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ABSTRACT

This first edition of a new semiannual publication for secondary school teachers of social studies features the article, "The Federal Deficit: Challenges and Opportunities for Policy Makers" (Walter Heller and Bruce Dalgaard) and provides ideas for subject area teaching activities in economics, U.S. government, and world history that offer teachers an opportunity to integrate the federal deficit topic into their courses. The teaching activity for economics presents a simulation where students participate in the real world of special interest politics and trade-offs involved in trying to balance the federal budget. In the simulation, students try to cut spending to meet the goals of the Gramm-Rudman Act. The U.S. history activity has students compare the public debt between the years 1790 and 1984. Also, students discuss the advantages and disadvantages of deficit spending and effects on national policy goals. The government teaching activity is a student panel discussion on how the federal deficit affects the local community. The world history activities illustrate how the concept of government debt applied to post-World War I Germany and draw parallels with current issues related to government debt and increasing deficits. (SM)

THE SENIOR ECONOMIST

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of Economics • United States History • Government • World History

THE FEDERAL DEFICIT

Page Contents • Volume 1, Number 1

The Joint Council On Economic Education Introduces *The Senior Economist.*

JCEE and a vast network of State Councils and local Centers for Economic Education are proud to bring you *The Senior Economist*. This publication is designed to help secondary teachers improve the economic education of their students. This edition stresses economic concepts related to the federal deficit and suggests teaching ideas for teachers of Economics, U.S. History, Government, and World History.

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We encourage our readers to consider sharing teaching ideas they have tried. Please use the subscription form on this page to indicate any interest you may have in writing for *The Senior Economist*.

We hope you enjoy this first edition.

Mark C. Schug, Ph.D.
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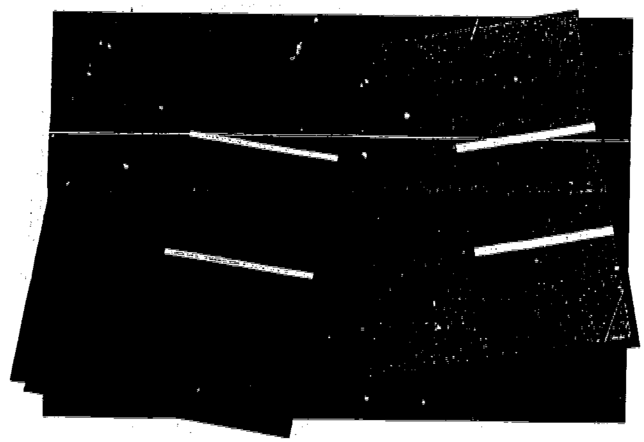

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The Federal Budget Deficit: Challenges And Opportunities For Policymakers

by Walter Heller

Walter Heller is Regents' Professor of Economics at the University of Minnesota and former chairman of the Council of Economic Advisers under Presidents Kennedy and Johnson.

by Bruce Dalgaard

Bruce Dalgaard is Associate Professor and Director of the Center for Economic Education at the University of Minnesota.

Speak not of my debts unless you mean to pay them.
Proverb

For years the American people and their elected representatives adhered to this old proverb. But now federal budget deficits have been growing year after year so that the 1985 fiscal year (FY) deficit exceeded $200 billion. Concern over the size of the annual deficits has led to dramatic action by Congress, the passage of the Gramm-Rudman Act. This legislation and the burgeoning deficits which prompted its passage have resulted in heated debates. The resulting publicity inevitably leads students to ask questions and this gives teachers an excellent opportunity to explore the economic issues surrounding the debate over the federal deficit.

What is the Federal Deficit?

A federal government *deficit* is the excess of the government's annual spending over its total collected revenues. That means that the taxes and fees collected by the government do not cover its expenditures. The government's current shortfall is huge. For FY 1985 (ending September 30, 1985) the government spent over $950 billion and collected under $750 billion resulting in a deficit of over $211 billion — that's slightly less than $1,000 for every citizen of the country.

Some people confuse "deficits" and "debt". When government revenues fall short of expenditures, the U.S. Treasury needs to do the same thing citizens do when they spend more than they have — it borrows money. That annual shortfall is the deficit. As the government runs a deficit year after year it accumulates debt. The *national debt* is the amount of money the federal government owes, the sum total of the deficits it has accumulated. The national debt was $369 billion in 1970 and $906 billion in 1980. Now it's nearly $2 trillion.

Where did the Deficit Come From?

To answer this question we need to explain the components of the deficit. Economists divide the deficit into two parts, cyclical and structural. The cyclical part results from the economy running below par. The structural part is the basic excess of spending over tax revenues that occurs even when the economy is at its full capacity.

The *cyclical deficit* results when the economy slows down or, worse yet, moves into a recession. As a result, government revenues drop primarily because as output drops and jobs are lost, incomes fall and people buy less. Thus, income and sales taxes shrink. At the same time, government spending on transfer payments rises as people use more food stamps, unemployment compensation rises, and so on. These "automatic stabilizers" help cushion the shock of economic downturns.

Throughout our history the economy has moved in cycles of expansion and then recession and then expansion again. Although our economy has been expanding for over three years now, it has not reached what economists consider "full employment". So part of our huge deficit is still "cyclical". Most economists consider a 6% rate of unemployment as about the best we can do without overheating the economy through, for example, increased government spending and causing inflation. So far in the 1980s we haven't come close to this 6% figure. Even in 1985, unemployment averaged 7.2%. There was still a sizeable gap between the amount our economy *did* produce (actual GNP) and the amount it *could have* produced at 6% unemployment (potential GNP). That gap, or GNP shortfall, accounted for about $50 billion of our deficit. In other words, higher employment would have meant fewer unemployment checks, less food stamps and so on while at the same time resulting in higher GNP and increased government revenues from a larger tax base.

The structural deficit results from a basic imbalance in spending and revenue flows. It tells us what the deficit would be even if the economy were operating at its potential, full capacity. For FY 1985 about $150 billion, or 75% of the deficit, was "structural". The majority of the deficit was due to an economy running far below its potential.

Cyclical deficits are now understood and generally accepted. Most economists agree that it's important for the government to have flexibility in its fiscal, tax and spending policies to allow it to use deficit spending to minimize the effects of economic downturns. Such *stabilization policies* have helped reduce the pain of economic cycles. As the economy recovers, one hopes that some of the borrowing used to finance the deficit spending can be paid back. That hasn't happened since 1969, the last time the federal government ran a surplus.

Has the U.S. Always Experienced Deficits?

Deficits have occurred throughout U.S. history. They were, however, not *chronic*. War time spending produced the largest deficits but years of budget surpluses often followed the war years. But even in the post World War II peacetime era when deficits have become commonplace, they were generally not excessive, at least not until recently. For the years 1950-79 federal budget deficits averaged less than 1% of GNP. Contrast that with the 1985 deficit which exceeded 5% of GNP.

Especially since World War II economists and policymakers alike have recognized that government stabilization policies, including deficit spending, can help prevent prolonged economic downturns. But the use of these policies doesn't explain the spiraling deficits we've experienced in recent years. Consider the fact that between FY 1980 and FY 1985 the federal budget deficit kept on rising even in an expanding economy.

How Did the Deficit Get so Large?

Federal government deficits (again expressed as a percent of GNP) were growing moderately during the 1970s but in the 1980s they exploded. Many economists believe that the economic conditions of the early 1980s coupled with Congressional legislation enacted at the initiative of the President help explain our large deficits.

The 1981 Economic Recovery Tax Act was the largest tax cut in history. By FY 1985 federal tax receipts were 25% lower than they would have been without the 1981 tax revisions. At the same time that the 1981-82 recession further cut government revenues while boosting transfer payments (as discussed above), federal spending was increasing. Total spending increased by $200 billion from 1981 to 1986. Military spending accounted for over half this increase (rising from $154 billion to a projected $259 billion for this year).

Also important in explaining the increasing deficits are the much higher interest rate payments on the government debt. The government was forced to issue bonds to cover the annual deficits and to refinance its outstanding debt — at a time when interest rates were at historically high levels. As a result net interest paid on the federal debt increased from $52 billion in 1980 to nearly $140 billion this year.

The drop in government revenues (declining annually by as much as 2% of GNP) combined with increased payments pushed the deficit to record levels. What's equally disturbing is that, as Figure 1 on page 6 shows, without some policy changes the deficits would remain at this high level.

What Are the Implications of a Large Deficit?

Deficits do tend to stimulate the economy. Despite some claims that the recovery from the 1981-82 recession was a result of a supply-side stimulus, it appears obvious to us that the recovery came about because of deficit spending by the government. Still, this short-term stimulus, when it results in deficits of such magnitude, creates long-term problems.

As the economy recovers the government's increasing need to borrow money to offset the deficit *crowds out* private investment spending. The government has been absorbing over one-half of private savings that might otherwise be used to finance private sector borrowing for new plant and equipment. This crowding out of private borrowers interferes with the desired expansion of our industrial base and slows down our economic growth.

The budget deficit creates further international imbalance. The large deficits coupled with high interest rates (which excessive government borrowing helped create) produce an *over-valued dollar* and enormous *trade deficits*. The high interest rates attract foreign investors (which helps create a pool of funds the Treasury can use to finance the budget deficit) but this pushes up the value of the dollar. Foreign investors increase the demand for U.S. dollars in international exchange markets. A higher value for the dollar makes imports cheaper (a 100-franc bottle of French perfume costs $20 if the dollar is worth 5 francs but only $10 if our dollar is worth 10 francs) and makes our exports more expensive in terms of other currencies. That makes it harder for U.S. producers to sell their products abroad. Consider the fact that the trade deficit jumped from around $25 billion in the late 1970s, at a time when earnings from our investments abroad more than offset the deficit, to its current $150 billion level, which is no longer offset by investment earnings since the U.S. is now a net debtor nation.

Our big federal borrowing is shifting private investment. So our capital stock — which, along with education and research and development, is the foundation for economic growth — is not accumulating at the desired pace. We are importing and consuming today, while leaving behind a leaner legacy of capital and a big foreign debt to pay off tomorrow.

What Can Be Done About the Deficit?

The passage of the Gramm-Rudman-Hollings Act in December 1985 focused public attention on the deficit and ways to reduce it. The question remains — What is the best way to deal with the deficit?

There are only two ways to affect the deficit — reduce outflows or increase revenues. In our judgment, the Gramm-Rudman Act provides a fiscal straight-jacket by dictating maximum budget deficit levels for each year beginning with the current fiscal year and continuing to 1991 when the budget is to be balanced. If the specified budget figure is not met in any given year this legislation provides for automatic cuts across the board, evenly divided between defense and domestic programs (although social security and several other programs are "off limits").

It remains to be seen whether this legislation will "hold up". Its constitutionality has already been challenged and,if the mandatory cuts are too big, Congress may balk and change the law. The best hope is that Gramm-Rudman Act will force the White House to join Congress in a grand compromise, kind of a "deficit disarmament agreement" in which a balanced set of budget cuts and some tax increases are blended to bring the federal deficit under control.

What Are the Main Elements to Get and Keep the Budget Under Control?

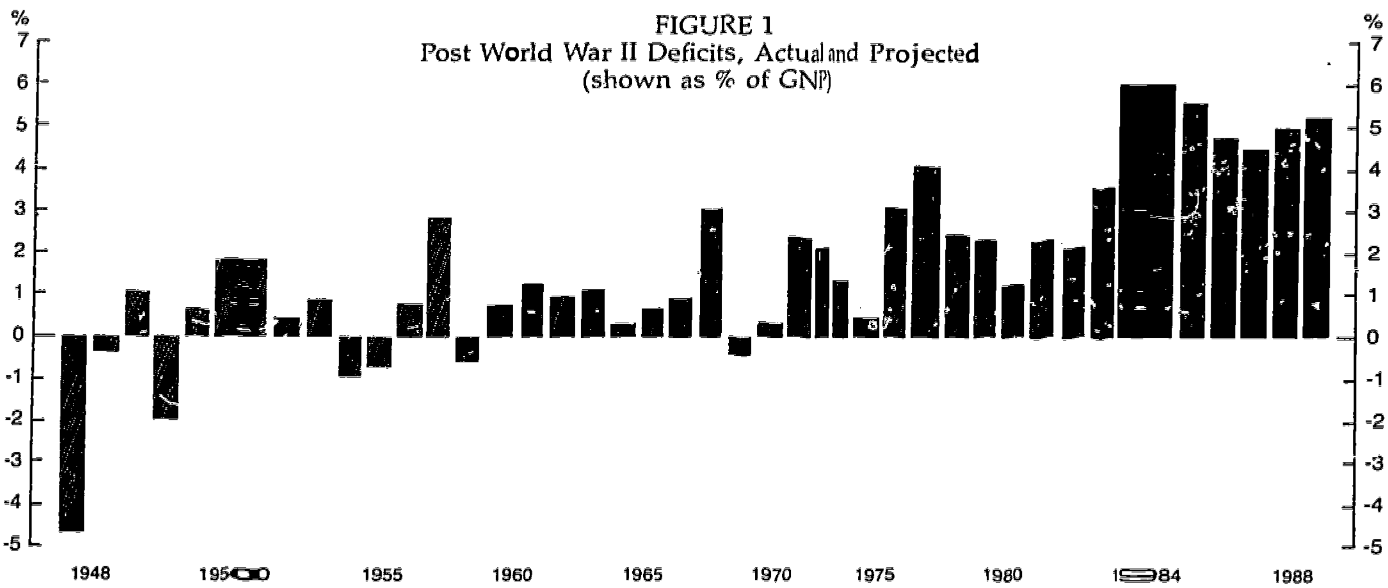
First, we need to begin a thoughtful, fair budget cutting process that will lead to a progressive reduction in the deficit. Many economists agree that this process must allow flexibility for fiscal policies to deal with any economic downturn.

Second, we need to utilize tax increases. The U.S. has the lowest tax burden of any advanced country. Many tax changes that would increase receipts have been suggested and are currently being discussed. Some of these changes include: making all individuals and corporations pay at least a minimum income tax (in 1983 over 29,000 individuals with incomes of more than $250,000 paid little or no income tax); scaling back tax shelters in the areas of oil and gas, real estate and timber, to name but a few; returning some of the income excluded by earlier tax reductions to the tax base (doing this will allow cuts in the tax rates and higher personal exemptions without further eroding tax receipts); imposing or increasing taxes on selected consumer goods considered by many as luxuries and on products which have falling prices thus reducing the psychological burden of the tax.

Third, for the longer run, the government needs to create conditions which will foster economic growth. Increased growth means increased tax revenues thus making deficit reductions less painful. We need to encourage economic expansion through expanded capacity utilization and increased productivity. This means encouraging investment in plant and equipment, expanding research and development initiatives, and initiating educational programs to develop our human capital stock. As deficits are cut and fiscal policy tightens, we have to run an easier, more stimulative, monetary policy. With sustained growth in GNP will come increasing revenues from a growing tax base which will ease the deficit situation.

It is imperative to reduce the budget deficit in a way that does not increase economic hardship. We can use the challenge of the budget deficit to review and streamline spending programs and to provide tax reform that is fair and equitable.

FIGURE 1
Post World War II Deficits, Actual and Projected
(shown as % of GNP)



Source: Preston J. Miller, "Budget Deficit Mythology" Federal Reserve Bank of Minneapolis Quarterly Review, *Fall 198[illegible].*

Confronting the Deficit: Trade-Offs and Hard Choices

by John Morton and David Smith

John Morton teaches economics at Homewood-Flossmoor High School in Flossmoor, Illinois and is Director of the Office of Economic Education at Governors State University. Among his publications are Consumer Action, a high school consumer education textbook, and Teaching Strategies: High School Economics Courses.

David Smith has a B.A. from Roosevelt University and an M.A. from Governors State University. He has taught economics and law at Thornton Township High School in Harvey, Illinois, for the past twelve years.

Introduction

The budget deficit is a result of the political process. Unfortunately, many citizens do not comprehend the economic problems associated with large deficits or the ways federal spending affects their lives.

The teaching activities which follow confront these issues. First, students read and discuss the article "The Federal Deficit: Challenges and Opportunities for Policymakers" by Walter Heller and Bruce Dalgaard. Then they participate in a simulation designed to acquaint them with the real world of special-interest politics and the trade-offs involved in trying to balance the federal budget. In the simulation, students try to cut spending to meet the goals of the Gramm-Rudman Act. Allow one class period for discussing the article and setting up the simulation. Allow another period to run and debrief the simulation.

Student Goals

1. Students analyze the major points in "The Federal Deficit: Challenges and Opportunities for Policymakers."
2. Students amend a hypothetical budget and defend their budget changes with logic and factual evidence.
3. Students analyze the opportunity costs and trade-offs involved in cutting the federal budget deficit.
4. Students recognize how federal programs affect the welfare of different groups in our society.

Teaching Activities

I. Should You Worry About Most Federal Deficits?

Assign the article "The Federal Deficit: Challenges and Opportunities for Policymakers" to the class as homework. Discuss with the students the main points of the article. Use questions such as:

— What is the federal deficit?

— What is the difference between the federal deficit and the federal debt?

— Why has the federal deficit become so large in recent years?

— Why is a large federal deficit worrisome?

— What are some of the harmful effects of a large federal deficit?

— Do you think the government should be forbidden to have a deficit? Why or why not?

— What are some ways to reduce the federal deficit? What are the advantages and disadvantages of these deficit reduction measures?

Divide students up into committees of 4 or 5 people. Each committee should have a chairperson and a recorder. Give each student a copy of Handouts 1 and 2. Explain to the students that cutting the deficit is harder in practice than in theory. People don't like to see their taxes raised. They would like to see government spending cut, but not for programs they favor. Different people benefit from different programs. Because of the politics of deficit reduction, Congress passed the Gramm-Rudman Act, which mandates across-the-board cuts if Congress and the President cannot cut the deficit. The deficit must be slashed to $144 billion in fiscal 1987, $108 billion in fiscal 1988, $72 billion in fiscal 1989, $36 billion in fiscal 1990, and $0 in fiscal 1991. Half the cuts would come in defense and half in non-exempted domestic programs. Social Security and several domestic programs are exempted from the cuts.

Explain to the students they have been appointed to a special committee of Congress to cut the deficit. Their recommendations must be politically feasible. They should remember that people get hurt when government cuts spending. They will make their recommendations to the Congress and President. Key people have sent memos to the committees; these memos should be considered by committee members. Be sure the students understand that they may make greater or lesser cuts than those on the list. For example, they may cut programs for the poor more than 10%, and they may certainly cut other programs less than 10%.

The simulation should follow these steps. First, the committees deliberate for 20 minutes. Second, each committee chairperson reports on the cuts or tax increases the committee recommends. Make sure the chairperson justifies the cuts or tax increases and understands the implications of each recommendation. Third, allow discussion among the committees to attempt to reach consensus on the issue. If none occurs in 10 minutes, implement the provisions of the Gramm-Rudman Act (teacher cuts 10% across the board).

Conduct a discussion of the budget cuts with questions such as:

- Why is it harder to cut the budget in practice than in theory?
- What are the advantages and disadvantages of reducing defense expenditures?
- What are the advantages and disadvantages of reducing social security?
- What are the advantages and disadvantages of reducing other domestic programs?
- What are the advantages and disadvantages of raising taxes?
- Who was hurt by each cut? Who was hurt by the tax increase?
- Why is there no "free lunch" in budget cutting?
- Do you think Congress and the President will be able to reduce the deficit, or will it be done through the Gramm-Rudman Act?

HANDOUT 1: MILKING SACRED COWS OR WILL YOU BE GRAMM-RUDMANNED?

The President or top leadership of the Congress has placed you on a committee to cut $60 billion in a $1 trillion budget. Even if you cut $60 billion, the deficit will still be $140 billion. If you fail, the automatic provisions of the Gramm-Rudman Act will take effect. Then there will be big across-the-board cuts in many programs, about half in defense programs and about half in domestic programs. These cuts will be deep because about 58% of the budget is not subject to the automatic ax. Areas which cannot be cut include Social Security, interest on the debt, veterans' compensation, food stamps, supplemental security income benefits, aid to families with dependent children, and Medicaid (medical care for low-income people). However, your committee can recommend cuts in any programs. The budget information that follows and memo summary should guide you in making your cuts. You may make partial cuts in programs. For example, you could cut pollution control programs by 50% and save $2 billion. In "Other Programs for the Poor," you may cut by more than 10%. Each 10% cut will save the dollar amount listed.

NATIONAL DEFENSE $322 billion	Potential cuts	Your cuts
Don't give the military a 3% raise	Save $3 billion	___
Cancel MX missile	Save $3.2 billion	___
Cancel Strategic Defense Initiative ("Star Wars")	Save $3.7 billion	___
Delay buying planes, tanks, ships	Save $10 billion	___
Eliminate cost-of-living allowance in pensions	Save $3 billion	___
Eliminate all foreign military aid	Save $6 billion	___
Close several military bases	Save $3 billion	___
Reduce troop strength by 100,000 (total troop strength–2,200,000)	Save $10 billion	___
TOTAL DEFENSE CUTS		___
SOCIAL SECURITY AND MEDICARE $290 billion		
Reduce cost-of-living adjustment	Save $9 billion	___
Reduce Social Security benefits	Save $2 billion/ % cut	___
Reduce Medicare payments by making patients pay 10% more of bill	Save $8 billion	___
TOTAL SOCIAL SECURITY CUTS		___
OTHER PROGRAMS FOR THE POOR $144 billion		
Reduce free medical care for poor 10%	Save $2.8 billion	___
Reduce food stamps 10%	Save $1.8 billion	___
Eliminate housing subsidies for poor	Save $3.4 billion	___
Reduce unemployment compensation 10%	Save $2 billion	___
Reduce aid to dependent children 10%	Save $2.1 billion	___
TOTAL CUTS IN OTHER PROGRAMS FOR THE POOR		___
INTEREST ON DEBT $150 billion		
This cannot be cut.		
OTHER PROGRAMS $100 billion		
Eliminate aid to education	Save $18 billion	___
Eliminate farm aid	Save $11 billion	___
Reduce energy programs	Save $5 billion	___
Eliminate space program	Save $6 billion	___
Eliminate pollution control programs	Save $4 billion	___
Eliminate highway/ transportation programs	Save $10 billion	___

Eliminate law enforcement programs	Save $6 billion	____
Eliminate revenue sharing	Save $2 billion	____
Eliminate foreign aid	Save $11 billion	____
Eliminate veterans' benefits	Save $25 billion	____
Eliminate health research	Save $5 billion	____
TOTAL CUTS IN OTHER PROGRAMS		____

If you cannot reduce the budget by $60 billion, you can raise taxes. Make a list of your reductions or tax increases, and write a few sentences to justify each.

HANDOUT 2: MEMO SUMMARY

The following memos should help guide you in cutting the budget. All the memos are addressed to your committee.

From the Secretary of Defense
The most fundamental and urgent role of the federal government is to provide for the national security of the United States. We cannot ignore our national interests and commitments. Large reductions in weapons will make our enemies think we are weak. Moreover, cutting military salaries will make it difficult to recruit good people to serve in the armed forces. We could reduce salaries if we reinstituted the draft — an unpopular idea to many young people and their parents. Deep cuts in defense are a prescription for disaster.

From the Secretary of Health and Human Services
The poor have repeatedly had programs which serve them reduced. Further cuts in food stamps, housing subsidies, and aid to families with dependent children might create desperately poor people. Much of the crime is committed by the poor who have lost hope. Can we afford the consequences of further reductions?

From the Speaker of the House of Representatives
The people of the nation are becoming older, and they rely heavily on their Social Security payments for retirement. We must keep our promise to these people. Also, remember that your recommendations must pass the Congress and few of our members want to run for reelection having voted to cut Social Security. If you reduce the cost-of-living allowance, retired Americans may pay higher prices without a higher income or have to substitute lower priced items when they shop. If you cut Medicare, they will have to dig even deeper into their pockets to maintain the same level of medical service. Should the burden of balancing the budget fall on older Americans?

From the President of the United States
You may be tempted to close the burgeoning federal deficit by raising taxes. Remember that the people of the United States overwhelmingly voted for me because of my pledge not to raise taxes. I will keep my campaign promise to the American people. I must consider vetoing any tax increase. Americans work hard for their income. They want to decide how to use their income, not have more of it taken away by the government.

From the Veterans of Foreign Wars
By keeping the United States free and safe, our members have paid their "dues" to the nation. We don't think the deficit should be reduced by cutting veterans' benefits. They have given enough.

From the Farm Aid Coalition
American farmers are feeding the world, but we ourselves are about to starve. The small family farmer is being forced off the land. If farm subsidies are cut, we may no longer be able to feed the world.

From the National Quality in Education Association
We must spend more money on education. Schools, students, and teachers are being shortchanged by the federal government. We are rapidly following behind countries like Japan in the training of scientists. To compete in a global economy, we cannot neglect the educational needs of our youth.

From the National Poor People's Coalition
Millions of Americans depend on the government to feed, clothe, and support them. These people will be cast out into the cold if cuts are made in Medicaid (free health care for poor people), food stamps, housing subsidies, and other essential programs. These are not cushions or extras — these are programs that provide the basic necessities of life for poor people.

II. The Effects of the Federal Budget on Your Community

How do the federal budget and potential budget cuts affect your local community? Have your students interview community leaders such as city or village officials, school administrators, mass transit officials, business owners, state legislators, and officials of local military bases. They should find the answers to questions such as these:

1. How much support does their organization get from the federal government?
2. How many jobs will be lost if there are cuts in programs that affect their area?
3. Who will be hurt if programs that affect their area are cut? For example, how will budget cuts affect school or city services?
4. What effect will higher taxes have on them?

> **Note:** Additional teaching ideas are available in *Teaching Strategies: High School Economics Courses* by John S. Morton published by the Joint Council on Economic Education.

Post Revolutionary America and Pre 1930s to the Present Time

by James B. O'Neill and Barbara Fournier

James B. O'Neill is Professor of Economics and the Director of the Center for Economic Education at the University of Delaware. Dr. O'Neill directs the Master's of Instruction in Economic Education degree program at the University of Delaware.

Barbara Fournier has taught social studies for sixteen years at Christiana High School, Newark, Delaware. She received a Master's degree in economic education from the University of Delaware, and serves as a DEEP coordinator to the Christiana School District.

Introduction

Government expenditures greater than revenues have occurred many times in our history. However, until the 1930s, these gaps were primarily associated with national defense. For example, the new emerging nation in the 1780s faced debt dilemmas as a result of the Revolutionary War. As Secretary of the Treasury, Alexander Hamilton concerned himself first and foremost with establishing the infant nation's creditability to pay the debt at face value. This objective of debt repayment included a foreign debt of $12 million and a domestic debt of $42 million.

When studying the role of government in the economy, students need to develop an understanding that just as individuals lack the resources to provide for all their wants, government is also limited by scarce resources. The public policy goals of society: growth, freedom, efficiency, equity, stability and security involve trade-offs and cannot all be accomplished in full measure at the same time.

Heller and Dalgaard note that policy makers today face hard decisions in dealing with the deficit. The first teaching activity emphasizes how government spending reflects the trade-offs that have been made regarding national policy goals over time. The last two teaching activities focus on the shifts in values that occurred from the pre 1930s belief in a balanced budget dominated by defense expenditures to the post depression attempts to use deficit spending to foster equity and stability within the economy, and economic growth, and personal security.

Student Goals

1. Students compare public debt and output (GNP) between the years 1790 and 1984.
2. Students compare reasons for government debt in 1790 to reasons today.
3. Students identify the advantages and disadvantages of Alexander Hamilton's proposition that the foreign and domestic debt be paid at face value.
4. Students correlate changes in the federal budget with major historical events.
5. Students discuss the advantages and disadvantages of deficit spending and effects on the national policy goals of growth, efficiency, equity, and freedom.

Teaching Activities

I. A Role Play on the Debt: 1790

Present the class with information about the size of the public debt in 1790, which was approximately 5.4 million, and the size of public debt in 1984 which was $1.6 trillion. Compute the percent of debt/GNP in 1790 and 1984. Ask students to speculate about some of the similarities among factors contributing to the debt in 1790 compared to the present time.

THE PUBLIC DEBT IN 1790 AND 1984

	GNP	Deficit	Debt
1790	$192 million	—	$5.4 million
1984	$3.7 trillion	$185 billion	$1.6 trillion

Explain that in 1790 there was some disagreement regarding the repayment of the domestic public debt. Some of the debt was no longer in the hands of the original owners and had been repurchased at a fraction of its face value by speculators. Many citizens argued that Alexander Hamilton was determined to win the enthusiastic approval of the moneyed class through repayment.

Using their history texts to gather background information, let students impersonate a group of Americans discussing Hamilton's financial plans for debt repayment. In this role-playing activity, ask the students to imagine that they are attending a town meeting. Consider the view of:

a. A member of Congress holding public debt
b. A farmer deeply in debt

c. A veteran of the American Revolution
d. A banker
e. A speculator holding government bonds
f. A widow who owns government bonds

Following the role-playing activity, discuss the costs and benefits which might be associated with each role in relation to Hamilton's proposal for debt repayment. For example, a farmer deeply in debt might oppose Hamilton's plan on the grounds that it might appear to only help bankers and speculators. A widow who holds government bonds might support the Hamilton Plan. A veteran of the American Revolution might note the importance of establishing the nation on a financially sound basis.

II. Changes in Federal Spending

Explain to the students that they are about to study how federal spending has changed in our history. Distribute the Data on Federal Spending Over Time and the Budget Summary to the class as a handout or on the overhead projector. Ask the students to work in small groups to create line graphs reflecting the change in federal spending from 1799 to 1986. Ask the students: "How has the level of federal spending changed from 1799 to 1986?" and "What events do you think may have influenced major increases in spending?" Key events such as the Civil War and the Depression can be noted on the line charts.

Ask the students to examine their line graphs as well as information about the categories of spending in the federal budget for 1985 in the Budget Summary. Question the students about how changing trends in federal spending might reflect changes in public goals such as the desire for economic growth, freedom, security, and stability. Ask the class to speculate about how their observed trends will continue over the next 40 years. Ask: What kind of events or changes in goals might encourage growth in federal spending? What events might discourage growth in spending?

III. The Press Conference: Role Playing

This activity introduces students to how the views of different Presidents influence federal spending. Depending on the ability level of the student and time allotment, the teacher can give all the data necessary or have individuals research their roles.

Roles

Reporters: Most of the students will serve as members of "the press." They should work in groups or as individuals to gather information related to the questions which follow. They should also be prepared with many additional questions they wish to ask.

Presidents: Seven students should be selected to play the roles of various Presidents including Thomas Jefferson, James Buchanan, Abraham Lincoln, Woodrow Wilson, Franklin Roosevelt, Lyndon Johnson, and Ronald Reagan. Have each person acting as a President, prepare answers to the following questions:

1. How much did the federal government spend during your term?

Data on Federal Spending Over Time

Congress decides on spending & revenue laws	1799	Congress spent $10 million $6 million - defense, $3.3 million debt repayment, revenue laws $700,000 Vets' pensions financed by taxes on imports
	1860	$63 million
	1865	$1 billion
	1920	$20 billion
	1921	Budget & Accounting Bill gives exec. power over budget
	1934	$2 billion or 28% (defense, vets benefits, debt and welfare)
	1950	$39.5 billion in spending
	1980	$576.7 billion
	1986	$994 billion (estimated)

Budget Summary

	1799	1985*
Defense	$6.0 million	$270 billion
Debt repayment	$3.3 million	$110 billion**
Vets pension	$ .7 million	$27 billion
Space technology		$9 billion
Energy		$3 billion
Agriculture		$14 billion
Commerce, housing credit		$1 billion
Transportation		$27 billion
Community & regional development		$7.5 billion
Education, employment		$28 billion
Health		$33 billion
Social Security & Medicare		$260 billion
Income security		$114 billion

* Source: Department of the Treasury (figures are rounded off)
** Net Interest Payment

2. What were the three major areas of spending?
3. What events during your administration required these expenditures?
4. Which national goal or goals does this spending reflect?
5. If there was deficit spending during your term, how much was it? Why did you believe deficit spending was necessary?

After the students have participated in the press conference, you might wish to extend their learning or have them formulate opinions. They might present the information in a time-line or write a newspaper article presenting the information. The students might follow up this lesson by to writing letters to members of Congress from their state or district to research views on the federal deficit or express opinions.

Note: Additional teaching ideas are available in *Strategies for Teaching Economics: United States History* by James B. O'Neill and *Teaching Economics in American History* by George G. Dawson and Edward C. Prehn both published by the Joint Council on Economic Education.

The Federal Deficit and the Local Community

by Stephen Haessler, Stephen Sansone, and Leon Schur

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Stephen Sansone teaches government and citizenship also in the Waukesha Public School District in Wisconsin. He is currently developing curriculum that combines human rights education with global perspectives.

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Introduction

High school students need to understand the current national debate over the federal deficit. Students are increasingly curious about whether a tax cut or a tax increase is necessary, about whether defense, social spending, or some combination should be cut. This curiosity provides an excellent educational opportunity. As voters, students should be able to make informed decisions between candidates offering a variety of solutions to the problem. Moreover, students want to understand the impact of deficits and recommended remedies on their own lives and on their own communities. The focus of this lesson is on assessing how fiscal policy controversy affects local communities.

Success with these activities will be enhanced if students have some background about federal deficits. For example, the article by Heller and Dalgaard might be introduced and discussed in class. For this lesson, it is especially important to stress the theoretical differences between liberal Keynesians and supply-side fiscal conservatives over the proper timing of tax increases or decreases, or the most appropriate type and amount of government spending. Students should associate Keynesians with those who believe stimulating aggregate demand is most important, while supply-siders are those who believe economic growth and expansion are most important.

Student Goals:

1. Students distinguish between Keynesian (demand-side) and Reaganomic (supply-side) approaches to federal deficits, taxation policy, and balanced budgets.
2. Students practice citizenship and critical thinking skills by sponsoring a panel of community resource persons.
3. Students make judgments on what they consider the most effective strategy to deal with government deficits.

Teaching Activities

I. Preparing for the Community Panel

Introduce the deficit debate by referring to local manifestations of the issue such as newspaper headlines. "Budget Bill Could Leave Poor in Cold," or "Budget Battle Could Raise State Taxes" are examples.

Introduce the class to the idea of having a community panel to address student concerns on the local impact of fiscal controversy as the culminating activity. Government teachers might have students identify the decision-making agency involved in each local fiscally-related concern.

Distribute copies of the fictitious speeches on deficits. Ask the students to classify sentences from the speeches into categories like agree-disagree, fact-value, argument-solution, or cause-effect. Through discussion bring out the philosophical differences in the competing points of view.

Have the students construct individual decision grids which evaluate fiscal policy options in terms of the probable impact on the local community. Provide the students with information from local agencies relying on federal or state funding. Decision grids (see sample) should relate fiscal options like tax increases or decreases, to local issues or groups.

Introducing the class to a decision grid involves six steps. First, the students should identify the problem. How will ways for solving the deficit affect people in our community? Second, the students should list the alternatives for dealing with the deficit. Taxes should be increased and taxes should be reduced are two suggestions in the speeches. Third, list criteria to help judge the alternatives. Criteria might include statements such as low income people and elderly should not be hurt or local businesses should be helped. Fourth, individual students should rank order the criteria according to what they consider to be most important to least important. Fifth, students should evaluate the alternatives according to the criteria by placing a +, −, or 0 in the appropriate places in the grid. Finally, individual students should be encouraged to make a tentative decision. Encourage the students to state their position while carefully noting how it meets criteria they judge to be important.

Sample Decision Grid

[illegible]	[illegible]
tax cut	[illegible]
tax increase	[illegible]
cut entitlement programs	[illegible]
increase defense spending	[illegible]

Divide the class into three or four groups of three or four. Designate a recorder for each group. Ask the students to use their decision grids to identify the most frequently mentioned or important criteria used to judge which alternatives are best.

The class should share results in a whole group discussion. Compile a representative list of from three to five criteria. A panel of several students should then be charged with the task of writing three discussion questions under each criterion which can be asked of community resource persons. If-then questions are useful, for example: "If Congress raises corporate income taxes, then what changes will your business make in the near future?"

Students should brainstorm on who from their community should be invited to participate in the panel and answer questions. Representatives from banks, government agencies, local businesses, and church groups might be sought. The student panel might send copies of the class's questions to the panel participants well ahead of time to help the community representatives prepare. Finally, the time and place of the panel forum should be set. The class may also want to send invitations to parents, other school personnel, and the local media.

II. Conducting the Community Panel

The panel of student questioners should ask community representatives the questions they have written. Spontaneous questions should also be encouraged. You might also seek comments from community guests on the strengths and weaknesses of the student-generated questions. What are important factors which have been omitted? How have key arguments been over-simplified?

III. After the Community Panel

Follow-up the forum with a class discussion. Emphasize the connections between fiscal controversy and local concerns. The decision grids used to prepare for the community panel should be reevaluated in light of the forum results.

Speeches:

Senator Sue Ply Cide —
"Curing the Federal Deficit Cancer"

The deficit is too big. We must reduce it now. It is best compared to a family budget. Huge deficits indicate the government, like a financially careless family, is living beyond its means. The longer we wait to deal with the deficit problem, the harder and more damaging will be the solutions.

Nonetheless, today's United States economy is one of the most prosperous and financially sound in the world. Our country has prospered because we have controlled public enemy number one: inflation. Just a few short years ago we were groaning under 13.5% inflation! Current policies helped bring that rate down. Now we have to maintain price stability. If we don't, we'll get both inflation and unemployment.

As I see it, the only solution to our economic problems is to stimulate economic growth through investment. To accomplish this we must cut taxes. High tax rates are bad because they discourage incentives to be productive as well as lower income and tax revenues. On the other hand, reduced tax rates increase people's incomes and eventually help tax revenues increase. The best way to simulate economic growth is to reduce the role of government in the economy.

Large government involvement in the economy is well intentioned but often causes many unexpected problems. For example, if the government doesn't balance its spending with revenue, we force the government to compete against U.S. businesses for credit in the financial markets. This will drive up the interest rates and stifle needed investment. High interest rates will slow the economy because businesses won't be able to expand as easily. The economic growth we so desperately need will not occur.

Now is the time to balance the budget. So far, Con-

(continued on last page)

Post World War I German and National Debt

by John Wende and Gloria Contreras

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Gloria Contreras is an Associate Professor and Research Director of the Economic Education Project at The University of Texas at Austin. She teaches courses in economics education, elementary and secondary social studies methods, and multicultural education.

Introduction

Heller and Dalgaard noted earlier the important distinction between the national deficit and the national debt. The following activities are designed to show how the concept of government debt applies to post World War I Germany and has implications for current issues related to government debt and increasing deficits.

The Versailles Treaty of 1919 made Germany accept guilt for starting the war. War reparations were demanded by the Allies. By acknowledging its liability for reparations payments, Germany agreed to pay 5 billion dollars within two years and an unnamed sum later. In 1921 the Allies set the total bill at 33 billion dollars. Germany entered a period of great economic depression. The new Weimer Republic, which provided Germany with a democratic government, tried to tackle the problem of the huge war debt. Instead of raising taxes to help pay for these costs, it printed excessive sums of paper money. The result was a dramatic increase in the inflation rate — too much money chasing too few goods. The German mark dwindled to almost nothing. What started as a national debt problem catapulted into a series of economic catastrophes.

Student Goals

1. Students recognize how Germany's economic chaos after World War I affected the daily needs and lives of the German people.
2. Students identify similarities and differences between the economic events of post World War I Germany and current economic policies related to the United States deficit and national debt.
3. Students recognize the phases of an economic cycle especially as they apply to post World War I Germany.

Teaching Activities

I. Hard Times at Home

Explain to the class that they are about to read about the personal hardships suffered by many Germans after World War I. Distribute Reading #1 to the class. Next, display the information in Table I using the overhead projector. Ask the students to identify the relationship between the information in Table I and the worker's plea. Point out that, for most workers, deprivation increased during the war and food rations did not provide the sufficient amount of calories needed for work. Undernourishment was pervasive.

Introduce Reading #2 by telling students that the author was a lieutenant in World War I. He and his family moved to the U.S. (Kentucky) in 1921 when he was 29 years old. During the war he kept a diary and in 1981 he published his memoirs.

Table I: Official Food Rations as Percentage of Peace-Time Consumption Levels

	1916/17	1917/18	1918
Meat	31.2	19.8	11.8
Eggs	18.3	12.5	13.3
Lard	13.9	10.5	6.7
Butter	22.0	21.3	28.1
Sugar	48.5	55.7-66.7	82.1
Potatoes	70.8	94.2	94.3
Vegetable Oils	39.0	40.5	16.6

Kocka, Jürgen. *Facing Total War: Germany Society 1914-1918*, trans by Barbara Weinberger. Warwickshire, Great Britain: Berg Publishers, 1984.
Reprinted by permission of Harvard University Press.

Reading #1

"It cannot go on like this. Our colleagues are perishing physically. For the last two years the prices of goods have risen in an altogether shameless manner. Goods which are produced in Germany have become 300 to 400 percent dearer. In order to buy a pair of working trousers, which formerly cost 4 or 5 M, one now needs a week's earnings. In 4 years, we received 50 percent rise in wages .... Despite the 50 percent wage increase, our colleagues suffer want. They cannot afford black market prices, and rationed goods cannot fill their stomachs. They no longer have anything to wear. It gets worse every week. Various articles have increased twenty times in price, earnings by only a half. We can no longer go on. We have come to an end .... (p. 25)"

Reading #2

Most historians agree that the conditions of the Treaty of Versailles simply could not be carried out. At first, things went fairly well. Germany surrendered whatever tangibles it possessed, such as what gold was left, silver, the merchant fleet, colonies and nearly everything that could be moved, including many thousands of cattle from the farmer's fields. But when it came to payments out of "profits," the impossibility of it all became apparent. The treaty said Germany must pay a "minimum" of 25 billion dollars in gold. How could such a sum be earned? When payments of money ceased coming, the French army marched into the Ruhr, and attempted to force the miners to work at bayonet point to mine coal to be shipped to France. The miners refused to work. They could see no advantage in producing coal for France while their families starved. (Reference: Nagel, Fritz. *The World War I Memoirs of a German Lieutenant*. Huntington, Va.: Der Angriff Publication, 1981, pp. 113-114.)

Conclude the reading with a discussion which focuses students' attention on the similarities and differences between the economic situation in post World War I Germany and contemporary economic policies. Construct a chart on the chalkboard which compares government debt in Germany in the past with the United States today.

Similarities and Differences Between Post World War I Germany and Contemporary United States

	Similarities	Differences
Post World War I Germany	- High level of government debt - Government actions to address the debt problem resulted in severe inflation and hardships	- High inflation - Government spending was driven by external pressures (war reparations) - Short experience with democratic institutions - Government debt was a high percentage of GNP
United States Today	- High level of government debt - Government actions to address the debt problem will result in hardship for some individuals	- Low inflation - Government spending is driven by internal pressures (domestic and defense spending) - Long experience with democratic institutions - Government debt is a low percentage of GNP

II. The Business Cycle

Many economists note that the cyclical nature of economic activity in Germany during the period from World War I to immediately prior to World War II serves as a good illustration of extremes in the business cycle from prosperity to depression. While recent business cycles have been more moderate — we have avoided a major depression since the 1930's — the business cycle remains an important feature of today's economies.

Draw a business cycle on the chalkboard and label the four main phases (Prosperity, Recession, Depression, and Recovery). Have students do the same on a piece of notebook paper. Ask the students to give at least 2 characteristics of each phase.

PROSPERITY — highest point in the business cycle.
(1) High employment of people, plant and equipment.
(2) High demand for goods and services results in shortages and higher prices.

RECESSION — A general decline in the business activity.
(1) People, plant, and equipment are underemployed.
(2) A decline in the total spending by consumers and businesses.
(3) A decline in real Gross National Product for 2 consecutive quarters (6 months).

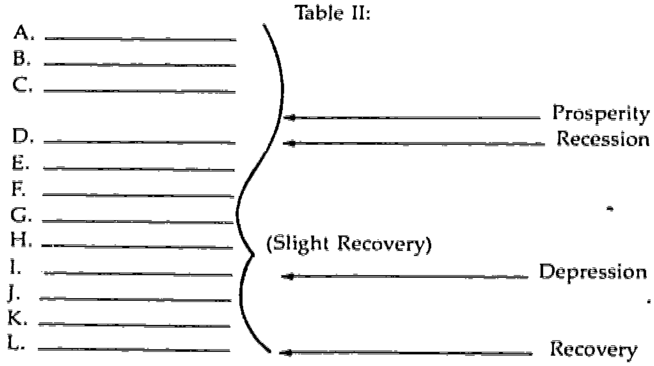
DEPRESSION — the lowest point in the business cycle.
(1) High unemployment of people, plant, and equipment.
(2) Further reductions in total spending by consumers and businesses.

RECOVERY — the general level of economic activity begin to increase.
(1) Re-employment of people, plant, equipment.
(2) Total spending increased by consumers and businesses spurred on by business optimism.

Listed below are a series of major events that occurred in Germany from roughly 1900 to 1936. Give these to the students in a random order and have them try to place each event on the business cycle.

A. 1900 — Emergence of a large German merchant fleet ushering in the beginning of active world trade.
B. 1900 — Germany enters the Industrial Revolution — especially in steel production.
C. 1900 — The emergence of a German industrial working class.
D. 1919 — The loss of foreign markets after WW I.
E. 1919 — The loss of industrial and food resources after WW I.
F. 1919 — Germany is forced to sign the Treaty of Versailles a nitting total responsibility of the war.
G. 1920 — Demands on Germany to begin reparations of war.
H. 1926 — Germany joins the League of Nations giving them official status in the world scene.
I. 1919 — American stock market crash resulting in a recall of American loans to Germany.
J. 1933 — Rise of Hitler to power socializing most of the Germany economy.
K. 1935 — Beginning of various public work's projects by the Nazi Party.
L. 1936 — Beginning of a large rearmament program in Germany.

Table II:



Note: Additional teaching ideas are available in *Strategies for Teaching Economics: World Studies* by James B. O'Neill published by the Joint Council on Economic Education.

(continued from page 13)
gress has lacked the political courage to cut the budget. Yet, the anti-poverty programs of the 1960's are making the poor too dependent. The poor need incentives and jobs more than food stamps and welfare. I personally favor cutting taxes, reducing wasteful government spending, and balancing the federal budget. We should continue to upgrade our defense program, but cut back on the entitlement programs like Social Security, welfare and the like. In the short run unemployment may rise, but remember the importance of stimulating economic growth in the long run. We need to send the business community a clear message — that we will live within our means and in fact reduce the large national deficit.

Senator Cane Zeean —
"Coping Successfully With the Federal Deficit"

Deficits are indeed big. But we must consider carefully how and when to reduce them. The federal deficits, unlike state or local government revenue shortfalls, is a fiscal tool which influences the economy. Federal spending shouldn't be thought of only as paying for various services, it can also play a useful role for the entire economy.

When the country is plagued by recession, the federal government should run a deficit and cut taxes. Yes, we should cut taxes in a recession to put money in the hands of citizens. This will increase consumption levels which increases demand, and encourages business to hire more workers.

The economy has recovered somewhat from the last recession. We need to increase income and business taxes to reduce the deficit. We must get this deficit down while we can. We cannot afford to enter the next recession with such a huge deficit. We have very sluggish growth rates and unemployment rates which are still too high. American factories are using only 80% of their capacity. That means if we raise taxes now, it will not cause inflation because of all that slack in productive capacity.

Now is not the time to panic and resort to extreme measures like the Gramm-Rudman Act which threatens to take economic decision making from policy makers. Such reactions may rob government leaders of the fiscal tools essential in guiding the economy through hard times. The deficit should be seen in historical perspective. In 1946, the total of all past deficits, the national debt, was 124 percent of our GNP. In 1982, it was 37 percent. This means deficits are not, by themselves, fatal.

We must get to full employment now, that is 6% unemployment or below. We should raise taxes to reduce the deficit. The current deficit is part of fiscal policy trade-offs. I personally prefer 7 or 8% inflation as long as unemployment is 6% or below. To achieve the full employment goal and a reduced deficit, we must increase taxes and continue to spend money in the economy where it will do the most good in creating jobs. Improving government job training is a good place to start. In the long run increased employment would reduce the deficit and people will be better off.

Note: Additional teaching ideas are available in the *Economics-Political Science Series* which includes six resource guides published by the Joint Council on Economic Education.

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