tax money comes from individual income taxes.
- **Social insurance taxes:** Social Security taxes are paid by both businesses and their employees.
  - Money collected from this tax is used specifically to pay current monthly benefits to senior citizens.
  - These taxes have grown significantly and now account for about one-third of the federal revenue.
  - As the population ages, more people will be expecting payments from the government. Economists are concerned that the baby boom generation may drain the system.
- **Borrowing:** The federal government has borrowed a huge amount of money over the years.
  - It borrows from foreign investors, foreign governments, and the American people by selling government bonds.
  - The government gets the money, but must pay it back to the bondholder with interest.
  - The money the government owes is the **national debt**.
  - About 7 percent of the federal budget is allocated to pay just the interest on the federal debt.
  - Future generations will have to pay for many policies enacted today.

- Lawmakers have considered proposing a **balanced budget amendment**, which would require Congress and the president to balance the budget each year.
- Critics argue that it is too difficult to predict a balanced budget because of the uncertainties of the economy.

### *Taxes and Public Policy*

- **Tax loopholes** are any tax break that allows a person to benefit from not paying a part of his or her taxes. Deductions for specific items are considered loopholes.
- Not everyone has the same access to loopholes.
- **Tax expenditures** are the losses in federal revenues that result from tax breaks, deductions, and exemptions.
- They function as built-in subsidies—the government loses money by excusing a homeowner from paying taxes on a mortgage, but then the government does not have to pay for programs, such as a homeowners' assistance program.
- Middle- and upper-income people benefit the most because they usually have more deductions and write-offs.
- **Tax reform:** How much to tax is almost always a point of contention among Congress and the public.
  - President Clinton raised tax rates on the wealthy. President George W. Bush enacted a series of tax cuts across all income levels, but which particularly benefitted the wealthy.

## **13.2**

### **Learning Objective 13.2: Analyze federal expenditures and the growth of the budget. (p. 454)**

#### ***Federal Expenditures***

- The government must pay its own operational costs, which make up a significant percentage of its overall expenditures.
- **National security** was a large expenditure during the Cold War and Reagan era, but it had begun to decline before September 11, 2001.
- **Social services** are now the biggest expenditure: programs for people of low income and senior citizens make up one-third of the budget.

- Social Security began with the **Social Security Act**, part of the New Deal.
- **Medicare**, initiated in 1965, extends medical coverage to senior citizens.
- Because people are living longer and the current generation of senior citizens is large, Social Security taxes have risen.
- **Uncontrollable expenditures** are a form of mandatory spending.
- Pensions and payments toward the national debt are fixed, and thus not subject to budgetary cuts or changes.
- **Entitlements** are benefits the government must pay to people who are eligible according to federal rules, such as veterans' aid, Social Security, and welfare.
- **Incrementalism** is the basis on which the budget is adjusted every year.
- A budget is calculated by assuming that the expenditures included in the budget of the previous year will rise for the next year.
- One issue is how large the increment should be, and another concern is that this creates a system of an ever-increasing budgets.

### 13.3

## Learning Objective 13.3: Outline the budgetary process and explain the role that politics plays.

### ***The Budgetary Process***

- The budget affects and involves agencies and departments in the federal, state, and even local governments.
- Every year, the budget process begins with the "spring review," when the federal agencies review their programs and prepare their requests for the next fiscal year.
- Budget requests are submitted to the **Office of Management and Budget (OMB)**.
- During the "fall review," the OMB reviews the requests, and then submits the final requests to the president. Interest groups and agencies often team up when making budgetary requests.
- Based on all of the agency requests, the president formally proposes a budget plan to Congress in February.
- Since 1922, the president has been required to prepare and submit a budget to Congress.

- In 1974, the **Congressional Budget and Impoundment Control Act** was passed by Congress to reform and regain some control over the budgetary process.
- The **House Ways and Means Committee** and the **Senate Finance Committee** write the tax codes that will determine how much revenue the government will have for the year.
- The **Appropriations Committees** in both houses determine how federal funds within the total expenditure will be allotted among agencies and departments.
- The House and Senate Budget Committees and the **Congressional Budget Office** review the proposal for its feasibility.
- Congress must agree on a **budget resolution**, the final amount of expenditures not to be exceeded for the year.
- Congress might make changes to existing laws to meet the budget resolution.
- **Reconciliation bills** revise program authorizations.
- The **Authorization bill** allows the expenditures for discretionary programs or enacts the requirements for entitlement programs are changed.
- Congress must pass the final budget bill and the president must sign it for it to become law.

**13.4**

**Learning Objective 13.4: Assess the impact of democratic politics on budgetary growth and of the budget on scope of government. (p. 467)**

### ***Understanding Budgeting***

- Budgets in democracies grow because the public and organized interests demand new and larger public services.
- Some politicians compete for votes by promising to limit budgets.
- Increasing budgets increase the scope of government, but decreases in taxes and increases in debt make it more difficult to add or expand programs.