Recession, Debt, Taxes, and Social Security

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v2.0

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Printed in the United States of America.

ISBN: 978-1-56004-722-3

Product Code: ZP664

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Introduction

This unit is designed to help students make informed decisions about issues that are as contemporary as the day's newspaper headlines and as old as discussions concerning the welfare state. These issues include: balancing the federal budget, raising taxes, reducing government spending, dealing with the aftermath of the subprime mortgage crisis, and resolving the upcoming shortfall in the Social Security Trust Fund.

By studying this unit, students will learn of the seriousness of our national debt problem, the history of the progressive income tax and the tax burden of various income groups, John Maynard Keynes's theory of the multiplier, the underlying cause of the recent recession, the theories that support and oppose spending stimulus money to end it, and the benefits and drawbacks of extending compensation to the unemployed. They also learn how the Social Security program was designed, the reasons it faces systemic problems, and the arguments for and against privatization. In addition they are provided with a multi-page review of each chapter to help them prepare for a unit test.

Each chapter includes numerous multiple-choice questions, as well as thought-provoking essay questions. In addition, teacher's pages provide an overview of each chapter, a list of objectives, and teaching strategies.

CHAPTER 1

KEYNES AND THE MULTIPLIER

Overview

To help students make comparisons between the recession that started in 2007 and the Depression that started in 1929, this chapter starts by explaining why President Herbert Hoover avoided deficit spending. Students then learn the theory of John Maynard Keynes's multiplier and are assigned to chart the relationship between Gross National Product, investment spending, and government spending between 1929 and 1944. They learn that New Deal spending did relatively little to end the Depression as compared to wartime spending. The latter helped restore GNP to pre-Depression levels and doubled GNP while running up a very large debt.

Objectives

Students will:

- learn of the severity of the Great Depression
- learn the reasons that Hoover did not try to "spend his way out" of the Depression
- learn the reasoning behind Keynes's theory of the multiplier
- graph changes in GNP, investment spending (I), and government spending (G) for the period 1929–1944, and explain whether the statistics prove that Keynes was right and whether they think the increased debt was acceptable.

Strategies

Day 1: Determine whether all students have done their homework by reviewing their answers to the multiple-choice questions. Then ask them to explain the severity of the economic situation in 1933 and compare that to what they know about the economy today. Review the concept of the multiplier and make sure that all students understand it. Proceed by asking whether they know what the formula **GNP = C + I + G** stands for, and if needed, review this concept (also covered in Book II of this series). Note that a reduction in investment spending of over $15 billion between 1929 and 1932 could account for the threefold reduction in GNP by about $46 billion over those years. Pass out copies of the graph at the end of this chapter and help students begin doing the graphing assignment that should be completed by the next time they come to class.

Day 2: Check to see whether students completed their assigned homework. Ask students to meet in small groups to explain what the results of the graphing exercise tells them about the effects of government spending. Have them note the extent of government spending and the increase in the debt and GNP between 1939 and 1942, and the growth of GNP during those years. Ask whether what they learned from this exercise provides a lesson on what the federal government should do today.

Assignment

Assign Chapter 2, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 1
KEYNES AND THE MULTIPLIER

Introduction

When confronted with a recession, a president may wish to learn what past presidents have done in similar situations. Because this unit examines the recession of 2007–10, we start with a description of what happened 79 years earlier by looking at the Great Depression of the 1930s. The Depression started with the collapse of the U.S. stock market in 1929 in much the same way the recent recession began with the bursting of the housing market bubble. Herbert Hoover was president when the Depression began and proved unable to prevent its downward spiral.

Let us look at the economy of the 1930s four years after Herbert Hoover became president: Gross National Product had gone from $104 billion in 1929 to $59 billion in 1932; average family income from $3,000 to $1,800 a year. Stocks fell from $310 to $34 per share. Farm income was down from $790 to $200 a year; a bushel of wheat that cost 45 cents to grow, was selling for 38 cents. Thirteen million people, 25% of the workforce, were unemployed and many people were starving.

During the four years that Herbert Hoover faced this situation, he consulted his advisers. They told him to balance the budget and not increase government spending. Hoover's advisors told him that the worst thing the government could do was increase the national debt. They thought this would drive up interest rates and wages and would make it more difficult for businesses to borrow money and expand. Furthermore, they warned, increasing the debt would raise doubts that it could be paid off and cause a lack of confidence in the federal government. Finally, they believed, raising the debt would be unfair to the children and grandchildren who eventually would have to pay it off.

One economist, an Englishman named John Maynard Keynes, disagreed with those who spoke in favor of a balanced budget. He said the way to get out of the Depression was for the government to spend its way out. In this chapter you will be asked to decide whether Keynes's unconventional economic advice actually brought the United States out of the Depression.

Gross National Product and the Multiplier

In 1929, our Gross National Product[1] (GNP) was $104.4 billion; in 1930, it was $91.1 billion; in 1932, it was $58.5 billion.

	1929	1930	1932
Consumption spending (billions $)	79.0	71.0	49.3
Investment spending (billions $)	16.2	10.3	0.9
Government spending (billions $)	8.1	9.2	8.1
Gross National Product (billions $)	104.4	91.2	58.5

A closer look at the chart shows that the largest percentage change between 1929 and 1930 was in investment spending. In fact, investment decreased by 35% while consumption declined only by 10%. By 1932, investment had decreased by 95% to $0.9 billion, while consumption only decreased by 38% to $49.2 billion. Economists had long noted that investment spending declines much more rapidly than consumption spending and concluded that depressions may be caused by declines in investment spending.

Careful studies of past fluctuations in business cycles have indicated that each dollar of reduced investment spending will result in a far greater negative change in GNP. Likewise, every dollar of increased investment spending will result in a much larger positive change in GNP. Here is how it works:

Suppose Henry Ford decided to spend $1 million to expand one of his factories in Detroit. The money is paid directly to his workers or to other businessmen who will use it indirectly to pay their labor costs, dividends, etc. Studies have shown that people tend to spend about two-thirds of their increased incomes. Therefore, those receiving the dollars that Ford pumped into the economy will spend about $666,666 and save the other $333,333. The increased spending will put cash in the hands of grocers, car salesmen, clothing-store salespeople, etc. Two-thirds of this money would then be spent by those receiving it, and this process will continue in an endless chain as illustrated by the following chart:

1. GNP is similar to GDP, but without accounting for balance of trade (imports – exports).

Stage	Amount ($)
1. Ford's investment	1,000,000
2. Money spent by Ford's workers (2/3 × 1,000,000)	666,666
3. Money spent by grocers etc. (2/3 × 666,666)	443,556
4. Money spent by those who received from stage 3 (2/3 × 443,556)	295,403
5. Same as stage 4 (2/3 × 295,403)	196,741
6. Same as stage 5 (2/3 × 196,741)	131,030
7. Total of all spending so far	2,733,396
8. All steps from stage 6 to infinity	266,604
9. Total of stages 1 to infinity	3,000,000

You should now understand the importance of business investment to the nation's economic well being. Each additional dollar invested results in as much as a threefold increase in GNP.

Savings and Investment

Most economists before the Great Depression assumed that money saved by some individuals would eventually be borrowed by businesses and invested. This assumption was so widely accepted that it was called Say's law, after the French economist J.B. Say. Yes, economists admitted, in the short run, savings may not go directly into investment. But the economy is basically self-correcting. In a recession, interest rates will drop low enough to entice businesses to borrow money again. Wages will come down because unemployed workers will take whatever job they can get. As more and more people secure jobs, the recession ends and recovery begins. This leads to more buying, borrowing, and employing. According to conservatives, interest rates, wages, and employment would adjust automatically as long as governments do not interfere.

Subscribing to the economic wisdom of his day, Herbert Hoover waited four years for the business cycle to correct itself. During his waiting, the GNP got lower and lower, unemployment increased, businesses failed, and banks closed their doors and went out of business. The Depression got worse every year.

Keynes Advocates Deficit Spending

John Maynard Keynes was much less optimistic than Herbert Hoover or Say about the power of the economy to correct itself. Keynes had seen no sign that the U.S. economy was correcting itself in any way. He concluded that, contrary to Say, savings are not automatically reinvested. He noted that the decline in the value of stocks and the loss of money through bank failures completely destroyed the savings of millions.

According to Keynes, there was both bad and good news: The bad news was that a nation may skid along at the bottom of a business cycle almost indefinitely—contrary to Say, there may be no automatic way out of a depression. The good news was that government spending could have the same beneficial multiplier effect as business spending. The multiplier, Keynes claimed, would work just as effectively if the government borrowed and spent money as when businesses spent it. According to Keynes, a nation could spend its way back to prosperity using government spending (G) rather than business spending (I).

A Summary

Both Say and Keynes would likely agree on the importance of savings and investment. However, Say assumed investment and savings would always tend to equalize in the long run. The government's job, according to Say, was not to interfere with these self-correcting forces. Keynes disagreed and said that government spending can and should make up for decreases in business spending. Keynes believed the government could and should spend its way out of a depression and not worry about balancing the budget. The budget would be balanced after the depression ended. Once the economy recovered, government spending would be replaced by business spending. At that point the government could collect enough taxes to pay off its debt. In short, Keynes believed that government spending could end depressions and create self-sustaining growth, which could continue without the government spending more money.

Did Government Spending End the Depression?

When Keynes met with President Franklin Roosevelt, he told the president to increase government spending by between $12 and $15 billion (about $250 billion in 2011 dollars) a year. Roosevelt in fact increased government spending, but only by a few billion dollars. When the President decreased government spending to balance the budget in 1937 (see chart below), GNP declined sharply, more quickly than the rate of decline from 1929 to 1933. Roosevelt pumped more money into the economy in 1938 and GNP went up. Beginning in 1939, the U.S. government effectively began preparing for World War II. During the war, government spending increased sharply, and by 1944, GNP was twice as high as GNP in 1929.

The National Association of Manufacturers, however, stayed with the conventional wisdom that increased government spending hurts rather than helps the economy. This businessmen's organization published a report in 1941, restating its long-standing opposition to deficit spending:

> Deficit spending has actually discouraged a greater amount of new private spending than it replaced. It has had little effect other than cause a staggering debt burden. The theory that by deficit financing we can achieve economic recovery overlooks the fact that government spending by itself cannot begin to provide the plant and equipment needed to put people back to work, that recovery is dependent on the stimulation of

> private investment, and that investors must be confident that private enterprise will be permitted to employ capital and labor properly (without government interference).[2]

One might say that history has proved the NAM wrong. But it is a far more open question whether deficit spending has ever created Keynes's predicted result of self-sustaining growth. As the $14 trillion ($370 billion in 1930s dollars) deficit of the year 2011 proves, it is far easier for the government to go into debt than it is for the government to reduce its debt.

GNP, Expenditures, Deficits, and Unemployment

Year	Total GNP (billions)	Total C (billions)	Total I (billions)	Total G (billions)	Surplus or deficit	Percent unemployed
1929	104.4	79.0	16.2	8.5	+ 1.2	3.2
1930	91.1	71.0	10.3	9.2	+ 0.3	8.7
1931	76.3	61.3	5.5	9.2	– 2.1	15.9
1932	58.5	49.3	0.9	8.1	– 1.5	23.6
1933	56.0	46.4	1.4	8.0	– 1.3	24.9
1934	65.0	51.9	2.9	9.8	– 2.9	21.7
1935	72.5	56.3	6.3	10.0	– 2.6	20.1
1936	82.7	62.6	8.4	11.8	– 3.5	16.9
1937	90.8	67.3	11.7	11.7	– 0.2	14.3
1938	85.2	64.6	6.7	12.8	– 2.0	19.0
1939	91.1	67.6	9.3	13.3	– 2.2	17.2
1940	100.6	71.9	13.2	14.1	– 1.4	14.6
1941	125.8	81.9	18.1	24.8	– 5.1	9.9
1942	159.1	89.7	9.9	59.7	– 33.2	4.7
1943	192.5	100.5	5.6	88.6	– 46.7	1.9
1944	211.4	109.8	7.1	96.5	– 54.6	1.2

C = private consumption; I = gross investment; G = government spending

2. *Fallacies about the Free Enterprise System* (National Association of Manufacturers, 1941), p. 26

Name: ______________________________________ Date: __________

Student Activities

Keynes and the Multiplier

A. Multiple-Choice

1. Herbert Hoover was:
   a. the president of the United States who believed in the multiplier
   b. president of the United States during the first four years of the Great Depression
   c. the president who ended the Depression
   d. an advisor to President Roosevelt

2. Which of the following was not true of the Great Depression?
   a. GNP declined by about one-half.
   b. On average, it cost more to grow wheat than it sold for.
   c. Stocks took a beating by falling about 90%.
   d. Twenty million people were unemployed.

3. President Hoover was advised not to borrow a lot of money to try to end the Depression because:
   a. it would cause interest rates to go up
   b. the next generation would have to pay it back
   c. it would make people lose confidence in the government
   d. all of the above

4. John Maynard Keynes was:
   a. a socialist
   b. the economist who advised Roosevelt to spend the United States out of the Depression
   c. an advisor to Herbert Hoover
   d. all of the above

5. GNP is similar to GDP except for which of the following:
   a. one puts investment spending ahead of consumer spending
   b. one includes the effects of foreign trade
   c. one measures production and the other measures purchasing power
   d. one includes imports whereas the other includes exports

6. John Keynes believed:
   a. that government spending could take the place of investment spending to stimulate economic growth
   b. that Say's law was wrong
   c. none of the above
   d. both a and b

7. At the same time that GNP decreased from $104 billion to $58.5 billion:
   a. investment spending increased by about 16 times
   b. government spending decreased by 16 times
   c. investment spending decreased by about 16 times
   d. government spending increased by about 16 times

8. According to Keynes and other economists who believed in the multiplier, if Ford invested $100 million in building a new factory:
   a. GNP would increase by about $100 million
   b. GNP would increase by about $200 million
   c. GNP would increase by about $300 million
   d. GNP would increase by about $400 million

9. Who would be most likely to agree with Say's law?
   a. Herbert Hoover
   b. Henry Ford
   c. John Maynard Keynes
   d. Barack Obama

10. If the U.S. economy declined by $3 trillion, Keynes would likely advise the president to spend about:

    a. half a trillion dollars

    b. one trillion dollars

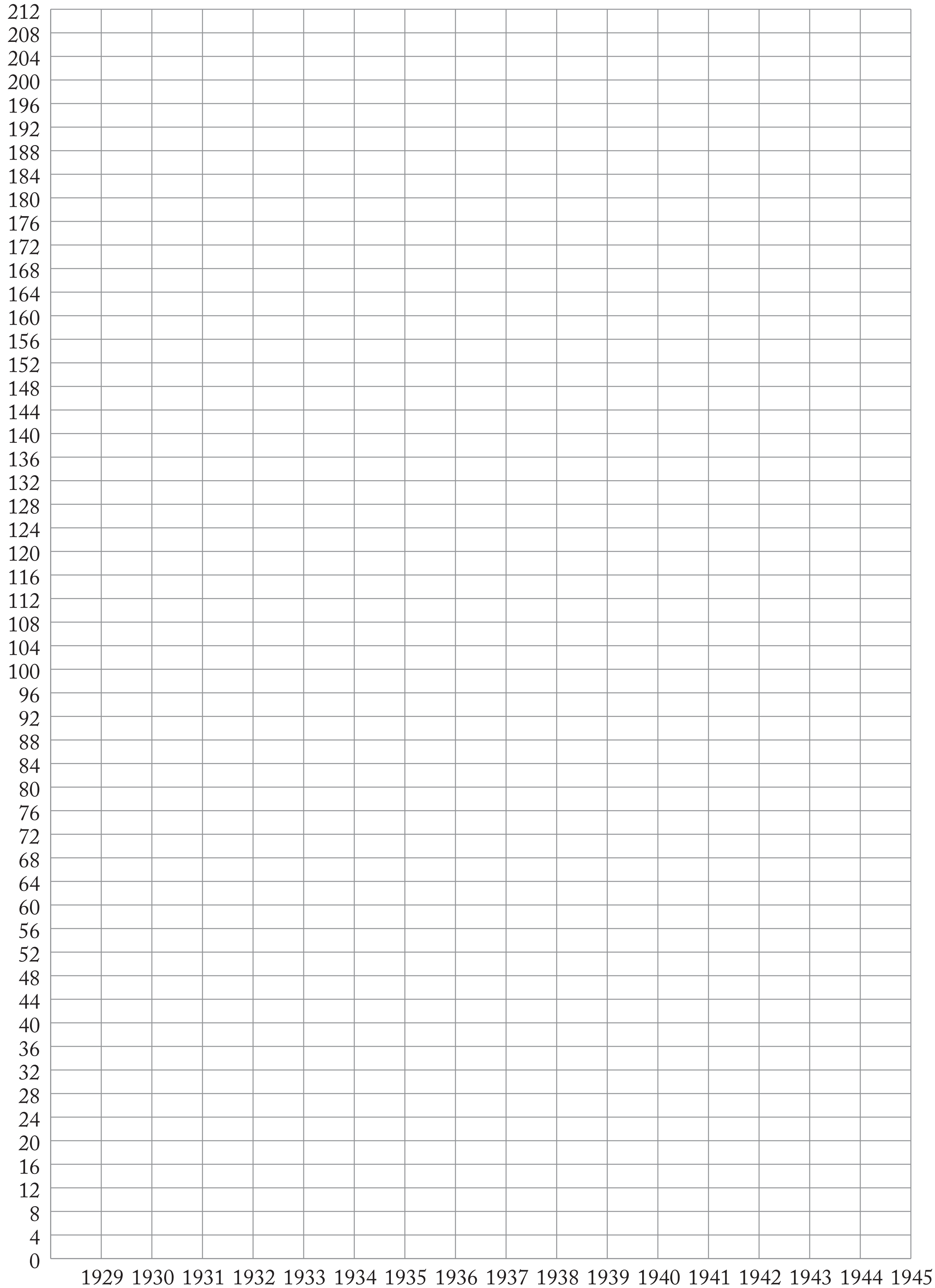
    c. two trillion dollars

    d. four trillion dollars

B. Graphing

Using the table at the end of the reading, graph changes in G, I, and GNP between 1929 and 1944. Then look at your graph and explain what it says about Keynes's economic advice. Explain how it provides evidence that Keynes or the National Association of Manufacturers was correct.

Relationship between G, I, and GNP (1929–1944)



CHAPTER 2

THE WORST ECONOMIC CRISIS SINCE THE GREAT DEPRESSION

Overview

This chapter covers the subprime mortgage crisis and its fundamental causes. The causes are explained as buyers purchasing homes they could not afford with mortgages they could not continue to pay. Students learn that these essentially toxic loans were bundled into securities that ratings companies gave the highest grades and sold to unsuspecting investors. They see that when the housing bubble broke, homeowners could not pay their ballooning mortgages or even sell their homes, and a series of foreclosures caused overextended financial institutions to teeter on the verge of bankruptcy. They then learn that the U.S. government bailed out these financial institutions but did not save the homeowners or halt the surge in unemployment.

Multiple-choice and matching questions test whether students understand the basic information and the concepts covered in this chapter. An essay question asks students to explain the cause of the subprime mortgage recession, describe the harm it caused, and tentatively assign responsibility to guilty parties: inadequate regulations, reckless financial institutions, or clueless homebuyers.

Objectives

Students will:

- explain the causes of the subprime mortgage crisis and describe its effects
- realize that a $700 billion bailout helped prop up America's financial institutions
- speculate on what they think caused the recession and who or what was most responsible
- explain what they think needed to be done to restore the economy and reduce unemployment.

Strategies

After determining whether all students have done their homework, ask whether they believe a bank should lend anyone enough money to buy a house that the potential buyer can't afford and whether the government should institute rules to prevent such loans. Point out that bad loans packaged into worse bonds ("toxic assets") and sold to gullible investors led to government bail-outs of banks and brokerage houses deemed "too big to fail" (in the sense of being allowed to fail). End class by leading discussions on who/what was most responsible for the financial crisis: inadequate regulations, reckless financial institutions, or clueless home buyers.

Assignment

Assign Chapter 3, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 2

THE WORST ECONOMIC CRISIS SINCE THE GREAT DEPRESSION

Introduction

On November 18, 2008, U.S. Treasury Secretary Henry Paulson announced:

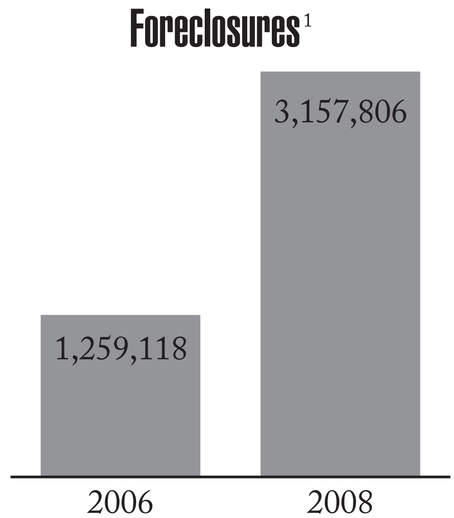
> We are going through a financial crisis more severe and unpredictable than any in our lifetimes. We have seen the failures, or the equivalent of failures, of Bear Stearns, IndyMac, Lehman Brothers, Washington Mutual, Wachovia, Fannie Mae, Freddie Mac, and the American International Group. Each of these failures would be tremendously consequential in its own right. But we faced them in succession, as our financial system seized up and severely damaged the economy.

This chapter will explain the major cause of the economic collapse. It will also help you decide whether the federal government should have spent more money trying to end this economic downturn, the worst since the Great Depression of the 1930s.

The Causes of the Worst Economic Crisis Since the Great Depression

There were warnings, but most people did not pay attention to them. Credit was easy and the stock market was soaring. Housing prices were at an all-time high. Houses that only a year or two earlier sold for $600,000 were selling for $750,000. The banks were demanding down payments (if at all) of about 5% and offered a very low initial rate of interest. Buyers were told that in a few years they could then borrow against the increased value of their homes. These risky mortgages were provided, often without credit checks or proof of income, to people who could not afford them. Millions of these types of loans were packaged into bundles called mortgage-backed securities (MBS). Investors then bought these packages on the assumption that the loans would be repaid or at least that the foreclosed properties would be worth more than was owed on them.

President [George W.] Bush explained the crisis that caused the collapse of some of the major respected financial houses on Wall Street and threatened to bankrupt many of the nation's major banks as follows:



> Many mortgage lenders approved loans for borrowers without carefully examining their ability to pay. Many borrowers took out loans larger than they could afford, assuming that they could sell or refinance their homes at a higher price later on. Both individuals and financial institutions increased their debt levels relative to historical norms during the past decade significantly.
>
> Optimism about housing values also led to a boom in home construction. Eventually the number of new houses exceeded the number of people willing to buy them. And with supply exceeding demand, housing prices fell. And this created a problem: Borrowers with adjustable rate mortgages [i.e., those with initially low rates that later rise] who had been planning to sell or refinance their homes before the adjustments occurred were unable to refinance. As a result, many mortgage holders began to default as the adjustments began.
>
> These widespread defaults [and related foreclosures] had effects far beyond the housing market. Home loans are often packaged together, and converted into financial products called "mortgage-backed securities." These securities were sold to investors around the world. Many investors assumed these securities were trustworthy, and asked few questions about their actual value. Credit rating agencies gave them high-grade, safe ratings…
>
> The decline in the housing market set off a domino effect across the U.S. economy. When home values declined, borrowers defaulted on their mortgages, and investors globally holding mortgage-backed securities…began to incur serious losses. Before long, these securities became so unreliable that they were not being bought or sold. Investment banks such as Bear Stearns [whose stock selling for $70 a share had to be sold for $2 a share]…found themselves saddled with large amounts of assets they could not sell. They ran out of the money needed to meet their immediate obligations…[2]

Thomas Friedman wrote in *The New York Times:*

> So many people were in on it: People who had no business buying a home, with nothing down and nothing to pay for two years; people who had no business pushing such

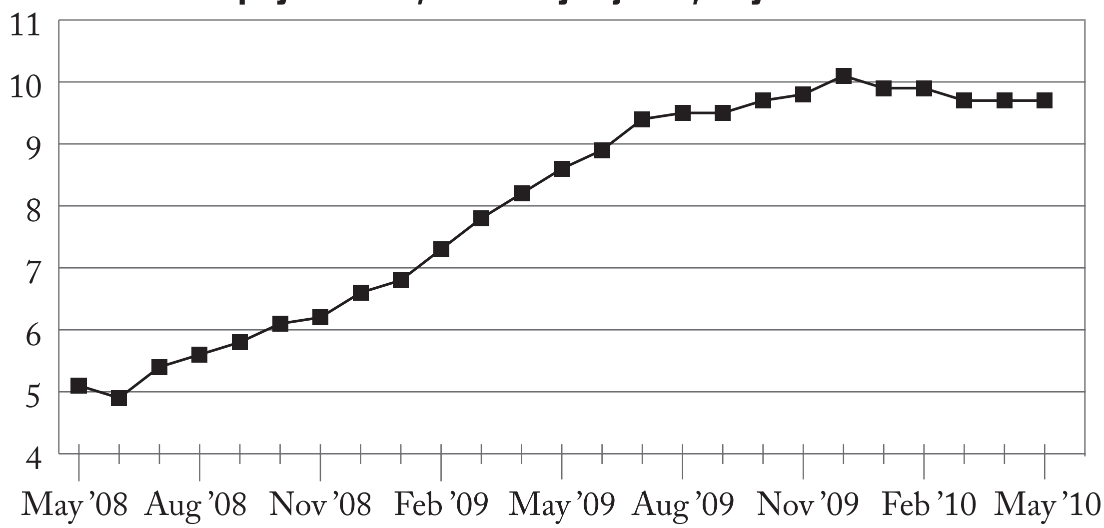
1. Chart from: Thomas Ladenburg, *The Twenties and the Depression*, Social Studies School Service
2. *The New York Times*, September 25, 2008

mortgages, but made fortunes doing so; people who had no business bundling those loans into securities and selling them to third parties, as if they were AAA bonds, but made fortunes doing so; people who had no business rating those loans as AAA, but made a fortunes doing so; and people who had no business buying those bonds and putting them on their balance sheets so they could earn a little better yield, but made fortunes doing so.[3]

The Mortgage Crisis Hits Main Street

The federal government helped shore up large investment banks and other financial institutions by providing $700 billion dollars to lend banks in order to keep them solvent (i.e., in business). This program was known as TARP (Troubled Assets Relief Program). It succeeded, and most of the large banks repaid their TARP loans while the top officials in these investment houses collected huge bonuses. But several million ordinary workers lost their jobs (up to 800,000 in a single month), unemployment increased from 5% to 8% and briefly to 10%. Eventually 15,000,000 Americans found themselves unable to find work—not counting those too discouraged to keep looking for a job or those who could find only part-time employment.[4]

Unemployment Rate, Seasonally Adjusted, May 2008–2010



3. *The New York Times*, November 26, 2008
4. Bureau of Labor Statistics, US Department of Labor, News Release, June 4, 2010

Name: ____ Date: ___________

Student Activities

The Worst Economic Crisis since the Great Depression

A. Multiple-Choice

1. Which came first:
   a. The collapse of major Wall Street investment banks
   b. A rapid rise in the number of unemployed workers
   c. Foreclosures on many home mortgages
   d. The election of Barack Obama

2. Which came first:
   a. Many people assumed mortgages they could not afford
   b. Risky mortgages were packaged into risky securities
   c. President Obama took office
   d. Investment banks teetered on the verge of bankruptcy

3. Who was to blame for the mortgage crisis?
   a. Irresponsible bankers who lent money to people who would be unable to pay it back
   b. People who borrowed more money than they could afford to buy homes
   c. Investment banks that packaged bad loans into securities
   d. All of the above

4. What conditions preceded the subprime mortgage crisis?
   a. A general prosperity
   b. Increases in the price of housing
   c. Irresponsible borrowing and lending
   d. All of the above

B. Matching

Column A. Persons	Column B. Identification
1. George W. Bush	a. president who proposed stimulus plan
2. Barack Obama	b. columnist who explained cause of recession
3. Thomas Friedman	c. Secretary of Treasury at time of subprime mortgage crisis
4. Henry Paulson	d. wrote about effects of recession on people
5. Bob Herbert	e. president when recession started

Column A. Terms	Column B. Identification
6. number unemployed	f. lose house for not paying mortgage
7. 800,000	g. 15 million
8. TARP	h. money lent to pay for property
9. foreclosure	i. number of people who lost their jobs in one month
10. mortgage	j. lent money to bail out banks

C. Short Essay

Write an essay of no fewer than 150 words on one of the following topics:

a. Who or what was most at fault for the recession of 2007–2009

b. Should President Obama spend up to an additional $867 billion to help the economy recover? Why or why not?

CHAPTER 3
DEBTS AND DEFICITS

Overview

This chapter explains the differences between the debt and the deficit, between the absolute amount of a nation's debt and the ratio of debt to GDP. Students learn how much of our increased debt since the year 2000 was due to tax cuts, wars in Afghanistan and Iraq, the recession starting in 2008, bailouts, and stimulus spending. Multiple choice and matching questions test whether students understand the basic information and concepts covered in this chapter, and an essay question requires students to account for increases in the debt since the year 2000.

Objectives

Students will:

- understand the following: debt, deficit, surplus, and ratio of debt to GDP
- realize that a projected yearly surplus of $800 billion in 2001 turned into a deficit of over $1.216 trillion in 2009
- compare U.S. debt to GDP ratio in three different times, 1945, 1980, and 2010, and discuss the relevance of these statistics
- discuss to what extent the debt and deficit of 2010 arose from each of several different factors.

Strategies

After determining whether all students have done their homework, start class by reviewing students' answers to the multiple-choice and matching questions. Make sure that all students understand the basic concept of the debt's percentage of GDP, and that they understand the many reasons for the great increase in the nation's deficits and debt between 2001 and 2010. Note that there is a huge difference in opinion in the U.S. over the significance of the U.S. debt, and who and what is most responsible for the situation faced by the nation in 2010.

Assignment

Assign Chapter 4, passing out the student reading and activities pages (you may wish to assign Chapter 5 as well). Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 3

DEBTS AND DEFICITS

STUDENT PAGES

Introduction

While the terms "debt" and "deficit" may be familiar to you on a personal level, they have deeper meanings when attached to the economies of governments. Debt, when applied to the federal budget, refers to the amount of money owed by the government. Deficit refers to the lack of revenues to cover what the government spends in a given year. The term "surplus" is used to describe what happens in the cases when government income exceeds what the government spent in a given year.

Year	Surplus/deficit (in billions $)	Debt (in billions $)
2000	86.4	9821.0
2001	−32.4	10,225.3
2002	−317.4	10,543.9
2003	−538.4	10,979.8
2004	−568.0	11,685.6
2005	−493.6	12,445.7
2006	−434.5	13,224.9
2007	−342.2	13,891.8
2008	−641.8	14,394.1
2009	−1549.7	14,097.5
2010	−1370.5	14,508.2
Estimates:		
2011	−1703.0	15,079.6
2012	−1177.2	15,812.5

The federal government's deficit in 2009 was expected to be $1.171 trillion because President Barack Obama submitted a proposal to spend $3.552 trillion, but only expected to collect $2.381 trillion. Primarily because of a decrease in tax revenues and an increase in government spending, the actual deficit for 2009 was over $1.5 trillion. With the deficit of 2010 added to the total debt, the U.S. owed well over $14 trillion at the end of 2010.[1]

In 2000, the U.S. actually had a surplus (revenues exceeding expenditures) of about $86 billion and the Congressional Budget Office predicted a surplus of $860 billion for the following decade. Instead, the U.S. recorded a $32 billion deficit in 2001 and the debt increased by over $4 trillion by 2010.

This chapter will begin an exploration of two questions:

1. Why the drastic turnabout?
2. What can and should be done about it?

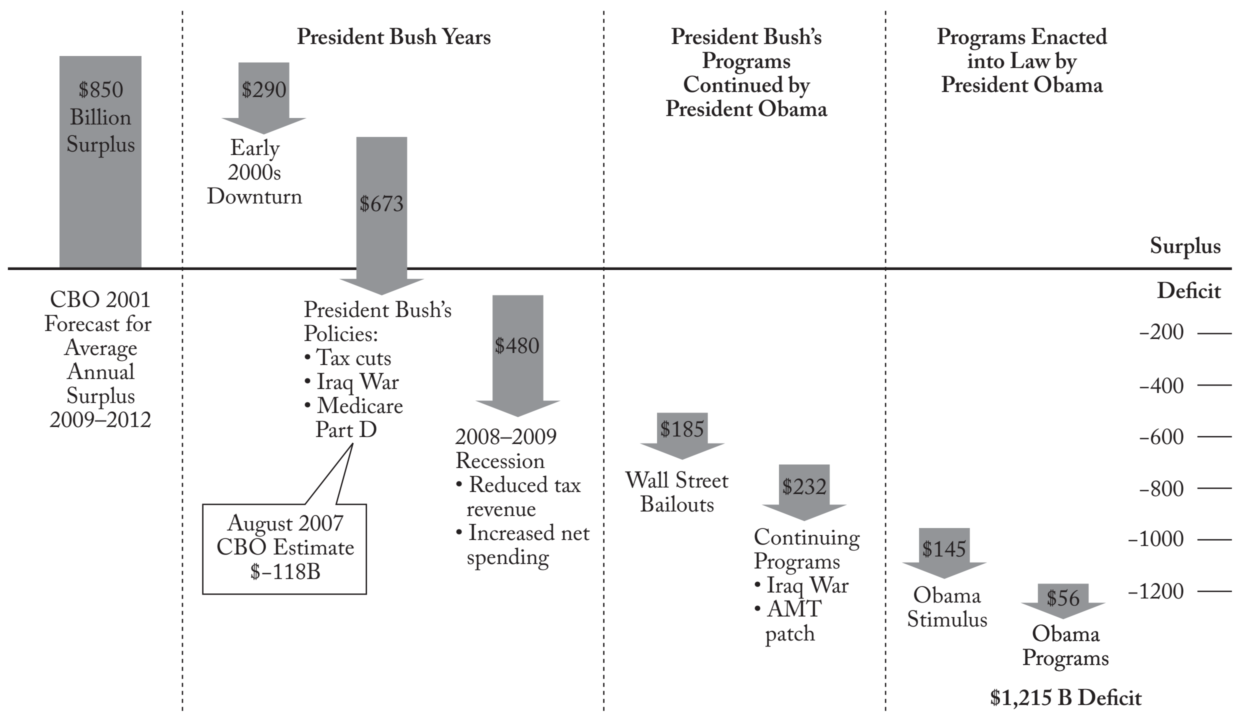
1. Statistics from *Economic Report of the President: 2011*. Report Spreadsheet Tables, table by Thomas Ladenburg

The U.S. Congressional Budget Office forecasted an average $850 billion surplus between 2009 and 2012 before a series of tax cuts, wars with Iraq and Afghanistan, and the prime-rate mortgage crisis caused the recession of 2008. This recession substantially reduced tax collections and increased federal spending on unemployment insurance and other safety-net programs. Furthermore, Congress passed a stimulus program to restore the U.S. economy and spent billions to prevent bankruptcies of major financial institutions and automobile companies. As a result, the average deficit forecast for 2009–2012 is over $1.414 trillion.

The New York Times estimated that the leading causes for this $2-trillion-per-year swing were as follows:[2]

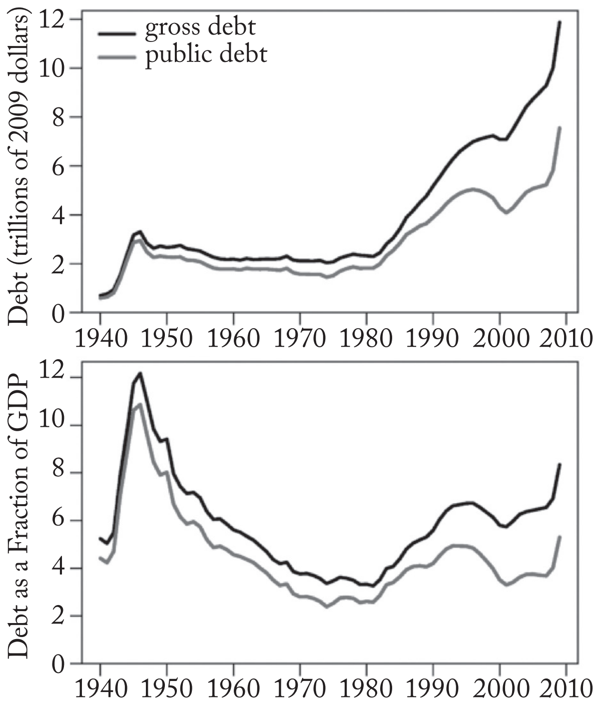
1. The recession: $290 billion + $480 billion = $770 billion.
2. Bush Administration policies (tax cuts, Iraq War, and increased spending for prescription drugs for seniors): $673 billion.
3. Policies initiated by Bush, including bailouts to save financial institutions, and continued under Obama: $400 billion.
4. New policies initiated by President Obama (economic stimulus package and new programs): $145 billion + $56 billion = $201 billion.

Causes of Change in Average Surplus/Deficits Forecasted by CBO for 2009–2012[3]



2. This is a file from the Wikimedia Commons. http://commons.wikimedia.org/wiki/Main_Page
3. Source: NY Times Analysis of CBO Data. Note that CBO forecasts are based on law enacted at time of forecast. Dollar amounts are in billions.

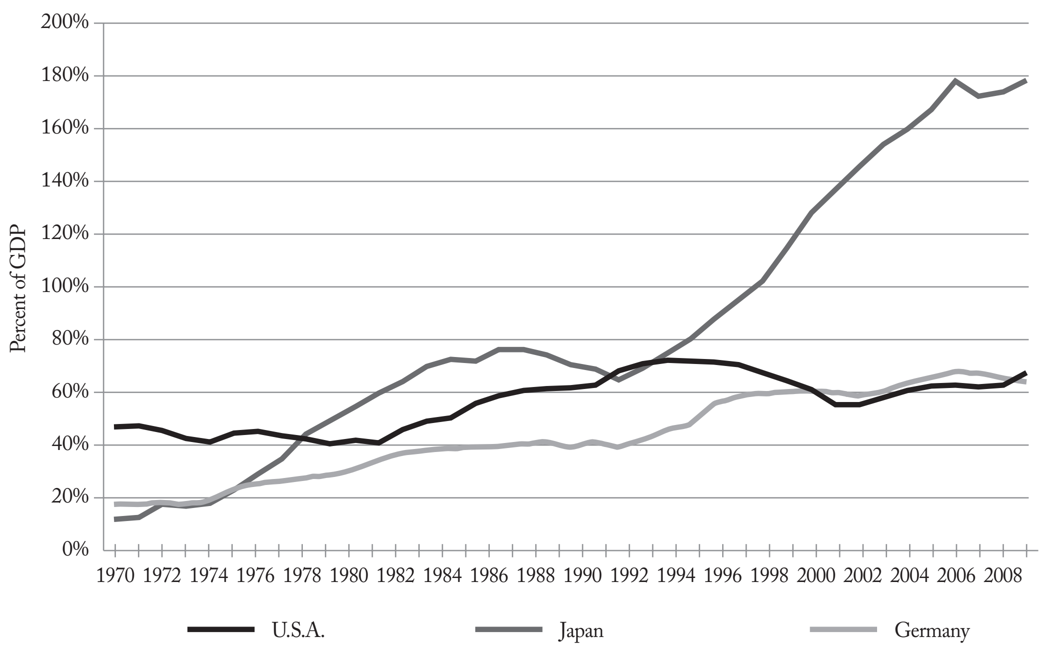
Two Ways of Looking at the National Debt



There are two different ways of representing the total debt. The most common is in current dollars as shown in the top graph. One must also be aware, however, of the relationship of the debt to Gross Domestic Product; this is shown in the bottom graph. The debt does not need to be understood in absolute terms. It is easier to pay a debt of $5 trillion if the GDP is $10 trillion, than it would be to pay it if the GDP were only $2 trillion.[4] Note that the bottom graph indicates the gross debt was approximately 120% of GDP in 1945 and was in the neighborhood of 90% of GDP in 2010.[5]

One more thing to consider: How serious is the U.S. debt problem? One indicator that has not yet been mentioned is how the U.S. compares with other nations with regard to debt versus GDP. This is illustrated in the following chart:[6]

Level of Debt as a Percentage of GDP: U.S.A., Japan, and Germany



4. The gross debt is the total amount including the government owes to itself (such as what the government borrowed from the Social Security Trust Fund.) The public debt does not include money the government owes to itself.
5. http://commons.wikimedia.org/wiki/File:USDebt.png
6. http://commons.wikimedia.org/wiki/File:PublicDebtTriade.PNG

Name: ______________________________ Date: __________

Student Activities

Debts and Deficits

A. Multiple-Choice

1. The difference between the debt and the deficit is:
   a. the former is the amount owed, the latter is the shortfall for a given year
   b. the former is the shortfall for a given year and the latter is the amount owed
   c. the debt is important; the deficit is not
   d. both b and c

2. Deficits occur:
   a. when there are no surpluses
   b. when governments spend more in one year than they receive in revenues
   c. only when countries are at war
   d. only when Democrats are in office

3. According to the chart on the first page of this chapter:
   a. the deficit has increased, but the debt has not
   b. the United States has run a deficit every year since 2000
   c. the debt in the year 2011 is predicted to be more than 50% greater than it was in 2000
   d. as the deficit increased, the debt went down

4. According to the reading:
   a. President Bush was not responsible for increases in the debt
   b. the Congressional Budget Office forecast a surplus of $860 billion for 2009–2012
   c. President Obama was most responsible for the increase in the U.S. debt since the year 2000
   d. the United States is coming closer to balancing its budget every year

5. The main reason that the gross debt is not as important as the deficit as a percentage of GDP is that:
   a. the debt is more important than the deficit
   b. deficits are short range items
   c. debts are easier to pay off if they are a small percent of the GDP
   d. Japan's ratio of GDP to debt is twice as bad as that of the United States

6. According to the chart, which of the following countries has the highest percent of debt compared to GDP:
   a. England
   b. Japan
   c. Germany
   d. the United States

7. What would Keynes most likely have said about the high U.S. debt in 1945?
   a. Debt doesn't matter.
   b. The United States is in a heap of trouble.
   c. The high debt probably stimulated the U.S. economy.
   d. The United States needs to balance its budget every year from now on.

8. Which if any of the following is not a reason for the 2010 U.S. debt?
   a. Bush's tax cuts
   b. The recession
   c. Two wars
   d. They all were causes

9. What very important lesson did you learn by studying this chapter?
   a. Never to take economics again.
   b. Debts are always bad.
   c. Countries seldom run surpluses.
   d. The amount of debt a country has is not as important as its ratio of debt to GDP.

10. Who or what was most to blame for the increase in debt and deficits in the first ten years of this century?

    a. The recession starting in 2007

    b. President Bush

    c. President Obama

    d. The wars in Iraq and in Afghanistan

B. Essay

On your own paper or in your notebook write an essay of no fewer than 125 words defending the answer you chose to question 10 (above).

CHAPTER 4
REDUCE UNEMPLOYMENT OR DEBT?

Overview

This chapter explains the issue of restoring the U.S. economy to pre-recession levels by spending more money in the hopes of replacing reduced consumer demand with government spending. The proposed alternative is to cut taxes and government spending to avoid a higher federal deficit, higher interest rates, and possible insolvency. Advocates for both positions present their arguments after students read about the Obama stimulus package and examine charts to determine whether it succeeded. After students answer multiple-choice questions to test their understanding of fundamental facts and concepts presented in this chapter, an essay question asks them to side with either the Keynesian spenders or the deficit hawks.

Objectives

Students will:

- learn about and evaluate Obama's American Recovery and Reinvestment Act
- understand the arguments for increasing government spending to end a recession and to avoid excessive government spending during a recession
- decide which of the two arguments is more convincing.

Strategies

After determining whether all students have done their homework, start class by reviewing students' answers to the multiple-choice questions. Ask students whether they are more in favor of stimulating the economy despite the danger of extending indebtedness or in minimizing debt at the expense of foregoing an economic stimulus. As students give their opinions, ask anyone who disagrees to summarize their opponent's main argument and explain why they disagree with it.

Assignment

Before you assign Chapter 5, *Extend Unemployment Benefits?*, decide whether you think that your class can benefit from reading and discussing the material in it. Most of the statements in the chapter appeal to emotions rather than intellect and therefore may not be an appropriate use of class time. On the other hand, this chapter is very likely to make for a highly energized discussion and give students a chance to couple what they have learned with their underlying feelings.

CHAPTER 4

REDUCE UNEMPLOYMENT OR DEBT?

Introduction

In this chapter you will read two arguments—one for reducing the debt and the other for increasing government spending. At the end of the chapter you will be asked which of the two arguments is most convincing. But, first you must learn of President Obama's major effort to end the recession—the Stimulus Act, formally known as the American Recovery and Reinvestment Act.

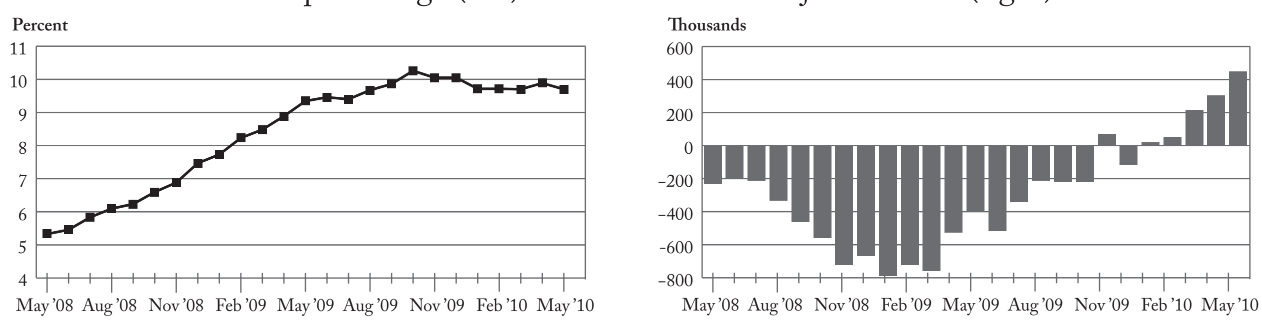
Government Stimulus Package: Did It Help?

To stem the increasing tide of unemployment, Congress passed the American Recovery and Reinvestment Act (ARRA), also known as the stimulus bill. It provided $787 billion to end the recession. Roughly one-third of that money was allocated to states, primarily to continue paying unemployment benefits and maintain state and local employees such as teachers and policemen. Another one-third was allocated for numerous projects including energy, high-speed rail, education, home and office insulation. Another third of the stimulus package was allocated for tax reductions for individuals and for small businesses.

How effective was the stimulus package? This question is definitely up for debate. Fearing it would be a waste of government money, all but three Republicans voted against it. Nevertheless, a major depression was averted and though the number of unemployed increased, the number losing their jobs every month decreased and employment increased.[1]

Unemployment from May 2008 to May 2010

as a percentage (left) and in thousands of jobs created (right)



1. Bureau of Labor Statistics, US Department of Labor, News Release, June 4, 2010

Nevertheless, as of May 2010, 15 million Americans were still without work and another 7 million could find only part-time work. The columnist Bob Herbert described the plight of millions of Americans still facing 15 months of unemployment after passage of the stimulus bill:

> More than 15 million Americans are out of work, and nearly half have been jobless for six months or longer. New college graduates are having a terrible time finding work, and many are taking jobs that require only a high school education. Teachers are facing the worst employment market since the Depression.
>
> Some inner-city neighborhoods, where joblessness is off the charts, are becoming islands of despair. Rural communities and rust belt cities and towns are experiencing their own economic nightmares. State and local governments, for example, are shedding workers as we speak.[2]

Reduce Unemployment or Debt?

Based on what you learned in the previous chapters you will be asked to decide what the President and Congress should do in the fall of 2010: try to reduce unemployment or reduce the debt. Read the following arguments and make up your mind.

Unemployment Causes More Pain Than Deficits

Money flows in circles: you get paid; you spend it, and the store pays someone else, who spends at another store. But what if everyone spent 90% and saved 10% in the bank? The circular flow of money would dwindle away to nothing, all the money would end up in the bank, the stores would shut and we'd all be out of work.

We do save some, so why doesn't this happen? Because other people and businesses borrow and spend what they borrow. That's good. It keeps things going.

But in a recession, like now, businesses don't want to borrow and invest. And right now people are saving more than they have in years. So the circle of money is dwindling and people are losing their jobs. So the economy is slowly running down. It's losing about half a million jobs per month relative to keeping up with labor force growth.

That's making people more pessimistic. So they feel less like borrowing and spending. We're in a trap. In the Great Depression we stayed in the trap for about 12 years. It was the enormous deficit spending for World War II that got us out.

So the only way we know to get out is for the U.S. government to borrow the money that you and I are saving and spend it for us. If they spend it fast enough, it will create enough jobs to turn this economy around.

And if they spend it on infrastructure and projects to build things our kids will need

2. Bob Herbert, "A Very Deep Hole," *The New York Times,* June 7, 2010.

or enjoy, then even though they have to pay back the debt, they will have gotten their money's worth. But even if the spending does not grow our domestic economy, it's still better than sliding into a depression. That's even worse for our future.[3]

The Deficit Is an Economic Nightmare From Which We Can't Escape

[A]ccording to the U.S. Treasury Department, on June 1st, the U.S. National Debt was $13,050,826,460,886.97. For those not used to seeing such big numbers, that is over 13 trillion dollars. To give you an idea of just how much a trillion dollars is, if you had started spending one million dollars every single day when Jesus was born, you still would not have spent one trillion dollars by now. And yet somehow the U.S. government has accumulated a debt of over 13 trillion dollars.

But the truth is that they continue to recklessly spend our money as if they have not learned anything. This year, it is projected that the U.S. government will issue nearly as much new debt as the rest of the governments of the world combined. The truth is that it is simply not possible to pay off the national debt. Most economists realize this and speak of more realistic goals such as getting our debt growth down to a level that is "sustainable."

But the reality is that we are way beyond being able to get this debt under control. If the U.S. government cut spending enough to make a real difference it would crush the economy and tax revenue would take a sharp nosedive. If the U.S. government borrows even more money and increases government spending even more it will help the economy in the short-term, but it will make our long-term problems even worse.

What we have done to future generations is beyond criminal. One day, if they get the chance, they will look back and curse this generation for what we have done to them. We spent all their money and we have stuck them with the bill for our wild excesses. We have taken the great American economic machine and we have driven it straight off a cliff.[4]

3. ZFacts.com, *Why Borrow and Spend for Economic Stimulus?*, July 11, 2009
4. BeforeItsNews.com, *Why Is U.S. Government Spending So Wildly Out Of Control?*, July 10, 2010

Name: ____ Date: ___________

Student Activities

Reduce Unemployment or Debt?

A. Multiple-Choice

1. The Stimulus Act of 2009 is best described as:
   a. a socialist piece of legislation
   b. an attempt to end the recession
   c. an act supported by most Republicans
   d. a complete success

2. ARRA stands for:
   a. the Anti-Repeal and Renew Act
   b. the American Reform and Relief Act
   c. the American Recovery and Reinvestment Act
   d. the American Robust Recovery Act

3. The money the government was authorized to use by the ARRA was:
   a. opposed by the Democratic Party
   b. a waste of the taxpayers' money
   c. split evenly between tax cuts, stimulus spending, and aid to states
   d. ended the recession and restored full employment

4. According to the chart, unemployment since passage of the ARRA in February 2009 has:
   a. increased
   b. increased but at a slower rate than before
   c. decreased significantly
   d. both a and b

5. Unemployment during the years following the recession:
   a. hovered around 9–10%
   b. was higher in total numbers than during the Great Depression
   c. included most Congressmen
   d. both a and b

6. According to the first argument:
   a. when people don't spend their money, the government must spend its money
   b. deficits don't matter
   c. the United States spent its way out of the Great Depression during World War II
   d. both a and c

7. What is meant by the expression in the first argument that the United States was losing half a million jobs a month relative to growth in the labor force?
   a. Losing half a million jobs a month was a good thing.
   b. The government is not spending enough to reduce unemployment.
   c. The United States did not need more government spending.
   d. Both a and c

8. According to the second argument:
   a. the amount of the debt is more important than its ratio to GDP
   b. it's going to be very difficult to pay back the debt
   c. short-term gains in the economy as the result of extra federal spending will make the problem worse
   d. both b and c

9. According to the second argument:
   a. a trillion dollars is not a lot of money considering how much the U.S. was in debt during World War II
   b. no one would be able spend a trillion dollars
   c. it would take spending more than a million dollars a day since the birth of Jesus to pay off the national debt
   d. it would take spending more than a million dollars a day since the birth of Jesus to spend a trillion dollars

B. Short Essay

Write an essay of no fewer than 150 words explaining which of the two arguments from the reading you agree with and why. Include your reasoning for why the opposing argument is wrong. Use information from this (and other chapters, if you wish) to support your argument.

CHAPTER 5
EXTEND UNEMPLOYMENT BENEFITS?

Overview

This chapter presents both sides of an emotional argument which may prove to be more important to the average voter than the sophisticated arguments made by economists. The chapter focuses on determining whether people should be provided with a government job if they can't find work in the private sector. It also covers the related question: whether, in times of mass (8+%) unemployment, those out of work are to be castigated because they are out of a job. Arguments on both sides of this question are presented in the words of writers responding to someone's blog. The arguments strike an emotional chord and appeal to emotions rather than intellect.

Objectives

Students will:

- learn how unemployment disproportionately affects various ethnic groups, teenagers, women, and men
- read arguments from ordinary people on whether helping the unemployed helps the country
- discuss whether the unemployed are responsible for their predicament and if working Americans are morally obligated to support people who aren't working, with their taxes.

Strategies

Start class by asking students whether they have any questions regarding the assigned work and by answering their questions. Then have at least one student volunteer to play the role of Deb, the taxpayer who does not want to support the indigent, and an equal number to play the role of the woman from Michigan whose husband has been laid off. Allow each student to pick a few friends to help prepare the arguments for and against extending unemployment insurance. While they are preparing their arguments, have the rest of the class get together in groups to discuss how they feel about the issue of extending benefits. When all are prepared, allow a spokesperson for each side to present his or her case and open the class up for a discussion. Make reference to the debt and the Keynesian arguments whenever they are relevant.

Assignment

Assign Chapter 6, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 5

EXTEND UNEMPLOYMENT BENEFITS?

Introduction

If you have a full-time job and lose it through no fault of your own, you are entitled to 26 weeks of unemployment insurance. The money to pay for this insurance is taken from an account funded by employers and their employees. The amount you get paid while not working depends on state laws. It generally is no more than half of what you earned while working, and the average unemployment check is approximately $300 a week. If you are eligible for unemployment benefits you must file a claim, wait for at least two weeks before you receive payment, and prove you are looking for a job while unemployed.

In cases of unusually high rates and long periods of unemployment, Congress may pass laws extending jobless benefits. In the year 2010, nearly two million of the 15.3 million unemployed Americans were due to lose unemployment benefits.

In this chapter you will have an opportunity to apply ideas you learned about the danger of deficits and the need for deficit spending to a proposal to extend unemployment benefits. You will read opposing opinions posted on a blog by real people with completely different ideas on this topic. You will also be asked to write an essay, supported by facts and concepts from this and preceding chapters, to support your views on this important issue.

Who Were the Unemployed in May 2010?

- 10% of all adult men
- 8.2% of all adult women
- 25.4% of all teenagers
- 16.5% of all adult African Americans
- 12.5% of all adult Hispanics
- 6.5% of all adult Asians

(Those not looking for a job, or who had part-time jobs and wanted to work full-time, are not considered unemployed.)

Extend Unemployment Benefits for Two Million People Whose Benefits Are About to Run Out?

The proposed bill extended unemployment benefits and supplied money to help states prevent layoffs of teachers and policemen, but the main argument was over extending unemployment at the cost of $131 billion. The bill would be partially paid for by closing tax loopholes of $63 billion that would affect wealthy taxpayers and corporations. Your task is to focus on the idea of using $131 billion to help unemployed workers at a time of a national debt in excess of $13 trillion.

We can't afford to extend unemployment insurance: [W]ith high and rising budget deficits, we can't afford to spend money on extended unemployment benefits. **Unemployment benefits don't promote economic recovery:** Maybe we should just pretend…that the government is not spending us into oblivion. Since you're such a genius, please explain to us lesser little people what happens when your spending outpaces your revenue. **Unemployment insurance increases unemployment** …[R]espected scholars argue these record unemployment-benefit expansions actually are resulting in more unemployment, not less. The idea here is that unemployed workers have a disincentive to look for work, since they are receiving a check…[B]enefits may, in some cases, prolong a worker's active job search	**We can't afford not to extend unemployment benefits:** [G]overnment spending on unemployment insurance is one of the most cost-effective ways to help strengthen the nascent economic recovery, and a robust recovery is the first step toward reducing the deficit. **Unemployment Benefits Promote Economic Recovery** When combined with subsidies to help unemployed workers pay for healthcare, I estimate that extended unemployment insurance benefits can help create over 900,000 jobs. **Unemployment insurance decreases unemployment** There are 5.6 workers for every job opening in this country. The problem is not a lack of willingness to work on the part of Americans; it's a lack of available work, If a laid-off engineer passes up a job waiting tables and then, two months later, finds work in his own field, then he'll be unemployed longer. But who in their right mind would say this is a bad thing?[1]

1. Adopted from Lawrence Mishell, The Bad Arguments Against a Much Needed Unemployment Extension

Input from Real People: One Unemployed and One with a Job

Deb wrote:

Wow! I must live in a different world than some of you. I know of people collecting unemployment that have no intention of looking for a job till the benefits get ready to run out. I personally don't care to continue to pay taxes so that others can sleep or play away their days. I've worked all my life and when one job left, I found another… I don't want my lawmakers to continue to extend the Unemployment. You will continue NOT to have employment if the government continues to tax companies...don't you get that? Quit whining and do something....think outside your box.[2]

A woman from Michigan wrote:

My husband has been layed-off since Feb. 2007, and guess what?, he has put out (and I am not exaggerating) 100~s or resumes, and he gets up and puts them out, and knocks on door after door, and he has been a Supervisor most of his working life!! We have lost EVERYTHING!!!! I bet you do not know what it feels like to first lose your boat, then your second car, then LOSE YOUR HOME!!! … people out there like you ,who has a job BE GRATEFUL and feel sorry for the rest of the working world who wants to work, and can't get a job to support their families do not need people like you to make the "breadwinners" feel any worse than they already do![3]

2. From online blog.
3. Talkback to article by Ken Thomas, Associated Press Writer Manufacturing.Net - May 16, 2008

Name: ______________________________________ Date: __________

Student Activities

Extend Unemployment Benefits?

A. Multiple-Choice

1. Which of the following is *not* true about the unemployed?

   a. There was a greater percent of women than men unemployed.

   b. The group with the highest percent of unemployed was teenagers.

   c. The group with the lowest percent of unemployed was Asians.

   d. Both b and c

2. In order to receive unemployment insurance you must:

   a. be over 21 years of age

   b. be out of a full-time job through no fault of your own

   c. be unemployed and so discouraged that you stopped looking for a job

   d. have earned at least $300 a week on a full-time job

3. Unemployment compensation usually lasts for:

   a. however long states decide

   b. 26 weeks but can be extended

   c. 26 weeks for men, but only 13 weeks for married women

   d. as long as a person is looking for work but cannot find it

4. One good argument for not extending unemployment benefits is that:
   a. it helps the economy because unemployed people spend more money
   b. it encourages people not to take the first job offered them and keeps them unemployed for longer periods of time
   c. the United States has plenty of money to spend
   d. it's not fair that people in one state get more unemployment insurance than people in other states

5. One good argument for paying unemployment insurance is that:
   a. it helps people in need
   b. it helps to keep the economy from getting worse
   c. it costs a lot of money
   d. both a and b

B. Essay

In no fewer than 150 words, answer the following question:

Should unemployment insurance be extended by 26 weeks during a long recession or a depression? Use facts and figures presented in this and in the previous chapter to support your answer. Include information concerning the economic effect of increasing or not increasing the debt and your ideas concerning the moral obligation of the government to this and/or to future generations. Come to class prepared to present your position, listen to the ideas of others, and either defend your opinion or change your views.

CHAPTER 6

WHO SHOULD PAY AND HOW MUCH?

Overview

This chapter explains the difference between a fee, a flat tax, and a graduated income tax. Students learn when the graduated income tax was introduced and how the rates changed between 1913 and 2010. They learn that the highest 1% of income earners earns over 36% of the total earned income and pay about 20% of the federal income tax, while the lowest 50% of income earners make 10% of the country's income and pay less than 4% of the nation's income taxes. The chapter also provides figures that show how much various income groups saved through the tax cuts of 2001–2004.

Multiple-choice and matching questions test whether students understand the basic information and concepts covered in this chapter and an essay question asks whether or not they would keep the Bush tax cut applying to taxable income in excess of $500,000.

Objectives

Students will:

- know the difference between a fee, a flat tax, a progressive tax, and a regressive tax
- know that the top marginal income tax rates have gone down from 94% to 35% since World War II
- know that the top 1% of income earners in the U.S. pay over one-third of the income taxes collected in the U.S.

Strategies

After determining whether all students have done their homework, review students' answers to the questions at the end of the chapter and make sure that all students understand the answer to each question. Point out that the richest 1% pay 20% of the nation's income tax but earn about 36% of the nation's income. Start a discussion on whether the part of the 2001 and 2004 tax cuts which reduced the highest marginal rate on taxable income from 39.6% to 35% should be (or should have been) repealed.

Assignment

Assign Chapter 7, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 6

WHO SHOULD PAY AND HOW MUCH?

Introduction

No one enjoys paying taxes. Yet it has been said that “taxes are the price we pay for civilization.” Taxes pay for the teachers in our schools, for the people who collect our garbage, for the soldiers who defend our country, for the food stamps that help feed the poor, for the roads that allow us to drive, and for the many other things that we can not provide for ourselves. The real questions are not only how much money our government needs to do these things effectively, but who should pay for these services and how much they should pay.

Some people believe that no person should be taxed more than anyone else—that Bill Gates, for instance, should not pay a higher tax than is paid by a retired policeman. An example of this idea is that everyone pays the same fee to get a driver’s license. Some individuals believe in what is called a “flat tax”: everyone should pay the same percentage of their income as everyone else. If those who make a $1000 a day pay 20% of their income, so should the person who makes $1000 a month. Everyone is therefore treated equally. Sales taxes and most property taxes are levied on this basis.

Some taxes are considered to be “regressive.” People with more money pay a lower percent of their income in taxes. Social Security tax rates are regressive. People pay the same percent of their income (flat or proportional tax), but those who make more than $106,800 do not pay Social Security taxes on any additional income.

There are others who believe in what is called a “progressive” income tax. People who make more money should pay a larger percent of their income in higher brackets. This principle is embedded in the U.S.’s federal income-tax code. As the following chart shows, people in higher income brackets pay a larger percent of this added income in taxes:

Income-Tax Rates

The marginal income-tax rate is the percent of your taxable income (see footnote 3 on opposite page) that must be paid on the highest income bracket you are in. The accompanying chart shows the marginal rates as 10, 15, 25, 28, 33, and 35 percent, depending on the income bracket. Everyone pays the same tax on their first $16,700, their first $68,000, and their first $137,000, etc. of taxable income (income minus deductions).

Income-Tax Brackets on Taxable Income for 2010[1]				
If taxable income is:				
Over	But Not Over	The Tax Is	Of the Amount Over	Maximum Total Tax
$0	$16,750	$0 + 10%	$0	$1,675
$16,750	$68,000	$1,675 + 15%	$16,750	$9,362
$68,000	$137,300	$9,362 + 25%	$68,000	$26,687
$137,300	$209,250	$26,687 + 28%	$137,300	$46,903
$209,250	$373,650	$46,833 + 33%	$209,250	$101,155
$373,650	n/a	$101,085 + 35%	$373,650	n/a

A Short History of the Modern Income Tax

For most of its first 120 years, the U.S. government raised money primarily by selling western land and taxing imports. Other sources of income, like the ill-fated whiskey tax of the 1790s, accounted for a small percentage of total government income. During the 1860s, the U.S. government taxed incomes in order to pay for the Civil War, but these taxes were repealed in 1872. An income tax was passed again in 1894 but the U.S. Supreme Court found it to be unconstitutional in 1895. It was not until 1913 that another income tax was passed. The rates on the highest earners were raised during World War I, lowered during the 1920s, raised again to help pay for New Deal programs and even more to finance World War II. Rates were lowered considerably in the 1960s and dramatically during the 1980s and the early parts of the twenty-first century. The chart below clearly demonstrates this history:

1. Table by Thomas Ladenburg

STUDENT PAGES

A Partial History of the Modern Income Tax[2]			
Applicable years	Top rate applied to taxable incomes over:[3]	Lowest bracket	Highest bracket
1913–1915	$500,000	1%	7%
1919–1920	$1,000,000	4%	73%
1925–1928	$100,000	1.125%	25%
1929	$100,000	0.375%	24%
1936–1939	$5,000,000	4%	79%
1944–1945	$200,000	23%	94%
1951	$400,000	20.4%	91%
1965–1967	$200,000	14%	70%
1971–1981	$205,000 avg.	13.825%	69.125%
1983–1986	$154,000 avg	11%	50%
1988–1990	$31,050 avg	15%	28%
1993–2000	$241,550 avg.	15%	39.6%
2004–200?	$356,000 avg.	10%	35%

Some people argue that the tax cuts of 2001–04 benefitted the people who made the most money. The following chart contains information used to support this belief:

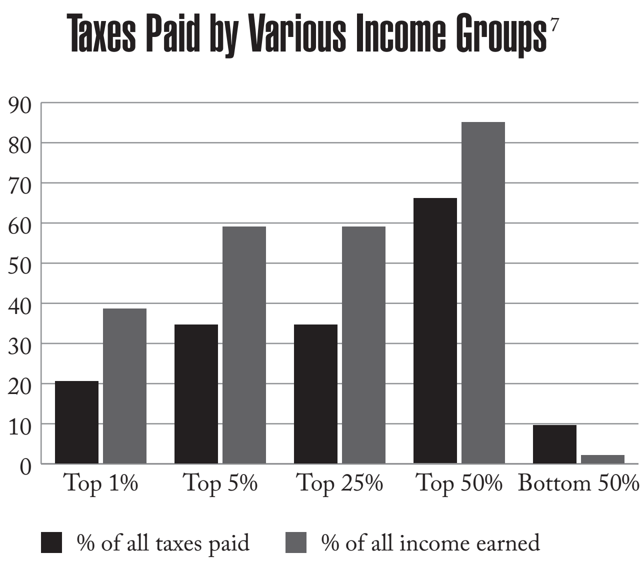
How Tax Cuts Between 2001–2004 Benefited Different Groups[4]			
Economic group (based on taxable income)	Average tax cut	% increase in after-tax income	% share of total tax cut
Middle 20%	$647	2.3%	8.9%
Top 1%	$34,992	5.3%	24.2%
Over $1 million	$123,592	6.4%	15.3%

2. Source: IRS
3. The difference between income and taxable income is that the former is the money made by the taxpayer, and the taxable income is the earnings minus deductions. Deductions include mortgage-interest payments, business expenses, charitable contributions, contributions to some types of retirement accounts, excessive medical expenses and much more.
4. Source: Urban-Brookings Tax Policy Center

Some argue that the rich already paid more than their share of taxes. The following chart contains information used to support this belief:

Percent of Total Taxes Paid by Various Income Groups in 2004[5]		
Percentiles ranked by average adjusted taxable income	**Average adjusted taxable income**	**Percentage of total federal income tax paid[6]**
Top 1%	$328,049	36.89%
Top 5%	$137,056	57.13%
Top 10%	$99,112	68.19%
Top 25%	$60,041	84.86%
Top 50%	$30,122	96.70%
Bottom 50%	< $30,122	3.30%

The chart shows the various amounts of income taxes paid by each major income group. Note that the top 50% of wage earners include the top 1%, 5%, and 25% percent, and decide whether you believe that each group is paying about the right amount, too much, or too little.



5. National Taxpayers Union, based on Internal Revenue Service sources
6. This does not include sales taxes, Social Security taxes, or property taxes, which are flat tax
7. Source information IRS, Statistics of Income, 2006. Chart based on one by Thomas Ladenburg

Name: ______________________________ Date: ____________

Student Activities

Who Should Pay and How Much?

A. Questions

1. What would your income tax be if you made:
   a. $25,000 a year but had deductions of $9000

   b. $100,000 a year with deductions of $20,000

   c. $600,000 a year with deductions of $100,000

2. Name three kinds of payments to governments and the theory on which each is based:
   a.

   b.

   c.

3. Which of the following statements is/are true?
   a. People who earn 36% of the nation's income pay about 20% of its income taxes.
   b. People who earn 50% of the nation's income pay about 40% of its income taxes.
   c. All earned income is taxed.
   d. Deducting $10,000 from earned income helps everyone paying taxes (regardless of earned income) equally.

4. At what time in American history, after 1919, would a person earning billions of dollars be:
   a. most likely to mind being a taxpayer?
   b. least likely to resent being a taxpayer?

5. What is the best argument for a person who is against raising the tax bracket for those earning over $500,000 a year in 2004:
   a. I can't afford to pay it.
   b. That would put me in the highest tax bracket in history.
   c. People like me are paying over 20% of all income taxes collected in the United States.

6. Who would be hurt most if there were no deductions allowed to reduce earned income to taxable income?
   a. the unemployed
   b. CEOs of large Wall Street firms
   c. government officials

7. What statistic in this chapter would you use to make an argument that wealthy money earners are already paying more than their fair share of taxes?

B. Short Essay

In recent times, Democrats have argued passionately that the tax rates that were set in 2003 under President George W. Bush should be changed to the tax rates for the highest income brackets that were in place between 1993 and 2000. Write an essay of no fewer than 100 words on why these taxes should or should not be increased, especially at a time of increasing deficits and high unemployment.

CHAPTER 7

SOCIAL SECURITY AND HOW IT WORKS

Overview

This chapter explains the meaning of the abbreviation OASDI, how to get a Social Security card, and the intergenerational concept behind Social Security. Students learn that, on average, recipients depend on Social Security for 45% of their retirement income and that payments average a little more than $13,000 a year. Students examine a chart picturing the increases in payroll deductions from 1935 to 2009 and learn that increased cost-of-living benefits as well as the declining proportion of workers to retirees will require that fiscal changes be made in Social Security for the system to remain solvent.

Students answer multiple-choice questions to test their understanding of fundamental facts and concepts and are asked to write an essay responding to the notion that Social Security will be broke before they are old enough to receive a check.

Objectives

Students will:

- understand that Social Security operates on a generational principle, wherein taxes collected from each generation of workers supports the retired
- many retired people depend on Social Security income from the Trust Fund
- understand the advantages and disadvantages of privatizing Social Security.

Strategies

After determining whether all students have completed their homework and reviewing the multiple-choice questions in the chapter, ask who has a Social Security card and if they know what it takes to obtain one. Review what OASDI stands for and make sure students understand the generational principle on which it is based. Have students tell you at least two reasons why some changes need to be made to keep Social Security solvent. Tell them that some people want to abolish Social Security completely and replace it with individuals paying into their own retirement accounts instead of paying into the Social Security Trust Fund. Ask your students what they think of that idea and tell them it is the subject of the next chapter.

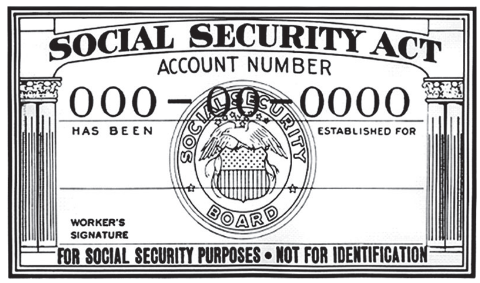
Assignment

Assign Chapter 8, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 7

SOCIAL SECURITY AND HOW IT WORKS

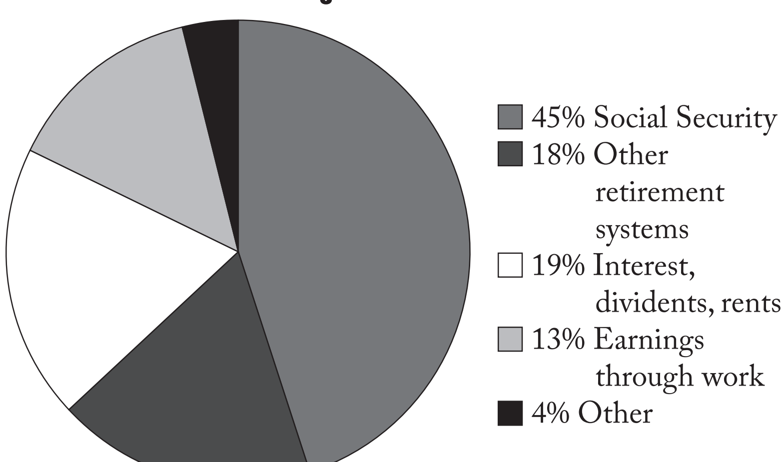
Introduction



You undoubtedly have a Social Security card—your parents could have applied for one on the day you were born, though they were not required to. They need to give their own Social Security numbers, give evidence of the date and place you were born, and prove you are a citizen. You will need the card when you apply for a job, open a bank account, receive Social Security benefits, or qualify for some government programs. You can obtain a card by providing proof of age, identity, and U.S. citizenship or immigrant status.[1]

If you receive a paycheck, you may have noticed that, in addition to deductions for income tax, money has been taken out of your paycheck for something called FICA (Federal Insurance Contributions Act). This money pays for Social Security and hospital insurance for people over 65. Your employer is required to make a similar contribution.

Proportion of Income of Single Beneficiaries Aged 65 and Older



More than 51 million Americans received a total of about $650 billion in Social Security benefits in 2008. This included about 35 million retirees and their dependents, 9.2 million people with disabilities and their dependents, and 6.5 million survivors of beneficiaries. The average monthly payment for retirees was about $1090, or a little over $13,000 for a year.

Thirteen-thousand dollars is not enough for a single individual to

1. Contact www.socialsecurity.gov or call (toll-free) 800.772.1213 for more information.

live well. Worse yet, Social Security alone could not provide enough money for someone supporting a family. Yet $13,000 is the sole support of about one-third of all people receiving Social Security (about 17 million people).[2]

This program's purpose was never to provide full support for the retired, the disabled, or their dependents. Personal savings and private retirement plans, combined with Social Security, were expected to serve as a three-legged stool to support people during their so-called golden years.

Even the meager income provided by Social Security may not be secure as times go by. Numerous studies have concluded that current Social Security payments cannot be sustained, and changes must be made for the system to survive.

This and the subsequent chapter will help you decide just what changes need to be made. But, first you must understand how this system was structured, how it works, and what changes people have proposed.

The Social Security Act

You should understand that what we know as Social Security is actually OASDI or Old Age, Survivors, and Disability Insurance. It consists of four parts: Old Age and Survivors Insurance, Disability Insurance, insurance for the unemployed, and aid to families with dependent children. We will only discuss only the first two parts of this bill—the parts that today are known as Social Security.

President Franklin Roosevelt signs the Social Security Act, August 1935

At the signing of this historic measure in 1935, President Roosevelt exclaimed that though:

> [W]e can never insure one hundred percent of the population against one hundred percent of the hazards and vicissitudes of life… We have tried to frame a law which will give some measure of protection to the average citizen and to his family against the loss of a job and against poverty-ridden old age.
>
> This law, too, represents a cornerstone in a structure which is being built but is by no means complete. It is a structure intended to lessen the force of possible future depressions. It will act as a protection to future Administrations against the necessity of going deeply into debt to furnish relief to the needy. The law will flatten out the peaks and valleys of deflation and of inflation. It is, in short, a law that will take care of human needs and at the same time provide the United States an economic structure of vastly greater soundness.[3]

The President predicted that the law would be regarded as a historic achievement.

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2. Congressional Research Services
3. *Statement of U.S. President Franklin Delano Roosevelt upon signing the Social Security Ac*t, August 13, 1935

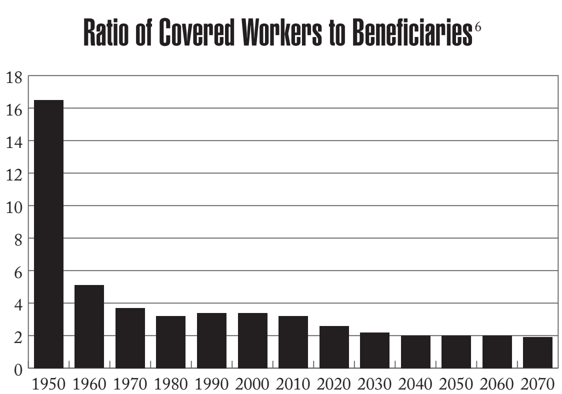
How OASDI Works

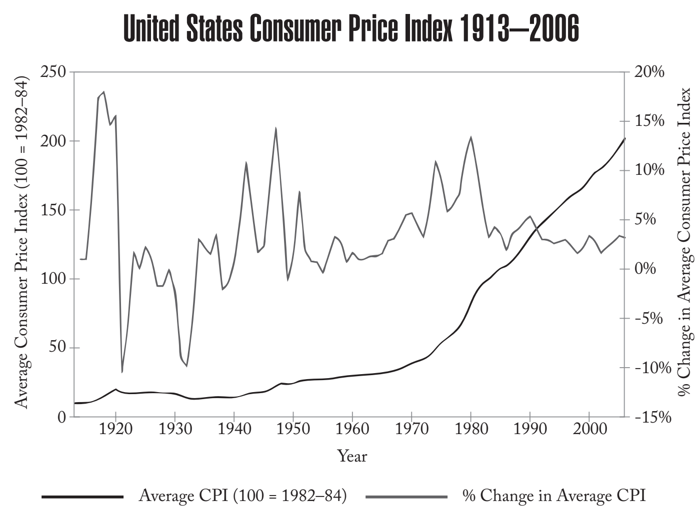
Many people do not understand how OASDI is set up. The important thing to remember is that it does not set up private retirement accounts. The money paid into Social Security by working people is used to pay retirement and disability benefits to people who are retired or disabled, just as people who receive these benefits paid into the system while they were working. That is one reason the first people to receive their retirement checks had to wait five years (until 1940) to get them.

Ms. Ida May Fuller was the first person to receive a monthly Social Security check. The check was for $22.54. In 2010, the average Social Security check was for about $1090, almost 50 times more than Fuller's (unadjusted for inflation).

Why Social Security Payments Are in Jeopardy

There are two major reasons that the Social Security Trust Fund may not be able to pay all recipients as much money as they were promised. The main reason is that the population of this country is aging and retirees are living longer. At the same time, the birth rate has declined and there are not as many young people paying into the system as there once were. When Social Security was started in 1935 and the first payments were made in 1940, there were approximately 16 people working and paying into the system for every retired person. That ratio remained about the same until the 1950s. The following chart shows how much the number of workers per retiree has declined since 1950 and how much more this decline is likely to go:





4. Source: Chart prepared by Congressional Research Service (CRS) from data in the 2004 OASDI trustees report
5. Based on chart from http://en.wikipedia.org/wiki/File:US_Consumer_Price_Index_Graph.svg

The other major reason for declining revenues for the Social Security Trust Fund has been that Social Security payments have been increasing primarily to keep up with the cost of living. When Miss Ida May Fuller received her check of $22.54 in 1940, she was able to use it to pay her living expenses. In 2005, it would take approximately $312 a month to live at a similar standard.[6] To keep pace with inflation, Social Security payments to retirees were raised by 77% in 1951 and by another 77% over the following 22 years. (See chart showing rate of inflation.) Another reason for increasing Social Security payments was to keep pace with a general increase in the standard of living.

Results of Increased Payments and Decreased Pool of Workers

Because of the reasons just stated, Social Security taxes not only increased as a percentage of income taxed but also on the amount of workers' incomes subjected to taxes. The following chart shows that taxes increased from a maximum of $60 in 1935 to a maximum of over $16,218.

Social Security Tax Rate and Maximum Contributions by Employer and Employee			
Year	Tax Assessed on Income up to Earnings of:	% Paid by Employer and Employee Combined	Total Amount of Combined Tax
1937	$3000	2%	$60
1953	$3600	3%	$108
1967	$6600	7.8%	$5148
1986	$42,000	10.1%	$4242
1997	$65,400	12.4%	$8109
2009	$106,800	12.4%	$16,218

Chart by Thomas Ladenburg

Danger of Social Security Trust Fund Being Unable to Pay Promised Benefits

As a famous New York Yankees catcher Yogi Berra once said, "It's tough to make predictions—especially about the future." There are so many different possibilities that no one is certain what will happen to the Social Security Trust Fund and whether the U.S. government will be able to pay what is currently required by law. However, according to the Government Accounting Office, payments into the trust fund will be sufficient until about 2017. After that, and for the following 24 years, the trust fund will pay out its acquired surplus of over $4.27 trillion to supplement the amount of Social Security payments. According to projections, after 2037, Social Security will be able to pay only 78% of scheduled benefits until 2082 and only 75% thereafter.

6. CPI-U 1913–2006; Source: U.S. Department of Labor

Name: ______________________________ Date: __________

Student Activities

Social Security and How It Works

A. Multiple-Choice

1. How does a person living in the United States obtain a Social Security card?
   a. It is issued at birth.
   b. One has to apply for it in person.
   c. Individuals or their parents apply for one and must meet certain criteria.
   d. Cards can only be obtained through the black market.

2. What is necessary to obtain a Social Security card?
   a. Proof that you have a job
   b. Proof that you are a citizen
   c. Proof that you are who you claim to be and a legal resident in the United States
   d. Proof that you want to work

3. Which of the following does not require a Social Security card?
   a. Getting a job in a store or a factory
   b. Getting a job mowing a neighbor's lawn
   c. Opening a bank account
   d. Receiving a Social Security check

4. What does OASDI stand for?
   a. Older Ancient Sibling and Dependent Individuals
   b. Old Age, Survivors, and Disability Insurance
   c. Old Age, Seniors, and Disabled Insurance
   d. None of the above

5. Who will your Social Security System taxes support?
   a. You and your immediate family
   b. The generation of workers who retired before you
   c. Some government bureaucrats
   d. Illegal immigrants

6. Who will pay for your Social Security benefits?
   a. Your parents and grandparents
   b. The people who are working after you have retired
   c. The interest from money in the Social Security Trust Fund
   d. No one—the system will be broke by the time you retire

7. If no changes are made in either benefits or in taxation, what percentage of promised benefits can be paid?
   a. 100% after 2037
   b. 0% after 2085
   c. 78% after 2037, until 2082
   d. 75% after 2037, until 2082

8. What conclusions can you draw by looking at the tax rate on Social Security wages?
   a. They have been going up since 1951.
   b. The maximum cost to the taxpayer and employer has increased by at least $16,258.
   c. A tax for hospital insurance (Medicare) has increased costs to taxpayers.
   d. All of the above

9. Which two things did not cause the tax rate to increase for OASDI?
   a. Inflation and people living longer
   b. People living longer and hospital insurance
   c. The cost of administering OASDI and graft
   d. Increased birth rate and inflation

10. What is Ms. Ida May Fuller known for?
    a. She lobbied President Roosevelt to sign the Social Security bill
    b. She was the first person to receive a monthly Social Security check
    c. She was paid $13,000 in Social Security benefits
    d. None of the above

B. Short Essay

Explain in no fewer than 100 words how you would respond to someone telling you that you should not have to pay taxes to Social Security because the system will be broke by the time you are eligible to receive a Social Security check.

CHAPTER 8

ADJUST OR PRIVATIZE?

Overview

This chapter asks what changes should be made to Social Security in order to keep it solvent and presents arguments for and against privatizing Social Security. After answering questions to test their understanding of the facts and concepts in this chapter, students write an essay favoring or disagreeing with the privatization of Social Security and decide which combination of the many different proposals for reducing benefits and for increasing payroll taxes they could support.

Objectives

Students will:

- understand arguments for and against privatizing Social Security
- see that there are many combinations of revenue enhancement and benefit reductions that could be used to keep Social Security solvent for the next 75 years
- decide whether privatization or combining revenue enhancing with benefit reductions is more likely to keep Social Security solvent.

Strategies

After determining whether all students have completed their assigned homework, spend time reviewing their answers to the multiple-choice questions. Make sure students understand the meaning of the term "privatization" and the arguments for and against exchanging collective Social Security accounts for individual retirement funds invested in the stock market. Allow students to explore this issue, either in a class discussion or in a formal debate. After a suitable amount of time, discuss some of the proposals for increasing revenues and cutting benefits. Ask students to take on the roles of people representing different ages and income levels and debate whether to privatize, cut benefits, or increase revenues.

Assignment

Assign Chapter 9, passing out the student reading and activities pages. Ask students to complete their assignment on their own paper if they run out of room on the handouts.

CHAPTER 8

ADJUST OR PRIVATIZE?

Introduction

We have already seen that under current law regarding taxes and benefits, Social Security can not continue to fully meet its obligations to the aged, their survivors, and the disabled. At a time when the U.S. government's debt exceeds $13 trillion, Social Security will require significant adjustments to remain solvent. Many experts have suggested that the U.S. raise FICA taxes, others have suggested that benefits be reduced, and quite a few call for reducing benefits and increasing taxes. Others have suggested that the time is over for making such adjustments and that a fundamental change in the system is required. President George W. Bush made changing the nature of the Social Security system a major campaign issue, and his election in 2004 gave him the opportunity to submit a plan that called for "privatizing" at least part of the program. President Bush meant he would "allow workers to divert some of their payroll tax to fund personal retirement accounts in exchange for somewhat more than a proportional reduction of their future Social Security benefits."[1] In other words, some of the money that would otherwise go into the Social Security Trust Fund would be deposited in individual retirement accounts owned and controlled by those who chose this option. In exchange, these people would receive less money from the trust fund.

The purpose of this chapter is to raise the question of which plan for Social Security would be the best: partial privatization or a combination of a reduction of benefits and an increase in payroll taxes.

Privatization

Privatization would change the nature of the Social Security system that was established over 75 years ago. Under the original system, it should be recalled, workers' payroll taxes would pay for the benefits received by the retired and disabled. No one would own his or her retirement account; each would be dependent on a promise from the U.S. government to pay them benefits. Under the Bush plan, all workers would have the opportunity to create their own retirement nest-egg and invest it as they see fit.

1. William A. Niskanen, "Bush's Economic Agenda Deserves Support," Cato Policy Report, March/April 2005

Advantages of Privatization	Disadvantages of Privatization
• It frees workers to invest a share of their high payroll taxes in individual accounts, rather than forcing them to give it to others. • Who knows whether Social Security will be around to pay benefits to those currently entering the workforce? • Return of investments in stocks have averaged about 8% since 1926, compared to investment in government bonds at about 4–5%. • It frees people to invest money that will help business grow and provide more jobs, instead of holding the money for future generations • The current system prevents people from collecting their savings or passing them on to their heirs if they die before they can receive them.	• Social Security is an intergenerational responsibility: Money from working generations is needed to pay for retirees' benefits. • Privatization will either cost the trust fund over $1 to $2 trillion or simply make it far more difficult to keep Social Security solvent. • Money could be invested in failing corporations and be lost while stockbrokers will make huge profits at investors' expense. • Social Security guarantees that everyone in the system a necessary, inflation-proof means of surviving after they retire. • Privatization will leave less money for survivors, dependents and disabled Americans in order to create private accounts for those who might invest.

Quotes on Privatization

Addressing Congress in 2005, President George W. Bush spoke in favor of privatizing Social Security:

> Here is why personal accounts are a better deal. Your money will grow, over time, at a greater rate than anything the current system can deliver—and your account will provide money for retirement over and above the check you will receive from Social Security. In addition, you'll be able to pass along the money that accumulates in your personal account, if you wish, to your children or grandchildren. And best of all, the money in the account is yours, and the government can never take it away.
>
> The goal here is greater security in retirement, so we will set careful guidelines for personal accounts. We will make sure the money can only go into a conservative mix of bonds and stock funds. We will make sure that your earnings are not eaten up by hidden Wall Street fees. We will make sure there are good options to protect your investments from sudden market swings on the eve of your retirement. We will make sure a personal account can't be emptied out all at once, but rather paid out over time, as an addition to traditional Social Security benefits. And we will make sure this plan is fiscally responsible, by starting personal retirement accounts gradually, and raising the yearly limits on

contributions over time, eventually permitting all workers to set aside four percentage points of their payroll taxes in their accounts.[2]

Several national organizations were strongly against privatizing Social Security; two provided reasons for their opposition:

To compensate for the loss of Social Security revenue sent into private accounts, the federal government would have to borrow significant sums for the next several decades in order to continue to pay promised benefits to currently retiring beneficiaries. One prominent proposal would require $1 billion in the first 10 years the private accounts were in place. Then, $3.5 trillion would be needed in the following decade. Younger workers would have to bear much of the burden for paying this debt. That's not right, and it's not fair to them.

Social Security is an insurance program, not an investment program. The essence of Social Security is that it has always been risk-free for all of us. It's also inflation-proof—something neither investments, nor even many pensions, can guarantee. Private accounts within Social Security would add a large measure of personal risk. AARP has publicly stated many times that there are places in retirement planning that are appropriate for taking risks, such as 401(k) plans, Individual Retirement Accounts, and mutual funds, but they should be in addition to the guarantee of Social Security.[3]

Several Ways to Keep Social Security Solvent

Adjusting Benefits to Assure Social Security Remains Solvent	Estimates on how much shortfall will be reduced:	
How benefits might be cut…	**For 75 years**	**After the 75th year**
Cut Social Security benefits by 13%	100%	50%
Raise the retirement age: first quickly and then based on longevity	30%	35%
Freeze purchasing power of benefits	100%	100%
Limit increases in purchasing power of benefits	65%	90%
Cut all benefits in 2037	100%	100%
How revenues might be increased…	**For 75 years**	**After the 75th year**
Increase payroll taxes by 2% of earnings	100%	40%
Increase maximum amount payroll cap can be raised (above $106,800)	40%	15%
Pay for shortfall out of income tax revenue	100%	100%
Invest 40% of revenues in stocks	35%??	??
Wait until 2037 to raise payroll taxes by huge amount	100%	100%[5]

2. Feb. 2, 2005 - George W. Bush, MBA
3. Apr. 28, 2010 - AARP (American Association of Retired Persons)
4. Charts based on work by Center for Retirement Research at Boston College

Name: ______________________________ Date: __________

Student Activities

Adjust or Privatize?

A. Multiple-Choice

1. Creating individual retirement accounts is called:

   a. ending the federal governmnent's commitment to the retired, survivors, and the disabled

   b. free enterprise and a defeat of socialism

   c. providing money for bankers

   d. privatizing Social Security

2. Workable solutions for ending the predicted Social Security shortfall include:

   a. increasing benefits

   b. decreasing payroll taxes

   c. increasing taxes while reducing benefits

   d. establishing individual retirement accounts

3. Individual retirement accounts:

   a. will solve the problem of providing for the predicted Social Security shortfall

   b. give workers more control over their payroll taxes

   c. help people who have already retired

   d. none of the above

4. Which of the following is not an argument for privatizing Social Security?
   a. Investments in stocks have historically yielded a higher return than investments in government bonds.
   b. Retirement accounts give individuals more control over their money than the way the system is set up today.
   c. It will solve the shortfall problem.
   d. The heirs of people who have retirement accounts can inherit the unspent money.

5. Which of the following is an argument for privatization?
   a. Stocks can go down in value.
   b. The whole idea of Social Security is that the current generation of workers pays to support the retired.
   c. It will help Wall Street brokers.
   d. Both a and b.

B. Short Essay

Elaborate on the argument for or against privatization with which you agree, and on one argument on the other side with which you disagree. Explain what you believe is wrong with the argument with which you disagree.

CHAPTER 9

UNIT REVIEW

Overview

This chapter provides students with a review that summarizes the important facts and concepts presented in this unit and will help them study for a unit test. This manual provides questions you may wish to use for the test.

Objectives

Students will be prepared to answer all questions they are asked on the test.

Strategies

Provide students with the following list of questions that may be on the test. Allow them to work in groups of no more than four while preparing answers to each. Circulate around the room helping students who need assistance. Depending on how much writing they can do in a class period and how much detail you demand, most students will probably have time to answer five to seven questions. You may want to make the test open book, assign students to do it as homework, select the questions you want them to answer, allow students to choose which questions they want to answer, or any combination of the above.

CHAPTER 9
UNIT REVIEW

Introduction

One advantage of completing a unit is having the opportunity to demonstrate what you have just learned. The following summation will help remind you of what was taught and what is likely to be on a test.

Keynes and the Multiplier

In 1932, one out of four Americans looking for work could not find a job. GNP had fallen from $104 billion to $58.5 billion in four years. President Hoover believed that his main job was to restore confidence in the economy, which required him to balance the budget. The British economist, John Maynard Keynes, believed the U.S. could and should spend its way out of its depression. He theorized that every extra dollar spent by the federal government would multiply through the economy and increase the GNP by three dollars. Though President Roosevelt never embraced this idea, he increased spending at first to help the unemployed and later to fight World War II. The result was a tremendous increase in GNP as unemployment dropped from 25% to a little over 1%. By 1940, GNP reached its pre-Depression level, and by 1944 it had more than doubled it. Meanwhile the deficit rose from $1.4 billion to $54.6 billion per year.

The Worst Economic Crisis Since the Great Depression

The subprime mortgage debacle resulted in multiple foreclosures, the near-failures of large investment firms such as J.P. Morgan that were judged "too big to fail," and a dramatic increase in the number of unemployed. The banks were saved by an expensive government bailout, but the foreclosed-upon and the unemployed received little government support. The cause of this crisis was reckless lending to underfunded homebuyers and the bundling of these "toxic" mortgages into securities that were given high ratings but that were hardly worth the paper on which they were printed. This combination of inadequate regulations, clueless homebuyers, and reckless financial institutions was responsible for an unemployment rate that peaked at 10% and the worst financial crisis in the U.S. since the Great Depression.

Debt and Deficits

The term "deficit" is used to describe what happens when a government has to borrow money to pay its bills. A "debt" is what the government owes as a result of one or more deficits. A surplus refers to the government's collecting more money than it spends. The U.S. government ran a surplus in the year 2000, when its debt was $9.821 trillion, and by 2010, it ran a deficit of $1.370 trillion (thereby accumulating a national debt of $14.508 trillion). In order to understand its significance, the size of the debt should be compared to the nation's GDP. The reason for the increase in the federal debt include the George W. Bush-era tax cuts, the cost of fighting two wars at the same time, the recession that started in 2007, the investment banks' bailout, and the cost of the stimulus package.

Reduce Unemployment or Debt?

Some informed Americans passionately believe that the U.S. needs to use something akin to the Keynesian multiplier to end the recession and increase employment. They claim the American Recovery and Reinvestment Act (also called the stimulus package) has saved the economy from a 1930s-type depression, but that more spending is necessary to return the economy to full employment. They believe that government spending is needed to create the purchasing power that will allow the economy to expand. Other equally passionate believers are more concerned about running up a debt that they claim is already far too high and will be nearly impossible to pay down. They claim that irresponsible government payouts are unfairly leaving future generations (your children and grandchildren) to pay for our excessive spending.

Extend Unemployment Benefits?

You were left to decide whether unemployment benefits should be extended to those who are out of work for whatever reason, including because (1) there just aren't enough jobs to go around, or (2) they would rather loaf while collecting checks from the government than work a real job. You are asked to make a value judgment about the number of people who are truly needy and those taking a free ride at taxpayers' expense. You must decide whether unemployment benefits provide more help to the truly needy than an excuse not to find a job, and whether or not society has a moral obligation to help both or either.

Taxes: Who Should Pay and How Much?

Of the three types of taxes, progressive, flat, and equal (such as fees), the U.S. government relies primarily on the first. The graduated income tax, with higher income brackets taxed at increasingly higher rates, took in 94% of all taxable income in excess of $200,000 during the last years of World War II. The highest tax rate in 2010 was 35% of taxable income over $373,650; people in the upper 1% of earners paid 20% of all federal income taxes collected in the U.S. but earned

36% of the income. The question raised in this chapter is whether recent (21st century) tax cuts have been too generous to high income taxpayers and should be repealed and replaced by a more steeply graduated tax, or whether the taxes paid by the very rich should remain what they were in 2010.

Social Security and How it Works

Everyone who works a regular job in the U.S. can apply for a Social Security card and obtain one if they have documented proof that they are in the U.S. legally and that they are who they say they are. Social Security is really Old Age Survivors and Disability Insurance. Workers in the U.S. need a Social Security card and pay a FICA (Federal Insurance Corporation Act) tax that is subtracted from their paychecks.

Payroll deductions are matched by contributions made by employers and are deposited in the Social Security Trust Fund. Money from this fund is used to pay Social Security benefits to retired beneficiaries, their survivors, and the disabled. The money paid into the system is used to pay the people receiving benefits. When they retire, those currently contributing will receive money from those who are still working. Because of the decline in the birth rate and increased life expectancy, the ratio of contributors to beneficiaries has declined from 16:1 to the current ratio of 3:1. Despite radically higher FICA taxes, by 2037 the incoming contributions will be enough to pay only 78% of the benefits to which recipients are currently entitled.

Social Security: Adjust or Privatize

One of the most radical suggestions made to modify Social Security is to change it from a collective responsibility, in which one generation supports the previous, to individual retirement accounts. According to this proposal, workers would invest their own money instead of being forced to divert their payroll taxes to the Social Security Trust Fund. The rationale for this plan is that money invested in the stock market receives a higher rate of return than money invested in government bonds. In theory, individuals would have the freedom to accumulate more money than they would receive from Social Security. They could also bequeath these retirement accounts to their heirs. There are several objections to this proposal: First and foremost, the individual retirement accounts would draw money out of the Social Security system and not solve the insolvency problem.[1] Secondly, the stock market, as recent experience has shown, is not always a safe place to invest one's money. Despite these objections, those favoring privatization are convinced that it is far better to allow people to make their own decisions regarding retirement than to have the government make major decisions for them.

1. It is estimated that it would cost the government between one to two trillion dollars to keep the trust fund solvent under the privatization plan.

Name: ______________________________________ Date: ___________

Student Activities

Unit Review

Chapter 1. Keynes and the Multiplier

- Explain the concept of the multiplier.
- Using statistics from the years 1929 and 1945, explain whether the multiplier worked when Roosevelt increased government spending.

Chapter 2. The Worst Economic Crisis Since the Great Depression

- Explain the causes of the subprime mortgage crisis and why it led to a near-collapse of the U.S. economy.
- How did lack of regulations, reckless lending and borrowing, and packaging toxic mortgages into supposedly AAA-rated securities contribute to the subprime mortgage crisis?

Chapter 3. Debt and Deficits

- What are the differences between the debt and the deficit?
- What contributed to the increased deficits between 2001 to 2010?
- What indicates that the total U.S. debt of about $14 trillion today is not as frightening as it appears to be?

Chapter 4. Reduce Unemployment or Debt?

- What was the ARRA?
- What, if anything, did it accomplish?
- Present arguments for or against extending the stimulus package.

Chapter 5. Extend Unemployment Benefits?

- Explain the major arguments for and against extending unemployment benefits based on value judgments rather than on economic reasoning

Chapter 6. Taxes: Who Should Pay and How Much?

- Distinguish between equal, graduated, and flat taxes, and give examples of each.
- What is meant by the "marginal rate" in income taxes, and how has it changed since 1913?
- Do the wealthiest Americans pay more than their fair share of the nation's income taxes? Give reasons to support your answer.

Chapter 7. Social Security and How It Works

- What do you need to get a Social Security card and why would you want one?
- Explain the intergenerational idea behind Social Security.
- Explain what the letters OASDI and FICA stand for.

Chapter 8. Social Security: Adjust or Privatize?

- Explain the idea of privatizing Social Security and the arguments for it.
- What are two of the major drawbacks to privatization?

ANSWER KEY

Chapter 1

Keynes and the Multiplier

A. Multiple-Choice Answers, pp. 8–10

1. Herbert Hoover was **(b)** president of the United States during the first years of the Great Depression.

2. It is not true that **(d)** 20 million people were unemployed during the Great Depression Note: 13 million people were unemployed, about 25% of the work force.

3. President Hoover was advised not to borrow a lot of money to try to end the Depression because **(d)** it would cause interest rates to go up, the next generation would have to pay it back, and it would cause people to lose confidence in the government.

4. John Maynard Keynes was **(b)** the economist who advised Roosevelt to spend his way out of the Depression.

5. GNP is similar to the GDP except **(b)** one includes the effects of foreign trade.

6. John Keynes believed that **(d)** government spending could take the place of investment spending to stimulate economic growth, and that Say's law was wrong.

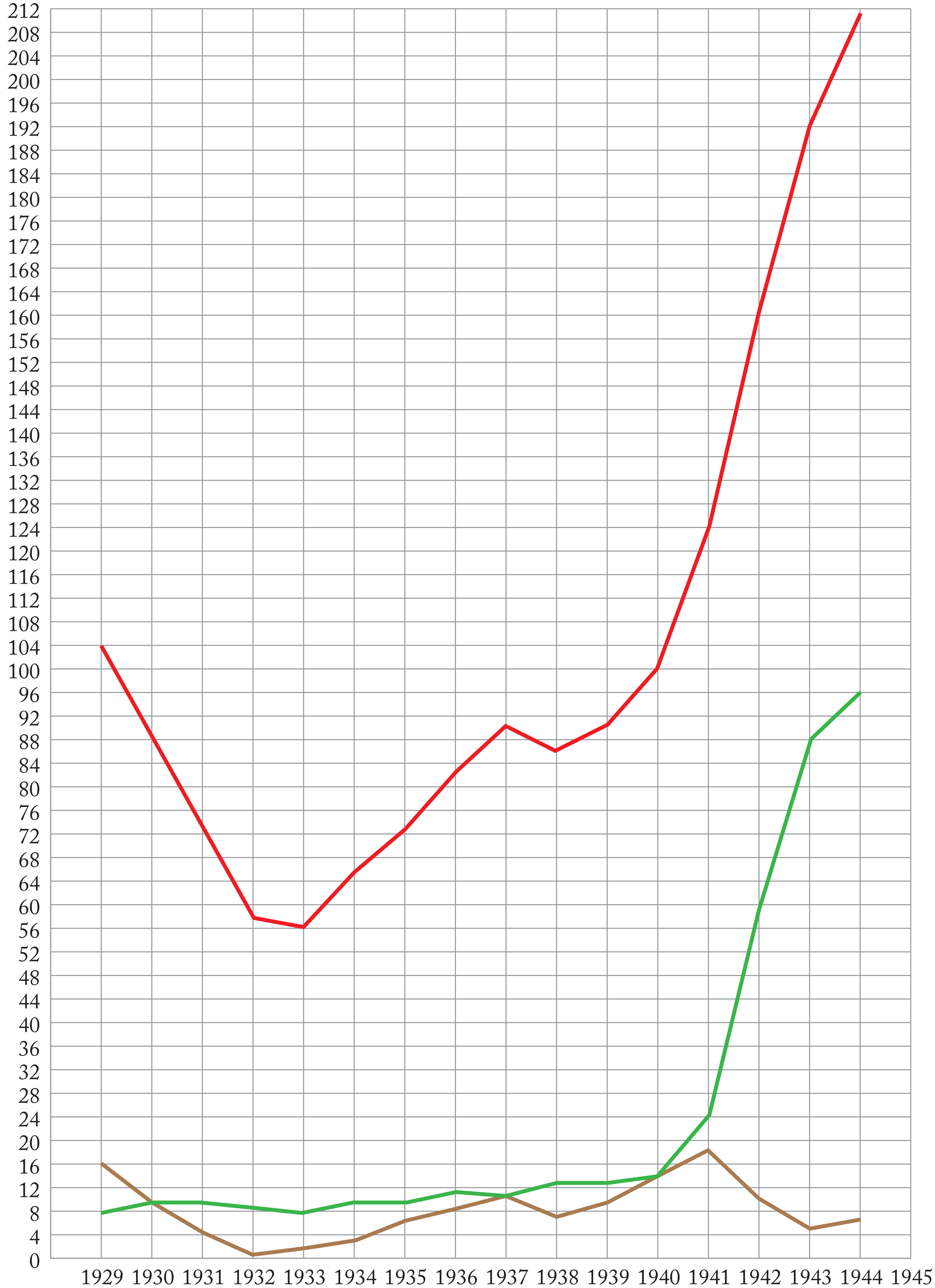
7. At the same time the GNP decreased from $104 billion to $58.5 billion, **(c)** investment spending decreased by 16 times (from $16.2 billion to $0.9 billion).

8. According to Keynes and other economists who believed in the multiplier, if Ford invested $100 million in building a new factory, **(c)** GNP would increase by about $300 million.

9. Herbert Hoover **(a)** would most likely agree with Say's law. Note: Henry Ford **(b)** also famously supported Say's law, so some teachers may also accept that answer, but Ford's support is not addressed in the text.

10. If the U.S. economy declined by three trillion dollars, Keynes would probably advise the president to spend about an additional **(b)** one trillion dollars.

B. Graphing, pp. 10–11



Chapter 2

The Worst Economic Crisis since the Great Depression

A. Multiple-Choice Answers, p. 18

1. The collapse of major Wall Street investment banks **(a)** came before rapid rises in unemployment and foreclosures, and before Barack Obama's election.

2. First people assumed mortgages they could not afford, then **(a)** banks packaged the mortgages into risky securities, and as a result the banks verged on bankruptcy, all before Obama took office.

3. All three groups **(d)** shared responsibility for the mortgage crisis. Irresponsible bankers pushed loans to people who were unlikely to be able to repay, unsophisticated borrowers took on more debt than they could handle, and investment banks packaged the bad loans into securities.

4. All three conditions **(d)** preceded the mortgage crisis: a general prosperity contributed to increases in the price of housing, and the housing bubble encouraged irresponsible borrowing and lending.

B. Matching Answers, p. 19

Persons	**Identification**
1. George W. Bush	e. president when recession started
2. Barack Obama	a. president who proposed stimulus plan
3. Thomas Friedman	b. columnist who explained the cause of the recession
4. Henry Paulson	c. Secretary of Treasury at the time of the subprime mortgage crisis
5. Bob Herbert	d. wrote about the effects of the repression on people

Terms	**Identification**
6. number unemployed	g. 15 million
7. 800,000	i. number of people who lost their jobs in one month
8. TARP	j. lent money to bail out bankers
9. foreclosure	a. lose house for not paying mortgage
10. mortgage	h. a loan to pay for property

Chapter 3
Debts and Deficits

A. Multiple-Choice Answers, pp. 26–28

1. The difference between the debt and the deficit is that **(a)** the former is the amount owed and the latter is a shortfall for a given year.

2. Deficits occur **(b)** when governments spend more in one year than they receive in revenues.

3. According to the chart on the first page of this chapter, **(b)** the United States has run a deficit in every year since the year 2000.

4. According to the reading, **(b)** the Congressional Budget Office forecast a surplus of $860 billion for 2009–2012.

5. The main reason that the gross debt is not as important as the deficit as a percentage of GDP is that **(c)** debts are easier to pay off if they are a smaller percent of GDP.

6. According to the chart, **(b)** Japan has the highest percentage of debt to GDP.

7. Keynes most likely would have said that the high U.S. debt in 1945 **(c)** probably stimulated the U.S. economy.

8. All of the following **(d)** were reasons for the high U.S. debt: Bush's tax cuts, the recession, and two wars.

9. The most important lesson taught in this chapter was that **(d)** the amount of debt a country has is not as important as its ratio of debt to GDP.

10. Most to blame for increasing the debt and deficit in the first ten years of the 21st century was whichever answer students can best defend.

Chapter 4

Reduce Unemployment or Debt?

A. Multiple-Choice Answers, pp. 34–35

1. The Stimulus Act of 2009 is best described as **(b)** an attempt to end the recession.

2. The ARRA stands for **(c)** the American Recovery and Reinvestment Act.

3. The money the government spent through the ARRA was **(c)** split evenly between tax cuts, stimulating spending, and aid to states.

4. Unemployment since passage of the ARRA has **(d)** increased and increased but at a slower rate than before.

5. Unemployment during the years following the recession **(a)** hovered around 9–10%.

6. According to the first argument, **(d)** when people don't spend their money, the government must spend its money, and the United States spent its way out of the Great Depression during World War II.

7. The author of the first argument meant to make the point that **(b)** the government is not spending enough to reduce unemployment.

8. According to the second argument, **(c)** short-term gains in employment as the result of extra federal spending will make the problem worse.

9. According to the second argument, **(d)** it would take spending more than a million dollars a day since the birth of Jesus to spend a trillion dollars.

Chapter 5

Extend Unemployment Benefits?

A. Multiple-Choice Answers, pp. 42–43

1. It is not true that **(a)** a greater percent of women than men were unemployed.

2. In order to receive unemployment insurance, you must **(b)** be out of a full-time job through no fault of your own.

3. Unemployment compensation usually lasts for **(b)** 26 weeks but can be extended.

4. One good argument for not extending unemployment benefits is that **(b)** it encourages people not to take the first job offered to them and keeps them unemployed for longer periods of time.

5. One good argument for paying unemployment insurance is that **(d)** it helps people in need and helps keep the economy from getting worse.

Chapter 6

Who Should Pay and How Much?

Questions With Answers, pp. 51–52

1. What would your income tax be if you made:

    a. $25,000 with deductions of $9,000?

    10% of $16,000 = $1,600

b. $100,000 with deductions of $20,000?

10% of $16,750 = $1,675

15% of ($68,000 - $16,750) $51,250 = $7,687

25% of ($80,000 – 51,250 – 16,750) $12,000 = $3,000

Total tax is $3,000 + $7,687 + $1,675 = $12,362

c. $600,000 a year with deductions of $100,000?

10% of $16,750 = $1,675

15% of $51,250 = $7,687

25% of ($137,300 – $68,000) $69,300 = $17,325

28% of ($209,500 – $137,300) $72,200 = $20,216

33% of ($373,650 - $209,500) $164,400 = $54,252

35% of ($500,000 - $373,650) $126,350 = $44,222.50

Total tax is $44,135 + $54,252 + $20,216 + $17,325 + $7,687 + $1,675 = $145,377.50

2. Three kinds of payments to government and the theory on which each is based are:

Kinds of payments to government	**Based on theory that…**
a. Flat tax	all people (regardless of income) should pay equal percent in taxes
b. Regressive	people with more money deserve to pay a smaller percent of that money in taxes
c. Progressive	people who can afford to pay more taxes should contribute a larger percent of their income to the common good

3. All the answers are false. Teachers may use this question to spark research and debate into the question of what would be a fair share of taxes for each income bracket to pay.

4. After 1919, a person earning a billion dollars would be most likely to resent being a taxpayer from 1944–1945, when the top tax rate was 94%. Our billionaire would be least likely to resent being a taxpayer in 1929, when the top rate was 24%.

5. The best argument against raising the tax bracket for those earning over $500,000 a year is that **(c)** the four-tenths of a percent of people in that bracket already pay more than 20% of U.S. income taxes.

6. Those who would be hurt most if there were no deductions allowed to reduce earned income to taxable income would be **(b)** CEOs of large Wall Street firms.

7. The statistic in this chapter that best supports the argument that wealthy individuals pay more than their fair share of taxes is that the top five percent already pay 57% of the nation's taxes.

Chapter 7

Social Security and How It Works

A. Multiple-Choice Answers, pp. 59–61

1. A person living in the United States obtains a Social Security card when **(c)** the individual (or the individual's parents) applies for one and meets certain criteria.

2. In order to obtain a Social Security card you must **(c)** prove that you are who you claim to be and are a legal resident in the United States.

3. A Social Security card is not required to **(b)** get a job mowing a neighbor's lawn.

4. OASDI stands for **(b)** Old Age, Survivors, and Disability Insurance.

5. The money you pay into the Social Security System pays for **(b)** the generation of workers who retired before you.

6. The people who are working after you retire will pay for your Social Security benefits, so **(b)**.

7. If no changes are made in either benefits or taxation, only **(c)** 78% of benefits will be paid between 2037 and 2082.

8. After looking at the tax rate on Social Security wages, you can conclude **(a)** they have been going up since 1951.

9. The two things that did not cause the tax rate to increase for OASDI are **(c)** the cost of administering OASDI and graft.

10. Ida May Fuller is known as **(b)** the first person to receive a monthly Social Security check.

Chapter 8
Adjust or Privatize?

A. Multiple-Choice Answers, pp. 68–69

1. Creating individual retirement accounts is called **(d)** privatizing Social Security.
2. Workable solutions for ending the predicted Social Security shortfall include **(c)** increasing taxes while reducing benefits.
3. Individual retirement accounts **(b)** give people more control over their payroll taxes.
4. The following is not an argument for privatizing Social Security: **(c)** It will solve the shortfall problem.
5. The following is an argument for privatization: **(c)** It will help Wall Street bankers.

Chapter 9
Unit Review

Chapter contains no questions that have specific answers.