May 23, 2023
Where Does Our Money Go?

In this lesson, we will learn how and where the Federal Government spends money. We also learn how much of that spending is mandatory vs discretionary spending, and how much of the spending is covered by tax revenue. Along the way, we compare our predictions with the actual budget of the Federal Government and discuss ways to deal with the shortfall in tax revenue.

Discretionary Spending - Elected officials have the discretion to change this spending from year to year as part of the annual budget and appropriations process.
Mandatory Spending - Spending is determined by law (prior commitments made by the government) and cannot be changed as part of the annual budget and appropriations process

Voluntary National Content Standards in Economics

We will understand that federal government budgetary policy and the Federal Reserve System's monetary policy influence the overall levels of employment, output, and prices.

● The federal government's annual budget is balanced when its revenues from taxes and user fees equal its expenditures. The government runs a budget deficit when its expenditures exceed its revenues. The government runs a surplus when its revenues exceed its expenditures.
● When the government runs a budget deficit, it must borrow from individuals, corporations, or financial institutions to finance that deficit.
● The national debt is the total amount of money the federal government owes. This is the accumulated net sum of its annual deficits and surpluses. The government pays interest on the money it borrows to finance the national debt.

NOTE: In 2021 mandatory spending was larger than all tax revenue collected. This is largely due
to the increases in COVID relief spending and can be seen in the "Income Security" category of the budget. For a comparison of pre and post COVID budgets as well as a comparison of budgets
vs actual revenue and spending

What suggestions do you have that can deal with the uncovered national debt and what opportunity costs suggestions do you think there could be.

● Cut discretionary spending
● Cut mandatory spending
● Raise Taxes
● Borrow the money
● Something else (ask what that solution was, ex: print money)

* If you chose to cut discretionary spending, what did you cut and why? What might be an opportunity cost of that choice?
* If you chose to cut mandatory spending, what did you cut and why? What might be an opportunity cost of that choice?
* What would it take to actually cut mandatory spending? (Changing laws) Do you think that would be relatively easy, or hard? Why?
* If you chose to raise taxes, why did you choose that? What might be an opportunity cost of that choice?
* Do you think that would be relatively easy, or hard to raise taxes? Why?
* .If you chose to borrow the money, why did you choose that? What might be an opportunity cost of that choice?
* From where do you think the federal government borrows the money? (American savers, foreign governments and individuals, itself)
* What impact would borrowing have on the future budget? (It will commit future dollars to be spent on paying the interest for that borrowed money. Borrowing more money or higher interest rates can increase the interest payments on the debt.

Lesson 2: Where Does Our Money Go?

* If you chose some other option, like printing money, why and what is the cost of that. (Simply printing more money would cause inflation which would devalue the currency. In other words, people's dollars would buy less than before. People that hold dollars would, in effect, pay for the extra spending by having all their dollars devalued. In that sense, inflation is like a tax that everyone who has dollars pays.)
* Which of these solutions do you think is most likely? Why?

Conclusion

Less than one quarter of the federal government spending is discretionary spending, meaning elected officials have the discretion to change that spending as part of the annual budget and appropriations process. The other two-thirds of spending is mandatory spending and it's largely spent on entitlement programs. As mandatory spending is projected to grow, decision makers, in this case, legislators, face tough decisions and trade-offs.
Do they spend less on discretionary categories like defense, education or infrastructure?
Do they borrow more money and commit future spending to fund consumption today?
Do they raise taxes?
Or do they make changes to laws to change mandatory spending?
Even the choices made by decision makers in government have opportunity costs.

Discretionary Spending

Discretionary spending is usually broken into two categories: defense spending and non-defense spending.

1. Defense spending is spending on the military and includes things like payroll for military personnel, weapons and maintenance on equipment. Defense spending is the largest component of discretionary spending but it has been declining as a share of government

spending over the past 50 years. In 1962, defense spending was 50% of the entire federal budget and 70% of discretionary spending. In 2019 it had fallen to 15% of the entire budget and 50% of discretionary spending. Another way to think about the amount of defense spending is as a proportion of GDP. Defense spending has fallen from 9% of GDP to just over 3% of GDP since 1962.
2. Non-Defense spending includes things like education, NASA, low-income housing provided by the Department of Housing and Urban Development, etc. Unlike defense spending, non-defense spending has been remarkably constant. It has made up between 15-25% of the total budget and about 4% of GDP since the 1960s.

Mandatory Spending

Mandatory spending is spending required by past commitments made by the government. Most mandatory spending is on programs referred to as entitlement programs because people have paid into the programs with the expectation that they would receive benefits at a later date. Medicare, Social Security and federal pensions are examples of entitlement programs. Mandatory does not mean unchangeable, but it does mean that change has to come about by changing the laws that dictate the spending.

Mandatory spending accounts for two-thirds of the federal budget and it has increased from 4.8% of GDP in 1962 to 12.9% of GDP in 2019.

The growth in mandatory spending is driven by the three largest categories of mandatory spending:
Social Security (24% of overall budget), Medicare (14% of overall budget) and Medicaid (9% of overall budget).

Interest Payments on the debt are another type of mandatory spending. They make up 8% of the overall budget. While the interest payments are not determined by legislation, they are payments the government committed to when they borrowed the money. They are payments to bondholders or those who lent the government money by buying bonds. This includes individuals, corporations, state or local governments, the Federal Reserve Banks, foreign governments, and entities outside the US. Interest payments as a percentage of GDP have not changed much since 1962 but they have ranged from 1.2% to over 3%. There are two things that can cause a growth in interest payments: higher interest rates, and higher levels of debt. While interest rates have actually been decreasing, the level of federal debt has been increasing and both of these will influence future interest rates.

Other mandatory spending includes things like pensions for federal employees, veterans benefits and income security, but these categories are relatively small compared to Medicare, Medicaid and Social Security....)
Looking forward, the Congressional Budget Office projects that federal spending as a percentage of GDP will continue to grow. Discretionary spending will continue to decline as a percentage of GDP and mandatory spending will continue to rise.

May 23, 2023
Is Our Federal Debt Sustainable?

The federal debt of the United States has grown rapidly in recent years and projections show that trend continuing. Should we be worried? Can we afford it? In this lesson, students will learn what factors drive that growth, how that debt compares to our nation's income, and what kinds of things could make our debt levels sustainable, or unsustainable.
Fiscal policy decisions (decisions about taxation and spending) are made by politicians. This activity puts students in the shoes of the decision-makers and tasks them with putting the federal budget on a sustainable course. After prioritizing their goals, students will explore possible policies, consider the costs and benefits of each and ultimately choose the policies that will best address their goals while bringing the debt to GDP ratio to a sustainable level. In comparing their choices and outcomes with other students in small groups, they'll discover there are many alternative plans that could put the federal budget on a sustainable course, but all of them require costly decisions today.

Voluntary National Content Standards in Economics

There is an economic role for government to play in a market economy whenever the benefits of a
government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.
● Governments often redistribute income directly when individuals or interest
groups are not satisfied with the income distribution resulting from markets; governments also redistribute income indirectly as side-effects of other government actions that affect prices or output levels for various goods and services.
● Governments provide an alternative method to markets for supplying goods and
services when it appears that the benefits to society of doing so outweigh the costs to society. Not all individuals will bear the same costs or share the same benefits of those policies.
● A government policy to correct a market imperfection is not justified
economically if its expected costs exceed its expected benefits.

Discussion Questions

* Is there a right way or best way to bring the debt to a sustainable level? Why or Why not? (No. "Best" is a value judgment influenced by each persons' goals. While economics can't answer the question of "best" it reminds us to think in terms of alternatives and trade-offs. For example, which plan brings the debt to a sustainable level at the lowest cost? ...in the least amount of time? ...with least cost to the poor and elderly? ...by impacting the fewest number of people? Etc.)
* Why were the choices made and opportunity costs born so different for each of you? (Value is subjective. Because people value things differently, they have different goals,

make different choices and face different opportunity costs.)
* Why do you think some goals are harder to achieve than others? (Some goals have immediate costs with benefits far in the future. Some goals may directly conflict with others. For example, one goal may require spending that conflicts with bringing the debt to a sustainable level. Etc.)
* What were some of the takeaways your group had when you compared policies chosen and who received benefits and bore the costs of those policies? (Answers will vary. The people that receive the benefits aren't necessarily the ones bearing the costs. Many of the "people" that bear the costs and/or receive benefits from policies today haven't been born yet. Etc.)
* How would your choices change if you were faced with [insert one of the scenarios below]?
i. Growing unfunded liabilities (Social Security, Medicare, Medicaid)
ii. Rising interest rates
iii. A global recession
iv. A global pandemic
* As a policymaker, what is more important? Choosing goals that are optimal or goals that are attainable?

Conclusion
Fiscal policy decisions are made by politicians. Like us, politicians are individuals with values that influence the goals they choose and choices they make in the arena of government. Politicians are often faced with tradeoffs that require choosing one goal at the expense of another or benefitting one group of people at the expense of another. While there are policies that can help bring the debt to a sustainable level, they all require costly decisions today. While economics can't tell us what the "best" plan is, it can help us (and politicians) evaluate the alternatives against measurable criteria.