INSTRUCTOR'S MANUAL

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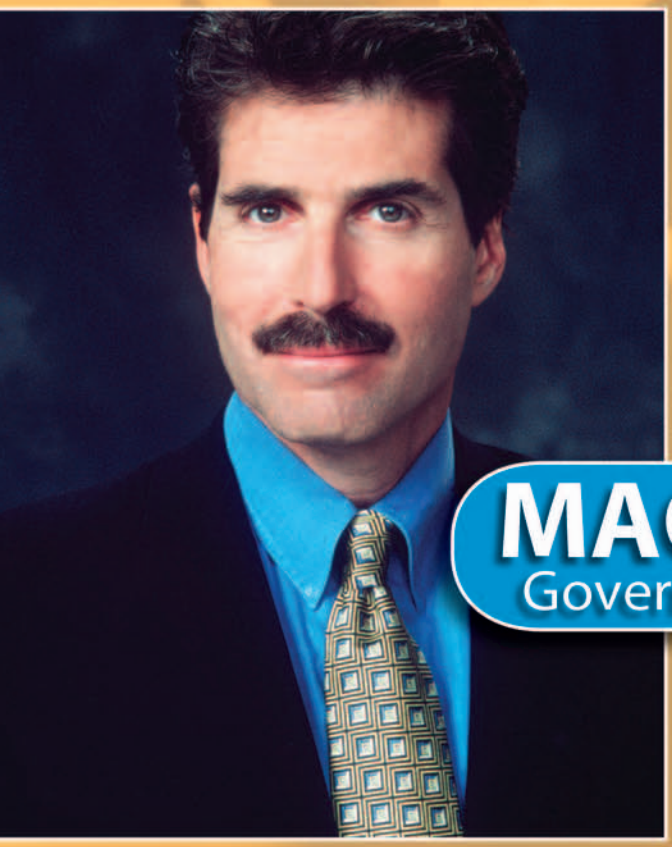

Teaching Tools for MACROECONOMICS, Government and International Trade

from

John Stossel

COLLEGE EDITION

Instructor's Manual to Accompany

Teaching Tools for **MACRO**ECONOMICS from JOHN STOSSEL

COLLEGE EDITION

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How to use the video clips effectively

This manual provides teachers with materials that will help them use the Stossel video clips more effectively in their classroom. The manual contains the following for each clip:

(1) a list of the various concepts illustrated by the clip,

(2) video description,

(3) preview question,

(4) discussion and analysis questions,

(5) multiple-choice assessment questions, and

(6) a related activity or exercise.

Many instructors will want to use the preview question to introduce the clip and focus students on the major topic it covers. The preview questions often encourage students to share their views prior to viewing the video. After the video is shown, the discussion and analysis questions provide suggested focal points for additional classroom discussion. Like the multiple-choice questions, the analysis questions may also be used to assess student understanding of the topics covered in the video clip. Finally, the related activity or exercise can be used to re-enforce the content of the clip. In some cases, this material will also be appropriate for use as a homework assignment. We believe that these video clips, along with selected use of materials from this manual, will help instructors enrich their classes and bring economic concepts more alive for students.

Clip 1: Is life getting worse?

Length: 5:06

Concepts Illustrated:

Income comparisons across time periods
Changes in per capita GDP across time periods
GDP and various quality of life indicators

Description:

The segment dispels the notion that life is worse or more difficult and risky today than in the past. The segment documents that most risks are greatly reduced from levels just a few years ago. Pollution levels and crime rates are down. Diseases such as diphtheria and rheumatic fever have virtually been eliminated while the flu, which killed 20 million people around 1918, has been contained. The type of work has changed from back-breaking farm labor to much easier means of employment. The fact is that America is the safest and most prosperous nation on Earth.

Preview Question:

"Is life in America today better or worse than it was 50 or 100 years ago?"

Take a poll and ask a few students on each side to give reasons for their answers. Do not judge or direct their opinions.

Discussion and Analysis Questions:

1. If you could choose whether to live in America today or 50 years ago, which would you choose? Why?

2. Make a list of goods that are readily available to most Americans today that were unavailable 50 years ago. Correspondingly, list goods that were readily available to most 50 years ago that are unavailable today. Which list is longer?

3. Without using the jargon of economics, explain why living standards are higher today than they were 50 years ago. Are there more natural resources today than 50 years ago? What are the major sources of economic progress?

4. What does GDP per capita measure? How has the per capita GDP of the U.S. changed during the last 50 years?

Multiple-Choice Questions:

1. Which of the following would be most appropriate for the measurement of differences in the average standard of living of people at different points in time?
   a. Nominal GDP.
   b. Real GDP.
   c. Nominal per capita GDP.
   * d. Real per capita GDP.

2. As per capita GDP has risen over time in the United States and other countries, the
   * a. life expectancy has increased.
   b. rate of illiteracy has increased.
   c. rate of infant mortality has increased.
   d. amount of leisure time has declined.

Extension Activity: Wonderful Trends of the Past 100 Years

The following statistics are from Stephen Moore and Julian L. Simon, "The Greatest Century That Ever Was: 25 Miraculous Trends of the Past 100 Years," *Policy Analysis,* Cato Institute, Dec. 15, 1999. Stephen Moore was interviewed in the video.

25 Wonderful Trends of the 20th Century

Trend	1900-1920	1995-98
Life expectancy (years)	47	77
Infant mortality (deaths per 1,000 live births)	100	7
Deaths from infectious diseases (per 100,000 population)	700	50
Heart disease (age-adjusted deaths per 100,000 population)	307 (1950)	126
Per capita GDP (1998 dollars)	$4,800	$31,500
Manufacturing wage (1998 dollars)	$3.40	$12.50
Household assets (trillions of 1998 dollars)	$6 (1945)	$41
Poverty rate (percent of U.S. households)	40	13
Length of workweek (hours)	50	35
Agricultural workers (percent of workforce)	35	2.5
TV ownership (percent of U.S. households)	0	98
Homeownership (percent of U.S. households)	46	66
Electrification (percent of U.S. households)	8	99
Telephone calls (annual per capita calls)	40	2,300
Cars for transportation (percent of U.S. households)	1	91
Patents granted	25,000	150,000
High school completion (percent of adults)	22	88
Accidental deaths (per 100,000 population)	88	34
Wheat price (per bushel in hours of work)	4.1	0.2
Bachelor's degrees awarded to women (percent of degrees)	34	55
Black income (annual per capita, 1997 dollars)	$1,200	$12,400
Resident U.S. population (millions)	76	265
Air pollution (lead, micrograms per 100 cubic meters of air)	135 (1977)	4
Computer speed (millions of instructions per second)	0.02 (1976)	700
Computer ownership (percent of U.S. households)	1 (1980)	44

Questions for Discussion or Written Response

1. In your view, which three of the above statistics indicate the most important advancements? Why?

2. The authors of the study say, "A central message of this study is that the fruits of a free society are prosperity, wealth, and better health." Do you agree or disagree? Why?

3. Are there any other statistics you would want to see before concluding that life is better today?" If so, what would they be?

Points to Consider: *According to the study's authors, "there have been worrisome increases in family breakups, abortions, illegitimate births, and teen suicide." Violent crime increased in the twentieth century before declining.*

4. Are there other major advancements not included in the trends listed above that you think should be? If so, what are they?

Is life getting worse?

Multiple-Choice Questions:

1. Which of the following would be most appropriate for the measurement of differences in the average standard of living of people at different points in time?

   a. Nominal GDP.
   b. Real GDP.
   c. Nominal per capita GDP.
   d. Real per capita GDP.

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   a. life expectancy has increased.
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Is life getting worse?

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Questions for Discussion or Written Response

1. In your view, which three of the above statistics indicate the most important advancements? Why?
2. The authors of the study say, "A central message of this study is that the fruits of a free society are prosperity, wealth, and better health." Do you agree or disagree? Why?
3. Are there any other statistics you would want to see before concluding that life is better today?" If so, what would they be?
4. Are there other major advancements not included in the trends listed above that you think should be? If so, what are they?

Clip 2: Gas prices: nominal versus real

Length: 2:45

Concepts Illustrated:

Real versus nominal figures

Adjusting nominal values for the effects of inflation

Description:

The segment clearly illustrates the error of comparing nominal (current) prices across time periods. Without adjusting for inflation, gas prices seem to be at their highest level. However, when adjusted for inflation, gas prices are actually lower than they have been for most of the 20th century. In addition, the segment brings out the point that a gallon of gas is cheaper than a gallon of ice cream or water. Some of the details of oil drilling and production are highlighted and compared to the relatively simple production processes of goods like water and ice cream.

Preview Question:

"Are gas prices higher today than in the past?"

Ask for a show of hands. Probably everyone will think "yes." Tell the students the video will provide the answer to the question, and the answer might not be as obvious as it seems.

Discussion and Analysis Questions:

1. When making comparisons across time periods, why is it important to adjust for changes in the general level of prices? (Hint: If the nominal price of a good increases, does this mean that one will have to give up more of other things in order to purchase the good?)

2. Could the real price of a good like gasoline decline even though its nominal price rose? Under what conditions would this occur?

3. Between 1982 and 2005, the general level of prices in the United States approximately doubled. The nominal price of gasoline in 1982 was $1.25. Indicate the 1982 price of gasoline measured in 2005 prices.

4. Why does the news media nearly always report changes in the prices of a good like gasoline in nominal rather than real terms?

5. What is the difference between real and nominal income? Which would one want to use when making income comparisons across time periods?

Multiple-Choice Questions:

1. Why is it important to use real rather than nominal figures when making comparisons of value across time periods?
   a. The real figures are a better measure of changes in the general level of prices.
   * b. The real figures are adjusted for changes in the general level of prices.
   c. The real figures reflect changes in the general level of prices as well as changes in purchasing power.
   d. The real figures adjust for changes in the level of interest rates.

2. In contrast with nominal values, real values refer to nominal values
   a. minus interest rates.
   b. minus personal income taxes.
   * c. corrected for price changes.
   d. corrected for depreciation.

3. The consumer price index is
   a. a measure of the increase in the average price of all goods produced.
   * b. a comparison of the cost of buying a typical bundle of goods during a given period with the cost of buying the same bundle during an earlier base period.
   c. The ratio of the average price of a typical market basket of goods compared to the cost of producing those goods during the previous year.
   d. a comparison of the cost of the typical bundle of goods consumed in period 1 with the cost of a different bundle of goods typically consumed in period 2.

Extension Activity: Nominal and Real Data

How can data from an earlier year be adjusted for changes in the general level of prices?

The nominal price of a gallon of regular unleaded gasoline is presented here along with data on the general level of prices as measured by the Consumer Price Index (CPI) for various years since 1973.

Year	Nominal Price (1)	CPI (1982–84 = 100) (2)
1973	$ 0.39	44.4
1980	1.25	82.4
1990	1.16	130.7
2000	1.51	172.2
2005 (November)	2.34	197.6

When comparing figures across time periods, it is important to adjust for changes in the general level of prices. The Consumer Price Index (CPI) is one measure of the general level of prices. Price and income data from an earlier year can be measured in terms of the price level of the later year by "inflating" the figure for the earlier year by the ratio of the CPI in the later year divided by the CPI of the earlier year. For example, the price of gasoline in 1973 can be measured in terms of the general level of prices in 2005 by multiplying the price of gasoline in 1973 (39 cents) by the ratio of the CPI in 2005 divided by the CPI in 1973. As the accompanying table shows, this ratio is 197.6 divided by 44.4, or 4.45. Multiplying the 4.45 times the 39-cent price of gasoline in 1973 yields $1.74. Thus, measured in 2005 prices, the real price of gasoline in 1973 was $1.74. (Note, the 4.45 indicates that the general level of prices in November 2005 was 4.45 times the level of prices in 1973.)

In economics, "real" always means adjusted for differences in the general level of prices (i.e. inflation). Answer the following questions about the real price of gasoline during the 1973-2005 period.

1. Measured in terms of the general level of prices in November of 2005, derive the real price of a gallon of gasoline for the years 1980, 1990, and 2000. Show your work for each of these calculations.

2. Indicate whether the real price of gasoline rose or fell during each of the following periods:
   1973-1980
   1980-2000
   2000-2005 (Nov.)

3. Was the real price of a gallon of gas higher or lower during November 2005 than during 1980?

Gas prices: nominal versus real

Multiple-Choice Questions:

1. Why is it important to use real rather than nominal figures when making comparisons of value across time periods?

   a. The real figures are a better measure of changes in the general level of prices.
   b. The real figures are adjusted for changes in the general level of prices.
   c. The real figures reflect changes in the general level of prices as well as changes in purchasing power.
   d. The real figures adjust for changes in the level of interest rates.

2. In contrast with nominal values, real values refer to nominal values

   a. minus interest rates.
   b. minus personal income taxes.
   c. corrected for price changes.
   d. corrected for depreciation.

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   1973-1980
   1980-2000
   2000-2005 (Nov.)

3. Was the real price of a gallon of gas higher or lower during November 2005 than during 1980?

Clip 3: Unemployment and labor mobility

DVD Clip: Laid off Steelworkers

Length: 2:57

Concepts Illustrated:

Unemployment

Dynamic change and labor productivity

Labor markets

Description:

Using the labor market in Youngstown, Ohio as an example, the segment addresses resource mobility. After several steel mills closed, many workers were laid off and unemployment grew to 25%. However, as new companies emerged most of those workers found better, safer, and higher-paying jobs. While labor conditions were poor for several years, total employment in Youngstown eventually grew so that there were more jobs than before the steel mills closed.

The segment goes on to compare labor mobility in Europe and America. Generally, European labor market regulations make it more difficult for businesses to reduce employment. Perhaps surprising to some, such policies slow down resource movement, which leads to higher unemployment and depresses income growth. Resource mobility is more flexible in America so we have less unemployment, more rapid growth, and higher living standards.

Preview Question:

"Would Americans be better off if the government made it more difficult for employers to lay off and dismiss workers?"

Accept a variety of responses. Here are some relevant points to bring up:

- *Lay-offs impose serious burdens on the workers involved. No one looks forward to being dismissed from his or her job.*
- *Making it more difficult to dismiss workers provides an incentive to employers to avoid hiring them at all.*

Discussion and Analysis Questions:

1. The movement of resources such as labor to more productive places takes time. How long do you think it took the workers in the clip to find new jobs? Why?

2. If regulations make it more difficult for employers to lay off and dismiss current employees, how will this influence their incentive to hire additional workers and expand employment in the future?

3. At any point in time, some businesses will be expanding and others contracting. If we want to get the most out of the available resources, why is it important for resources, including labor, to move from the businesses that are contracting to those that are expanding?

4. What are the major causes of persistently high rates of unemployment?

5. How does the rate of unemployment in most European countries compare with the rate for the United States? Is this likely to change in the near future? Why or why not?

Multiple-Choice Questions:

1. The unemployment rate equals the number of persons
   a. unemployed divided by the number employed.
   * b. unemployed divided by the number in the labor force.
   c. unemployed divided by the population age 16 and over.
   d. not working divided by the population age 16 and over.

2. The unemployment rate in the United States is
   * a. lower than the rate in Germany and France.
   b. about the same as the rate in Germany and France.
   c. higher than the rate in Germany and France.
   d. lower than the rate in France but higher than the rate in Germany.

3. Which of the following is a positive effect of job search and the unemployment that often accompanies it?
   a. It keeps wages and income levels low.
   * b. It permits individuals to better match their skills and preferences with the requirements of a job.
   c. It reduces the wage gap between high-skill workers and those with few skills.
   d. It creates political pressure for an increase in the minimum wage, which will reduce the rate of unemployment in the long run.

4. When the dismissal regulations of a country mandate lengthy periods of severance pay and make it costly for employers to reduce employment,
   a. the country's rate of unemployment will generally be lower than the rate of similar countries with less restrictive dismissal regulations.
   * b. employers will be reluctant to add workers during periods of strong demand because it will be costly to dismiss them if future conditions are less favorable.
   c. it will be easier for new labor force entrants to find jobs than would be the case if the restrictive dismissal regulations were absent.
   d. the growth of employment in the country will generally be higher than the employment growth of countries with less restrictive dismissal regulations.

Extension Activity: Comparing Economic Freedom and Unemployment

Explain to the class that there is a correlation between nations that have high levels of economic freedom–limited government spending and lower taxes, secure property rights, low inflation, free trade, fewer business regulations–and positive economic outcomes including higher living standards and lower levels of unemployment.

The *Economic Freedom of the World Annual Report* published by the Fraser Institute ranks nations around the world in terms of their levels of economic freedom.

Ask the students to predict which of the nations in Table 1 would rank near the top in terms of economic freedom and which would rank near the bottom. Then ask the students to fill in the economic freedom ranking that is provided.

Next, ask the students to visit the *World Factbook* published by the CIA. This is a widely used website that contains a great deal of data on individual nations. It allows students to make many comparisons among nearly all the nations of the world. The *World Factbook* can be found at **www.cia.gov/cia/publications/factbook**. Ask the students to go to this website. Once there, they should enter the name of one of the countries in Table 1 and then click on "economy." Look up the unemployment rate and enter it into the last column on the right in Table 1.

When they are done, ask: What appears to be the correlation between high levels of economic freedom and the unemployment rate? (High ratings of economic freedom appear to be associated with low levels of unemployment. Low levels of economic freedom appear to be associated with high levels of unemployment.)

Table 1. Economic Freedom and Unemployment

Economic Freedom Rank[1]	Country	Unemployment Rate
(1)	Hong Kong	(5.8%, 2005)
(2)	Singapore	(3.4%, 2005)
(3)	New Zealand	(4%, 2005)
(3)	United States	(5.1%, 2005)
(112)	Syria	(20%, 2002)
(115)	Russia	(7.6%, 2005)
(124)	Venezuela	(12.3%, 2005
(126)	Zimbabwe	(60%, 2005)

[1] *Economic Freedom of the World 2005 Annual Report* Vancouver, B.C: Fraser Institute.

Unemployment and labor mobility

Multiple-Choice Questions:

1. The unemployment rate equals the number of persons

   a. unemployed divided by the number employed.
   b. unemployed divided by the number in the labor force.
   c. unemployed divided by the population age 16 and over.
   d. not working divided by the population age 16 and over.

2. The unemployment rate in the United States is

   a. lower than the rate in Germany and France.
   b. about the same as the rate in Germany and France.
   c. higher than the rate in Germany and France.
   d. lower than the rate in France but higher than the rate in Germany.

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   a. It keeps wages and income levels low.
   b. It permits individuals to better match their skills and preferences with the requirements of a job.
   c. It reduces the wage gap between high-skill workers and those with few skills.
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   b. employers will be reluctant to add workers during periods of strong demand because it will be costly to dismiss them if future conditions are less favorable.
   c. it will be easier for new labor force entrants to find jobs than would be the case if the restrictive dismissal regulations were absent.
   d. the growth of employment in the country will generally be higher than the employment growth of countries with less restrictive dismissal regulations.

Unemployment and labor mobility

Extension Activity: Comparing Economic Freedom and Unemployment

Table 1. Economic Freedom and Unemployment

Economic Freedom Rank[1]	Country	Unemployment Rate
	Hong Kong	
	Singapore	
	New Zealand	
	United States	
	Syria	
	Russia	
	Venezuela	
	Zimbabwe	

[1] *Economic Freedom of the World 2005 Annual Report,* Vancouver, B.C: Fraser Institute.

Clip 4: Government spending, jobs, and unemployment

DVD Clip: Broken Windows

Length: 2:40

Concepts Illustrated:

Expenditure multiplier
Fiscal policy
Wealth and living standards

Description:

John breaks several windows in an apartment to illustrate how jobs would be created by the destruction. Cleaning crews, window repairers, glass manufacturers, and many others would see an increase in demand for their services. At first glance it looks like the economy is helped because the destruction creates jobs and expands employment. But wait a minute—the destruction also destroys wealth and if the funds had not been spent repairing the damages, they would have been spent elsewhere. Therefore, destructive acts do not create jobs, they merely re-shuffle them. Furthermore, the destruction reduces wealth and the availability of goods and services for consumption.

Preview Question:

"If destructive acts such as hurricanes and earthquakes lead to increased spending to repair the damage, do they expand employment and thereby help the economy?"

Discussion and Analysis Questions:

1. The clip outlines what is sometimes referred to as the "broken window fallacy." What is the "broken window fallacy"? Why is it a fallacy?

2. Do destructive hurricanes create jobs in the repair and construction industries? Do they increase demand for building materials and employment in that industry? If the government spends more on road repairs and subsidies to storm victims, will this spending create jobs? Will all of this spending lead to an expansion in total employment and aggregate output? Why or why not?

3. If the government increases its total spending, what must it do in order to obtain the funds for the additional spending? How will this affect output and employment?

4. Are the jobs created by additional government spending often more visible than any that might be destroyed by higher taxes or additional borrowing? Is this a potential source of economic confusion?

5. What determines the economic well-being of people? Are jobs the source of economic prosperity?

6. If the government borrows the funds to increase its spending, will the borrowing influence employment? Why or why not?

Multiple-Choice Questions:

1. A hail storm that breaks lots of windows in buildings is
   a. good for the economy because the spending on repairs will expand net employment.
   b. good for the economy because spending on the repairs will drive up the general level of prices.
   c. bad for the economy because the damage from the storm will be subtracted from this year's GDP.
   * d. bad for the economy because wealth was destroyed and more spending on repairs will result in less spending on other goods and services.

2. If the government levies $20 billion in taxes to finance additional spending on military weapons, the net impact on total employment will be
   a. a substantial increase in employment because the additional spending will create lots of jobs.
   b. a substantial decrease in employment because the higher taxes will destroy lots of jobs.
   * c. small because the higher taxes will reduce spending in other areas, which will tend to offset any jobs created by the government spending.
   d. a substantial expansion in employment, but only if the additional spending leads to an increase in the general level of prices.

3. If the government increases its spending, the funds for the additional spending will have to come from
   a. higher taxes.
   b. additional borrowing.
   c. an expansion in the supply of money.
   * d. some combination of higher taxes, borrowing, and expansion in the supply of money.

4. If the government spends an additional $20 billion on a new prescription drug program for senior citizens, aggregate output will
   a. increase by $20 billion if the economy is operating at full employment.
   b. increase by more than $20 billion if the economy is operating at full employment.
   * c. increase very little, if at all, because the increased spending will lead to higher drug prices and the combination of higher taxes and additional borrowing to finance the spending will reduce output in other areas.
   d. decline by $20 billion if the economy was already operating at full employment.

5. When the government borrows funds in order to pay for its current expenditures,
   a. the government will have to repay the borrowed funds within five years.
   b. the government can spend without having to increase taxes, either now or in the future.
   * c. future taxes will have to be higher in order to pay the interest on the borrowed funds.
   d. the cost imposed on the private sector is virtually eliminated because taxes can remain constant.

Extension Activity: The Attack of September 11, 2001

Distribute the following handout to your class and ask the students to respond to the Question for Discussion.

September 11 and the Broken Window Fallacy

After the attacks on the World Trade Center on September 11, 2001, some well-meaning economists suggested that rebuilding New York City would stimulate billions of dollars of economic activity. Buildings would need to be repaired, new buildings would be built, subways would have to be repaired, and security systems would need to be improved. The economy was in a mild recession at the time. So in a sense, the attacks of September 11, 2001, were an economic "win" for the United States.

Question for Discussion

Were the events of September 11, 2001 good or bad for the U.S. economy? Did they expand employment in some industries? Did they expand overall employment? Be sure to keep in mind the "broken window fallacy."

Government spending, jobs, and unemployment

Multiple-Choice Questions:

1. A hail storm that breaks lots of windows in buildings is

   a. good for the economy because the spending on repairs will expand net employment.
   b. good for the economy because spending on the repairs will drive up the general level of prices.
   c. bad for the economy because the damage from the storm will be subtracted from this year's GDP.
   d. bad for the economy because wealth was destroyed and more spending on repairs will result in less spending on other goods and services.

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   c. small because the higher taxes will reduce spending in other areas, which will tend to offset any jobs created by the government spending.
   d. a substantial expansion in employment, but only if the additional spending leads to an increase in the general level of prices.

3. If the government increases its spending, the funds for the additional spending will have to come from

   a. higher taxes.
   b. additional borrowing.
   c. an expansion in the supply of money.
   d. some combination of higher taxes, borrowing, and expansion in the supply of money.

4. If the government spends an additional $20 billion on a new prescription drug program for senior citizens, aggregate output will

   a. increase by $20 billion if the economy is operating at full employment.
   b. increase by more than $20 billion if the economy is operating at full employment.
   c. increase very little, if at all, because the increased spending will lead to higher drug prices and the combination ofhigher taxes and additional borrowing to finance the spending will reduce output in other areas.
   d. decline by $20 billion if the economy was already operating at full employment.

5. When the government borrows funds in order to pay for its current expenditures,

   a. the government will have to repay the borrowed funds within five years.
   b. the government can spend without having to increase taxes, either now or in the future.
   c. future taxes will have to be higher in order to pay the interest on the borrowed funds.
   d. the cost imposed on the private sector is virtually eliminated because taxes can remain constant.

Government spending, jobs, and unemployment

September 11 and the Broken Window Fallacy

After the attacks on the World Trade Center on September 11, 2001, some well-meaning economists suggested that rebuilding New York City would stimulate billions of dollars of economic activity. Buildings would need to be repaired, new buildings would be built, subways would have to be repaired, and security systems would need to be improved. The economy was in a mild recession at the time. So in a sense, the attacks of September 11, 2001, were an economic "win" for the United States.

Questions for Discussion

Were the events of September 11, 2001 good or bad for the U.S. economy?

Did they expand employment in some industries?

Did they expand overall employment?

Be sure to keep in mind the "broken window fallacy."

Clip 5: Stadiums, subsidies, and taxes

Length: 5:54

Concepts Illustrated:

Government spending
Job creation
Subsidies
Taxes
Political decision-making and special-interest issues

Description:

The segment uses the new baseball stadium for the Chicago White Sox as an example. Jerry Reinsdorf, the majority owner of the White Sox, and former Illinois Governor Jim Thompson are interviewed to describe the rationale and the process involved to fund the new stadium. By using tax dollars, the stadium costs are reduced for the owners of sports teams. Since costs are reduced, owners are able to increase both player salaries and profitability. Another concept is that taxes are used to transfer income away from some and toward others. In this case, the stadium was funded by a motel/hotel tax. Therefore, taxes are collected from consumers who typically reside outside of Illinois and transferred to the citizens of Illinois, mostly to the sports team and its owners.

Preview Question:

"Do subsidies for sports stadiums create jobs and promote economic development?"

Ask for a show of hands–yes, no, and maybe. Ask a few students for the reasons for their opinions.

Discussion and Analysis Questions:

1. Who is helped and who is hurt by government subsidies for the finance of sport stadiums? Do these subsidies increase or decrease income inequality?

2. If the sports stadiums were not subsidized, do you think that the team owners would go out of business? Would the players shift to other jobs such as truck driver or construction worker? Would the quality of the teams and their entertainment value decline if the subsidies were eliminated? Why or why not?

3. If the government is going to subsidize sports, does fairness require that it also subsidize other forms of entertainment such as opera, classical music, rock concerts, and circuses? Why or why not?

4. If a majority of the voters favor the subsidies, does this mean that they are an efficient use of resources?

5. "Subsidies to sports stadiums help wealthy owners and players at the expense of ordinary citizens. They reflect special-interest politics and do nothing to improve the quality of sports entertainment. Government action in this area is totally unjustified." Evaluate this view.

Multiple-Choice Questions:

1. Which of the following provides the most reasonable explanation for why sports teams lobby for higher subsidies?
   a. Without the subsidies, sports teams would cease to exist.
   b. Subsidies promote the efficient use of resources.
   * c. Sports interests seek a redistribution of income favoring themselves.
   d. The subsidies reduce costs, which helps the poor.

2. Restrictions that limit sugar imports, subsidies for the construction of sports stadiums, and federal spending on programs like the construction of an indoor rain forest in Iowa all provide examples of government programs
   a. based on careful analysis of benefits relative to cost.
   b. designed to redistribute income from the rich to the poor.
   * c. that reflect the political attractiveness of special-interest issues.
   d. that promote the general welfare.

3. Proponents of government-financed stadiums and civic centers often argue that spending on these projects will trigger a multiplier effect that will cause the local economy to grow by three or four times the initial expenditures. Which of the following should cause one to be skeptical of such claims?
   a. Full realization of the multiplier effect assumes that the spending leads to the employment of resources that would have otherwise been unemployed.
   b. To a large degree, spending on such projects merely replaces other types of spending.
   c. Tax increases used to finance such projects reduce spending in other areas.
   * d. All of the above are true.

4. Proponents of a $500-million taxpayer-financed stadium for the new National League baseball team in Washington, D. C. argued that the spending would expand the local economy by several billion dollars. They were
   a. probably correct because such projects generally increase local income by three or four times the spending on the projects.
   b. probably incorrect because spending on such projects mostly replaces other types of spending.
   c. Probably incorrect because the tax increase necessary to finance the project will reduce spending on other goods and services.
   * d. both b and c are correct..

Extension Activity: Government Decision-Making

This is a brief simulation that illustrates that every choice for government spending has an opportunity cost. There is no free lunch in government spending–just as there is no free lunch in private spending. Every choice has an opportunity cost, and too often that opportunity cost is ignored.

1. **Set up the situation.**
   The state government is considering a temporary half-cent increase in the sales tax to expand government programs. The tax is expected to raise $500,000,000 per year, and the governor and state legislature are considering the following choices:

   a. New stadium
   Build a new stadium for the professional football team that has threatened to move to another state. The new stadium would be a state-of-the-art facility with comfortable seats, skyboxes, extensive restrooms, and numerous food areas. Backers claim the construction will create many high-quality jobs.

   b. "Education for the Future"
   This is a plan to improve the public schools and improve student performance in math, reading, and science. Under this plan teacher salaries would increase, schools would get new facilities, and accountability for student performance would increase. Backers believe that improving the skills of future members of the workforce will attract businesses that will create high-quality jobs.

   c. "Transportation Express"
   This is a plan to create highways throughout the state and public transportation in urban areas. Backers believe that the improved transportation system will stimulate business development and make the state a more pleasant place in which to live. They also believe the construction will create many new jobs.

   d. No new taxes
   Some state legislators believe that the taxpayers should keep the money they earned and the sales tax should not be raised. They argue that lower taxes create incentives for people to work, spend, save, and invest. They argue, therefore, that more jobs will be created and living standards will be raised.

2. **Time to choose.**
   Write each alternative on a separate sheet of paper and spread the four sheets throughout the classroom. Have the students go to the sheet of paper with the program they support.

3. **Discuss the decision.**
   Have the students discuss their choices and encourage students who made different choices to be critical. The key here is not that one choice is better than the others but each decision has benefits and opportunity costs.

Finally, ask what choices members of the state legislature might make and why. Which special interests would support each program?

Stadiums, subsidies, and taxes

Multiple-Choice Questions:

1. Which of the following provides the most reasonable explanation for why sports teams lobby for higher subsidies?

   a. Without the subsidies, sports teams would cease to exist.
   b. Subsidies promote the efficient use of resources.
   c. Sports interests seek a redistribution of income favoring themselves.
   d. The subsidies reduce costs, which helps the poor.

2. Restrictions that limit sugar imports, subsidies for the construction of sports stadiums, and federal spending on programs like the construction of an indoor rain forest in Iowa all provide examples of government programs

   a. based on careful analysis of benefits relative to cost.
   b. designed to redistribute income from the rich to the poor.
   c. that reflect the political attractiveness of special-interest issues.
   d. that promote the general welfare.

3. Proponents of government financed stadiums and civic centers often argue that spending on these projects will trigger a multiplier effect that will cause the local economy to grow by three or four times the initial expenditures. Which of the following should cause one to be skeptical of such claims?

   a. Full realization of the multiplier effect assumes that the spending leads to the employment of resources that would have otherwise been unemployed.
   b. To a large degree, spending on such projects merely replaces other types of spending.
   c. Tax increases used to finance such projects reduce spending in other areas.
   d. All of the above are true.

4. Proponents of a $500-million taxpayer-financed stadium for the new National League baseball team in Washington, D. C. argued that the spending would expand the local economy by several billion dollars. They were

   a. probably correct because such projects generally increase local income by three or four times the spending on the projects.
   b. probably incorrect because spending on such projects mostly replaces other types of spending.
   c. Probably incorrect because the tax increase necessary to finance the project will reduce spending on other goods and services.
   d. both b and c are correct..

Clip 6: How much tax do the rich pay?

Length: 1:54

Concepts Illustrated:

Impact of marginal tax rates

Description:

The segment documents the proportion of income taxes paid by the wealthiest Americans. At the beginning of the clip, the Reverend Al Sharpton, former Democratic presidential candidate, claims the top 1% of income earners pay less than 5% of total income taxes. He suggests they should pay 15%. The fact is that the top 1% of income earners already pay 34% of the total income tax collected by the IRS. The top 5% pay over 50% of the total income tax.

Preview Question:

"Do the rich pay their fair share of taxes? Should their tax rates be increased?"

Prior to showing the clip, elicit the views of students on these questions and ask a few students to give reasons for their opinions.

Discussion and Analysis Questions:

1. Prior to 1981, the top marginal federal income tax rate imposed on those with the highest incomes was 70 percent. Did the rich pay more of the income tax during that period than they do today?
   (Answer: No. For example, the top 1 percent of taxpayers paid 19 percent of the federal income tax in 1980 compared to approximately one-third of the tax during recent years.)

2. What is the "marginal tax rate?" Why is the marginal tax rate important?

3. How do high marginal tax rates affect the incentives of individuals to work, invest, and earn?

4. Will an increase in the marginal tax rates imposed on high-income taxpayers cause the revenues collected from them to increase proportionally? Can the higher rates be counted on to increase the revenues collected from the rich? Why or why not?

5. "High marginal tax rates make it cheap for high income taxpayers to purchase business-related goods and other items that are tax deductible." Is this statement true?

Multiple-Choice Questions:

1. In 1980, the top 1 percent of earners paid 19.1 percent of the federal personal income tax. By 2002, the share of this tax collected from the top 1 percent of earners
   a. had declined to less than 15 percent.
   b. was still slightly less than 20 percent.
   c. had risen to approximately 22 percent.
   * d. had risen to approximately 33 percent.

2. The share of the personal income tax paid by the bottom half of earners
   a. rose to an all-time high in 2002.
   b. was substantially higher in 2002 than during the 1960s and 1970s.
   * c. was substantially lower in 2002 than during the 1960s and 1970s.
   d. has been relatively constant during the last four decades.

3. The share of the federal personal income tax paid by the bottom half of earners is
   a. higher than the share paid by the top 1 percent of earners.
   b. about 10 percent of all income taxes paid.
   * c. less than 4 percent of all income taxes paid.
   d. both a and b are correct.

Extension Activity: Income Levels and Tax Rates

The table below updates the figures in the video to 2003 and provides an opportunity for the students to see who really pays taxes. AGI is adjusted gross income, which is income after business expenses but before exemptions and deductions are taken.

	NUMBER OF RETURNS	AGI ($ MILLIONS)	INCOME TAXES PAID ($ MILLIONS)	GROUP'S SHARE OF TOTAL AGI (%)	GROUP'S SHARE OF INCOME TAXES (%)	INCOME SPLIT POINT	AVERAGE TAX RATE (%)
All taxpayers	128,609,786	6,287,586	747,939	100.00	100.00		11.9
Top 1%	1,286,098	1,054,567	256, 340	16.77	34.27	Above $295,495	24.31
Top 5%	6,430,489	1,960,676	406,597	31.18	54.36	Above $130,080	20.74
Top 10%	12,860,979	2,663,470	492,452	42.36	65.84	Above $94,891	18.49
Top 25%	32,152,447	4,078,227	627,380	64.86	83.88	Above $57,343	15.38
Top 50%	64,304,893	5,407,851	722,027	86.01	96.54	Above $29,019	13.35
Bottom 50%	64,304,893	879,735	25,912	13.99	3.46	Below $29,019	2.95

Sources: Internal Revenue Service, The Tax Foundation

Questions:

1. True, false, or uncertain and why? "The top 1 percent of taxpayers may pay 34 percent of federal personal income taxes, but they also earn more than 34 percent of the income."

2. What percentage of federal personal income taxes does the bottom 50 percent of earners (people earning below $25,912) pay?

3. How does the average income tax rate of those in the bottom half of the income distribution compare with the average rate paid by the top 1 percent of earners?

4. Is there a good reason why the poor pay less of their income in taxes than the rich?

5. Do you think people whose income is in the lower half of all income pay any other taxes?

Points to consider: *Yes, those with lower incomes pay other taxes such as social security tax, state income tax, state and local sales taxes, and property tax. However, the rich pay more of these taxes also. Further, the social security benefit formula favors those with lower incomes.*

How much tax do the rich pay?

Multiple-Choice Questions:

1. In 1980, the top 1 percent of earners paid 19.1 percent of the federal personal income tax. By 2002, the share of this tax collected from the top 1 percent of earners

   a. had declined to less than 15 percent.
   b. was still slightly less than 20 percent.
   c. had risen to approximately 22 percent.
   d. had risen to approximately 33 percent.

2. The share of the personal income tax paid by the bottom half of earners

   a. rose to an all-time high in 2002.
   b. was substantially higher in 2002 than during the 1960s and 1970s.
   c. was substantially lower in 2002 than during the 1960s and 1970s.
   d. has been relatively constant during the last four decades.

3. The share of the federal personal income tax paid by the bottom half of earners is

   a. higher than the share paid by the top 1 percent of earners.
   b. about 10 percent of all income taxes paid.
   c. less than 4 percent of all income taxes paid.
   d. both a and b are correct.

How much tax do the rich pay?

Extension Activity: Income Levels and Tax Rates

The table below updates the figures in the video to 2003 and provides an opportunity for the students to see who really pays taxes. AGI is adjusted gross income, which is income after business expenses but before exemptions and deductions are taken.

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Top 10%	12,860,979	2,663,470	492,452	42.36	65.84	Above $94,891	18.49
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Points to consider: *Yes, those with lower incomes pay other taxes such as social security tax, state income tax, state and local sales taxes, and property tax. However, the rich pay more of these taxes also. Further, the social security benefit formula favors those with lower incomes.*

Clip 7: Are boycotts of sweatshop products helpful?

Length: 5:50

Concepts Illustrated:

International trade
Labor markets
Minimum wage
Price controls

Description:

The role of profits in business activity to import goods from cheaper, foreign countries is a general theme. The segment begins with scenes from various student protests regarding imported goods made by "sweatshops." As expressed during interviews with several students, their stated goals are to raise wages and improve conditions for the workers in foreign countries. They are implicitly calling for price controls either through artificially raising prices of the goods or implementing some kind of minimum wage for the workers. Either one would result in fewer goods being imported which would actually lower the wages and increase unemployment for the workers in the "sweatshops." The protestors claim foreign workers are being exploited. During interviews with representatives from foreign countries, quite the opposite story is depicted. Those countries and workers desire those jobs and would like to have more.

Preview Question:

"Would workers in poor countries be better off if Americans refused to buy items produced in sweatshops?"

Accept a variety of responses. Here are some relevant points to bring up:

- *Poor working conditions and low wages are relative to the countries involved.*
- *What is considered a low wage in the United States, a nation characterized by highly productive workers, is quite different from what is considered a low wage in Mexico, a nation characterized by less productive workers.*
- *Companies are not compelled to open factories in poor nations. They do it voluntarily and are usually welcomed by the people of the host nation.*

Discussion and Analysis Questions:

1. (a) According to the college students, do companies like Nike exploit their workers by paying low wages?
   (b) According to the people who live in these countries, do companies like Nike exploit their workers by paying low wages?

2. If Americans bought fewer products produced by firms in low-wage countries, how would the demand for workers in these countries be affected? What impact would this have on their wages and employment opportunities?

3. Why are the workers employed in the "sweatshops" willing to work for the low-wage employers? Would these workers be better off if the firms paying the low wages were driven out of business or moved their operations to another country?

4. If firms selling goods in the U.S. were required to pay the U.S. minimum wage to workers that they employ in low-wage countries like Mexico or India, for example, would the workers in the low-wage countries be helped? Why or why not?

5. American labor unions are often at the forefront of those providing funds for "sweatshop" protestors. Do you think that the union leaders are primarily concerned about the low-wage foreign workers? Might they have another motivation for supporting the protestors?

Multiple-Choice Questions:

1. If Americans bought fewer products produced by firms in low-wage countries, there would be

* a. a reduction in the demand for labor and increased unemployment in low-wage countries.
b. an increase in the demand for labor and increased unemployment in low-wage countries.
c. a reduction in the demand for labor and decreased unemployment in low-wage countries.
d. an increase in the demand for labor and decreased unemployment in low-wage countries.

2. A decrease in the demand for a product will cause the
   a. demand for and prices of the resources used to produce the product to increase.
   * b. demand for and prices of the resources used to produce the product to decrease.
   c. demand for and prices of the resources used to produce the product to remain unchanged.
   d. price of the product to decrease.

3. According to international trade theory, a country can gain
   a. if it protects domestic industries from low-wage foreign producers.
   b. only if the trade harms its trading partners.
   * c. by importing goods when they can be obtained more economically from foreign producers.
   d. if it maximizes the employment in domestic industries that face competition from foreign producers who have lower costs.

4. American textile manufacturers and union members have often lobbied successfully for restrictive quotas limiting the importation of textile products. The major impact of these quotas is
   a. a permanent reduction in unemployment in the United States.
   b. lower prices for American consumers and an improvement in the quality of textile products available.
   * c. higher prices for American consumers, a narrower selection of products, and less competition in the U.S. textile industry.
   d. long-run profits in the U.S. textile industry that are substantially above market equilibrium.

5. "Trade restrictions limiting the sale of cheap foreign goods in the United States are necessary to protect the prosperity of Americans." This statement is
   a. true for a reduction in trade restrictions but false regarding an increase in trade restrictions.
   * b. false; if a good can be bought cheaper abroad than it can be produced at home, the purchase from abroad will promote prosperity.
   c. false; American prosperity depends on jobs, not the availability of goods and services.
   d. essentially correct.

Extension Activity: The Sweatshop Shortage

Distribute the following handout to your class and ask the students to respond to the Questions for Discussion.

The World Does Not Have Enough Sweatshops

Jeffrey Sachs is a well-known economist. A professor at Harvard for many years, he now has an appointment at Columbia University. Professor Sachs is deeply concerned about reducing world poverty and has written and spoken extensively on the subject.

In a recent book Professor Sachs writes that "the rich-world protesters . . . should support increased numbers of such jobs [because] the sweatshops are the first rung on the ladder out of extreme poverty." He goes on to say that "by now the anti-globalization movement should see that globalization, more than anything else, has reduced the numbers of extreme poor in India by 200 million and in China by 300 million since 1990." [1]

Professor Sachs suggests that sweatshops can help to reduce poverty. He suggests further that we don't have enough sweatshops! Why? Many nations around the world are hostile to companies that wish to open factories in their nations. Leaders in some nations–nations which became independent of colonial powers at a time when socialist ideas were popular–do not embrace the institutions of a free-market economy as the way out of poverty. India, for example, was leery of market reforms until the early 1990s. Also, many interest groups, including labor unions, are opposed to sweatshops.

[1] *The End of Poverty: Economic Possibilities for Our Time,* by Jeffrey D. Sachs, Penguin Press, 2005.

Questions for Discussion

1. What do you think Professor Sachs means when he says that sweatshops are "the first rung on the ladder out of extreme poverty"?

2. Why do labor unions and domestic producers in the United States often criticize low-wage foreign producers? Do you think that their criticism is motivated primarily by a concern for low-wage workers in poor countries? Why or why not?

Are boycotts of sweatshop products helpful?

Multiple-Choice Questions:

1. If Americans bought fewer products produced by firms in low-wage countries, there would be

   a. a reduction in the demand for labor and increased unemployment in low-wage countries.
   b. an increase in the demand for labor and increased unemployment in low-wage countries.
   c. a reduction in the demand for labor and decreased unemployment in low-wage countries.
   d. an increase in the demand for labor and decreased unemployment in low-wage countries.

2. A decrease in the demand for a product will cause the

   a. demand for and prices of the resources used to produce the product to increase.
   b. demand for and prices of the resources used to produce the product to decrease.
   c. demand for and prices of the resources used to produce the product to remain unchanged.
   d. price of the product to decrease.

3. According to international trade theory, a country can gain

   a. if it protects domestic industries from low-wage foreign producers.
   b. only if the trade harms its trading partners.
   c. by importing goods when they can be obtained more economically from foreign producers.
   d. if it maximizes the employment in domestic industries that face competition from foreign producers who have lower costs.

4. American textile manufacturers and union members have often lobbied successfully for restrictive quotas limiting the importation of textile products. The major impact of these quotas is

   a. a permanent reduction in unemployment in the United States.
   b. lower prices for American consumers and an improvement in the quality of textile products available.
   c. higher prices for American consumers, a narrower selection of products, and less competition in the U.S. textile industry.
   d. long-run profits in the U.S. textile industry that are substantially above market equilibrium.

5. "Trade restrictions limiting the sale of cheap foreign goods in the United States are necessary to protect the prosperity of Americans." This statement is

   a. true for a reduction in trade restrictions but false regarding an increase in trade restrictions.
   b. false; if a good can be bought cheaper abroad than it can be produced at home, the purchase from abroad will promote prosperity.
   c. false; American prosperity depends on jobs, not the availability of goods and services.
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Professor Sachs suggests that sweatshops can help to reduce poverty. He suggests further that we don't have enough sweatshops! Why? Many nations around the world are hostile to companies that wish to open factories in their nations. Leaders in some nations–nations which became independent of colonial powers at a time when socialist ideas were popular–do not embrace the institutions of a free-market economy as the way out of poverty. India, for example, was leery of market reforms until the early 1990s. Also, many interest groups, including labor unions, are opposed to sweatshops.

[1] *The End of Poverty: Economic Possibilities for Our Time,* by Jeffrey D. Sachs, Penguin Press, 2005.

Questions for Discussion

1. What do you think Professor Sachs means when he says that sweatshops are "the first rung on the ladder out of extreme poverty"?

2. Why do labor unions and domestic producers in the United States often criticize low-wage foreign producers? Do you think that their criticism is motivated primarily by a concern for low-wage workers in poor countries? Why or why not?

Clip 8: Does outsourcing cost Americans jobs?

Length: 5:33

Concepts Illustrated:

International trade
Secondary effects
Employment

Description:

Lou Dobbs of CNN argues that outsourcing is bad and should be restricted. However, as some jobs are sent to foreign countries, labor resources are freed up to move to more productive areas. While the short-term consequences can be difficult, the long-term benefits often include better and higher-paying jobs for the displaced workers. The Levi factory in Powell, Tennessee is used to illustrate the major point of the clip. When the plant closed because the jobs were sent to Mexico, the people who had worked there for twenty years became unemployed. Many of the workers from the Levi factory have found better jobs.

Preview Question:

"Would Americans be better off if outsourcing were prohibited?"

Prior to showing the clip, elicit the views of students and ask a few students to give reasons for their opinions.

Discussion and Analysis Questions:

1. Why do business firms "outsource" certain activities?

2. Would people in your state be better off if the business firms of the state were not permitted to outsource–that is, to buy things from suppliers in other states? Would a prohibition on outsourcing to suppliers in other states increase employment in your state? Why or why not?

3. If you can acquire a good or service cheaper via trade than you can produce it yourself, should you trade for it? If Americans can acquire a good or service cheaper from foreigners than they can produce it domestically, would they be better off by trading for it?

4. Would Americans be better off if outsourcing were prohibited? Would employment be greater if outsourcing were prohibited?

5. If Americans purchased fewer things from foreigners, how would this affect the ability of foreigners to buy things from us? Do restrictions on imports also limit the exports of a country? Why or why not?

6. "Policies that reduce imports and expand employment in import-competitive industries will simultaneously reduce exports and employment in export industries. On balance, trade restrictions do not increase employment; they merely re-shuffle it." Evaluate this statement.

Multiple-Choice Questions:

1. If businesses in the United States were prevented from outsourcing some jobs to low-wage countries, how would American consumers be affected?
   a. Consumers would pay less for some goods and services.
   b. Consumers would pay about the same for some goods and services.
   * c. Consumers would pay more for goods and services.
   d. Consumers would ignore any changes.

2. The argument that import restrictions save jobs and promote prosperity fails to recognize that
   a. there are no secondary effects of import restrictions.
   b. import restrictions will lower prices in the protected industries.
   c. import restrictions cannot create jobs in any industries.
   * d. U.S. imports provide people in other countries with the purchasing power required for the purchase of U.S. exports.

3. If labor-intensive textile products could be produced more cheaply in low-wage countries than in the United States, the United States would gain if it
   a. levied a tariff on the goods produced by the cheap foreign labor.
   b. subsidized the domestic textile industry so it could compete in international markets.
   * c. used its resources to produce other items while importing textiles from foreigners.
   d. levied a tax on the domestic textile products to penalize the industry for inefficiency.

4. If the United States imports low-cost goods produced in low-wage countries instead of producing the goods domestically,
   a. the United States will lose jobs in the aggregate.
   * b. the United States will gain, and domestic resources will be employed more productively.
   c. dollars that leave the United States will not return to buy goods produced by high-wage American workers.
   d. the availability of consumption goods in the United States will be reduced.

5. If import restrictions prohibit foreigners from selling various goods in the U.S. market,
   a. the United States will be able to export more goods abroad.
   * b. foreigners will have fewer U.S. dollars with which to buy goods from Americans.
   c. the United States will be able to produce a larger output than would otherwise be the case.
   d. the domestic producers in the protected industries will supply goods to U.S. consumers at lower prices than would otherwise be the case.

Extension Activity: How Could Outsourcing Produce More Jobs?

Distribute the following handout to your class and ask them to respond to the Questions for Discussion.

How Could Outsourcing Produce More Jobs?

A study done in 2004 by Professor Matthew J. Slaughter at Dartmouth University found that outsourcing is actually a way of increasing the number of American jobs. He found that employment increased not only for American firms involved in outsourcing, but also for their affiliates in other countries. While employment in foreign affiliates rose by 2.8 million jobs, employment in the U.S. parent firms rose even more –by 5.5 million jobs. In other words, for every one job outsourced, U.S. firms created nearly two jobs in the United States. Companies that outsource create far more domestic jobs than companies that do not.

Professor Slaughter's findings are surprising to some. Is this some statistical trick? How could jobs be created by outsourcing in the real world? Consider the case of a small manufacturer in Milwaukee, Wisconsin. Irv Jackson owns a factory that manufactures parts for large, earth-moving equipment.

Irv's customers started to tell him that his prices were too high. He protested. He was charging the same prices for his products as he did in previous years. His customers said that while that was true, Irv's competitors were charging even less. Irv's customers valued their relationship with his company. He had been a trustworthy supplier for many years. They encouraged him to consider outsourcing some of his manufacturing to China. This was all new to Irv. Like many Americans, he was skeptical that outsourcing could work.

Irv's business started to decline. He lost contracts. He laid off workers. He hated this. He'd always been proud of the number of jobs his business had created. He decided that he had to make a change. He contacted a manufacturer in China. He was stunned at the low prices charged by the Chinese company to produce some of the parts he wanted. He quickly made a deal and shifted some of his manufacturing to his new affiliate in China.

What happened? Irv's business was able to cut costs. Soon his bids were being accepted by more of his customers. His

business expanded. As his business expanded, he hired more workers. Not only did he hire back most of the people who were laid off, he started hiring new workers.

All this took place over a period of a couple of years. There was no single event. No reporters sought out Irv to learn how he had gradually added new jobs due to outsourcing. Lou Dobbs never called to see how Irv was able to add new jobs in Milwaukee.

Questions for Discussion

1. Why did Irv Jackson's business begin to decline?

2. What did the decline in sales mean for some of Irv's workers?

3. How did Irv's arrangements with a manufacturer in China help his business?

4. Why didn't Lou Dobbs call Irv Jackson?

Point to consider: *Irv's success took place gradually. There was no one event to attract attention.*

Does outsourcing cost Americans jobs?

Multiple-Choice Questions:

1. If businesses in the United States were prevented from outsourcing some jobs to low-wage countries, how would American consumers be affected?

   a. Consumers would pay less for some goods and services.
   b. Consumers would pay about the same for some goods and services.
   c. Consumers would pay more for goods and services.
   d. Consumers would ignore any changes.

2. The argument that import restrictions save jobs and promote prosperity fails to recognize that

   a. there are no secondary effects of import restrictions.
   b. import restrictions will lower prices in the protected industries.
   c. import restrictions cannot create jobs in any industries.
   d. U.S. imports provide people in other countries with the purchasing power required for the purchase of U.S. exports.

3. If labor-intensive textile products could be produced more cheaply in low-wage countries than in the United States, the United States would gain if it

   a. levied a tariff on the goods produced by the cheap foreign labor.
   b. subsidized the domestic textile industry so it could compete in international markets.
   c. used its resources to produce other items while importing textiles from foreigners.
   d. levied a tax on the domestic textile products to penalize the industry for inefficiency.

4. If the United States imports low-cost goods produced in low-wage countries instead of producing the goods domestically,

   a. the United States will lose jobs in the aggregate.
   b. the United States will gain, and domestic resources will be employed more productively.
   c. dollars that leave the United States will not return to buy goods produced by high-wage American workers.
   d. the availability of consumption goods in the United States will be reduced.

5. If import restrictions prohibit foreigners from selling various goods in the U.S. market,

   a. the United States will be able to export more goods abroad.
   b. foreigners will have fewer U.S. dollars with which to buy goods from Americans.
   c. the United States will be able to produce a larger output than would otherwise be the case.
   d. the domestic producers in the protected industries will supply goods to U.S. consumers at lower prices than would otherwise be the case.

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Clip 9: Economic freedom and prosperity

DVD Clip: The Role of Freedom in Prosperity

Length: 2:16

Concepts Illustrated:

Economic growth

Sources of prosperity

Description:

A single point is made in this segment. Where economic freedom and liberty are allowed to flourish, economic growth and prosperity follow. The clip compares and contrasts places where government planning dominates (India, North Korea, Syria, and Haiti) against places where there is relatively little government planning (U.S., Hong Kong, Switzerland, and New Zealand). The countries with government planning are poorer and are less undesirable places to live.

Preview Question:

"Why do some countries prosper while others are poor?"

Ask the students for their opinions and list them without comment. At the end of the lesson, discuss the keys to economic freedom and compare them to the students' original ideas.

Discussion and Analysis Questions:

1. "Economic freedom is present when private property is protected, people are free to compete, and when resources, goods, and services are allocated by voluntary exchange and market prices rather than by the government." Does this statement provide an accurate definition for economic freedom? Why or why not?

2. How does economic freedom influence the incentive of individuals to develop resources and produce products that are highly valued relative to their cost? How will this affect economic efficiency and the growth of an economy?

3. How does the growth rate of economies with more economic freedom compare with those that are less free?

4. When resources are allocated via the political process, what determines whether or not a project will be undertaken? What determines whether projects will be undertaken when resources are allocated by markets? Does the difference between these two methods of economic organization affect the efficiency of resource use? Why or why not?

Multiple-Choice Questions:

1. The recent growth records of Japan and Hong Kong during the last 50 years indicate that a nation can grow rapidly without
   a. securely defined property rights.
   b. adopting modern technology.
   c. significant capital formation.
   * d. abundant domestic natural resources.

2. Why do political instability and insecure property rights retard economic growth?
   a. Fear that private property will be confiscated substantially reduces the incentive to invest and create wealth.
   b. When property rights are insecure, foreign investors will be reluctant to invest in the country.
   c. Savings will tend to flow out of a country if individuals fear their property is insecure.
   * d. All of the above are correct.

3. Which of the following would be most likely to help the residents of a nation produce a larger output and consume a wide variety of products at economical prices?
   a. Imposition of tariffs on imported goods.
   b. Quotas that protect domestic businesses against foreign producers that pay workers low wages.
   * c. Free trade.
   d. Exchange rate controls.

4. Which of the following is an important ingredient of efficient economic organization?
   a. Highly restrictive exchange rate controls.
   * b. Secure property rights and political stability.
   c. High and variable rates of inflation.
   d. High marginal tax rates.

5. On average, countries that have a larger degree of economic freedom tend to have
   a. Higher per capita income levels but slower rates of economic growth than countries with less economic freedom.
   b. Lower per capita income levels but more rapid rates of economic growth than countries with less economic freedom.
   * c. Both higher per capita income levels and more rapid growth rates than countries with less economic freedom.
   d. Both lower income levels and slower growth rates than countries with less economic freedom.

Extension Activity: Economic Freedom, Prosperity, and the Quality of Life

Most college economics textbooks do not mention the importance of economic freedom to prosperity or even define the term. This activity provides some ideas on how to correct this deficiency. All statistics in the activity are from James Gwartney and Robert Lawson with Erik Gartzke, *Economic Freedom of the World, 2005 Annual Report,* Fraser Institute, 2005.

1. Help the students understand what economic freedom is. According to Gwartney, Lawson, and Gartzke, economic freedom rests on four cornerstones, which are:
   - Personal choice rather than collective choice;
   - Voluntary exchange coordinated by markets rather than allocation through the political process;
   - Freedom to enter and compete in markets; and
   - Protection of persons and their property from aggressive acts by others.

   Economic freedom can also be defined by what governments do and do not do. To promote economic freedom, governments should:
   - Establish an evenhanded legal system;
   - Protect individuals and their property from people using violence, coercion, and fraud to seize things that do not belong to them;
   - Facilitate access to sound money; and
   - Provide an infrastructure for voluntary exchange and the operation of markets.

   To promote economic freedom, governments should restrain from:
   - Taking actions that interfere with personal choice, voluntary exchange, and the freedom to compete in the labor and product markets;
   - Increasing taxes and government expenditures;
   - Increasing government regulations on the choices that businesses and people can make; and
   - Limiting access into occupations and business activities.

2. What difference does economic freedom make? Ask the students to examine the statistics below and make conclusions based on them. These statistics compare eight characteristics of nations that score in the top fifth in economic freedom with nations that score in the bottom fifth. The differences should dramatically illustrate the difference that economic freedom makes in a nation's standard of living and quality of life.

Economic Freedom Index

Characteristic	Top Fifth	Bottom Fifth
Per capita GDP	$25,062	$2,409
Economic growth rate	2.5%	.6%
Investment per capita	$4,903	$195
Unemployment rate	5.2%	13%
Life expectancy	77.7 yrs.	52.5 yrs.
Income level of poorest 10%	$6,451	$1,185
Adult literacy	96.4%	65.3%
Access to improved water	97.0%	70.9%

Source: James Gwartney and Robert Lawson with Erik Gartzke, *Economic Freedom of the World, 2005 Annual Report*, Fraser Institute, 2005.

3. Research project. Have the students compare the top 10 nations in the Economic Freedom Index (EFI) with the bottom 10 nations. Have the students look at factors such as per capita GDP, life expectancy, infant mortality, economic growth rate, adult literacy, unemployment rate, and inflation rate. A good online source for research is the *CIA Factbook*, available at **http://www.cia.gov/cia/publications/factbook/**. Have each student select a nation to research and report to the class. Then make generalizations about countries with high economic freedom and low economic freedom.

TOP 10 COUNTRIES AND BOTTOM 10 COUNTRIES

TOP 10			BOTTOM 10		
NATION	EFI	PER CAPITA GDP	NATION	EFI	PER CAPITA GDP
Hong Kong	8.7		Gabon	5.1	
Singapore	8.5		Central African Rep.	4.9	
New Zealand	8.2		Congo, Rep. of	4.8	
Switzerland	8.2		Algeria	4.6	
United States	8.2		Burundi	4.5	
United Kingdom	8.1		Guinea-Bissau	4.5	
Canada	8.0		Congo, Dem. Rep.	4.3	
Ireland	7.9		Venezuela	4.3	
Australia	7.8		Zimbabwe	3.3	
Estonia	7.8		Myanmar	2.8	

Source: James Gwartney and Robert Lawson with Erik Gartzke, *Economic Freedom of the World, 2005 Annual Report*, Fraser Institute, 2005.

Economic freedom and prosperity

Multiple-Choice Questions:

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Economic freedom and prosperity

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Singapore	8.5		Central African Rep.	4.9	
New Zealand	8.2		Congo, Rep. of	4.8	
Switzerland	8.2		Algeria	4.6	
United States	8.2		Burundi	4.5	
United Kingdom	8.1		Guinea-Bissau	4.5	
Canada	8.0		Congo, Dem. Rep.	4.3	
Ireland	7.9		Venezuela	4.3	
Australia	7.8		Zimbabwe	3.3	
Estonia	7.8		Myanmar	2.8	

Source: James Gwartney and Robert Lawson with Erik Gartzke, *Economic Freedom of the World, 2005 Annual Report*, Fraser Institute, 2005.

Clip 10: Institutions, growth, and freedom

DVD Clip: Economic Freedom in the U.S., India and Hong Kong

Length: 11:04

Concepts Illustrated:

Economic growth

Sources of prosperity

Description:

The segment compares and contrasts the ease with which businesses operate in each of the three countries. The freedom of firms to innovate and create new goods is a key source of economic growth and prosperity. In India, which is dominated by socialist policies, it is very difficult to open a new business and existing businesses find conditions to be restrictive and burdensome. The U.S. has the reputation of being a free market country but the government is still heavily involved in many business aspects and the policies can be barriers to innovation. Hong Kong is arguably the country with the most economic freedom. As John illustrates, a simple form is all one needs to open a new business. Several entrepreneurs are interviewed to describe their experiences in the U.S., India and Hong Kong.

Preview Question:

"Should just anyone be allowed to open a business? Are regulations needed to protect the consumer?"

Discussion and Analysis Questions:

1. In a market economy, who determines whether a business will be successful? What must successful businesses do?

2. Is government regulation needed to protect consumers against businesses supplying shoddy goods at high prices? Why or why not?

3. If just anyone is allowed to open and operate a business, will resources be wasted producing things of little or no value? Why or why not?

4. Is the freedom to open a business important? How does it influence the competitiveness of markets and the rate of innovation and product improvement?

Multiple-Choice Questions:

1. High levels of economic freedom in places such as Hong Kong tend to result in
   a. low levels of per capita income.
   b. modest levels of per capita income.
   * c. high levels of per capita income.
   d. modest but consistent levels of per capita income.

2. A legal system that protects private property and enforces contracts in an evenhanded manner helps promote economic growth because it
   a. makes it possible for individuals to generate large incomes and get ahead without cooperating with others.
   * b. provides people with a strong incentive to supply others with things that they value at an economical price.
   c. encourages people to use resources now rather than conserving them for the future.
   d. keeps the real wages of workers low and, thereby, makes it possible for business firms to supply goods and services economically.

3. When the markets of an economy are more competitive, economic growth
   a. is harmed by the resulting low rates of profit for industry.
   * b. is enhanced because producers have a stronger incentive to provide goods efficiently.
   c. will be slower because prices do not rise as rapidly.
   d. is unaffected.

4. If the political leaders of a country want to promote economic growth, which of the following policy alternatives would be most effective?
   a. Imposition of price controls on agricultural products in an effort to keep food cheap.
   b. A public-sector investment program financed by highly progressive taxation.
   * c. Low taxes, a monetary policy consistent with long-run price stability, and the abolition of price controls and trade restrictions.
   d. Expansionary monetary policy designed to keep interest rates low.

Extension Activity: Mystery Nations

Distribute the handout "Mystery Nations" to the class. Ask the students to read the characteristics of each nation and predict whether the nation is rich or poor. Then distribute the handout "Mystery Nations Revealed." Discuss the identities of the nations. Finally, discuss how high levels of economic freedom explain why some nations are rich while other nations are poor.

Mystery Nations[1]

Predict which of the following nations are rich and which are poor:

Country A

- Size: Three-tenths the size of the United States
- Population: About 40 million (small for a nation this size)
- Natural Resources: Rich resources with fertile land, lead, zinc, tin, copper, iron ore, oil, uranium

Is this nation likely to be rich or poor?

Country B

- Size: About the size of California
- Population: Over 127 million
- Natural Resources: Fish, no mineral resources

Is this nation likely to be rich or poor?

Country C

- Size: Twice the size of California
- Population: Large population of 128 million
- Natural Resources: Vast resources including oil, tin, iron ore, coal, limestone, lead, zinc, natural gas

Is this nation likely to be rich or poor?

Country D

- Size: 1.8 times the size of the United States.
- Population: 143 million
- Natural Resources: Vast resources with major deposits of oil, natural gas, coal, many strategic minerals, vast timber supplies

Is this nation likely to be rich or poor?

Country E

- Size: 3.5 times bigger than Washington, D.C.
- Population: 4 million
- Natural Resources: Fish, deepwater port

Is this nation likely to be rich or poor?

[1] The source of statistics for this exercise is the *CIA World Factbook* available at **www.cia.gov/cia/publications/factbook**.

Mystery Nations Revealed

Country A: Argentina
Population: 39,537,943
Per capita GDP: $13,600 (2005)
Life expectancy: 75.91 years
Literacy rate (age 15 and over can read and write): 97.1%
Infant mortality: 15.18 deaths/1,000 live births

Country B: Japan
Population: 127,417,244
Per capita GDP: $30,400 (2005)
Life expectancy: 81.15 years
Literacy rate (age 15 and over can read and write): 99%
Infant mortality: 3.26 deaths/1,000 live births

Country C: Nigeria
Population: 128,771,988
Per capita GDP: $1,000 (2005)
Life expectancy: 46.74 years
Literacy rate (age 15 and over can read and write): 68%
Infant mortality: 98.8 deaths/1,000 live births

Country D: Russia
Population: 143,420,309
Per capita GDP: $10,700 (2005)
Life expectancy: 67.1 years
Literacy rate (age 15 and over can read and write): 99.6%
Infant mortality: 15.39 deaths/1,000 live births

Country E: Singapore
Population: 4,425,720
Per capita GDP: $29,700 (2005)
Life expectancy: 81.62 years
Literacy rate (age 15 and over can read and write): 92.5%
Infant mortality: 2.29 deaths/1,000 live births

What are the characteristics of nations that have produced wealth? These nations have a common set of institutions[2] that provide a stable environment which rewards the activities of entrepreneurs. These factors include:

- Limited size of government in terms of expenditures, taxes, and state-run enterprises,
- Stable legal structure which has an independent system of justice and secure protection of property rights,
- Low levels of inflation and access to sound money,
- Freedom to trade internationally, and
- Limited government regulation of financial institutions, labor markets, and business.

[2] *Economic Freedom of the World, 2005 Annual Report*, Fraser Institute, 2005.

Institutions, growth, and freedom

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Clip 11: Property rights, eminent domain, and the role of government

DVD Clip: Eminent Domain in New Rochelle

Length: 4:19

Concepts Illustrated:

Role of government

Protection of property rights

Description:

Eminent domain is the ability of the government to take private land for public use. Property rights and their enforcement are the major themes. Using a neighborhood in New Rochelle, New York as an example, the segment documents the local government forcing people out of their homes because it feels the land is better served in another capacity. Interviews with the mayor and a group of residents bring out both sides of the debate.

Preview Question:

"Should political officials be able to take property from some private owners and transfer it to others if they think that will promote the public good?"

Accept a variety of responses. Here are some relevant points to bring up:

- *Private ownership of property is a fundamental right in a market economy.*
- *Private property rights provide an incentive for people to save, invest, innovate, exchange, and care for property.*
- *When resources are privately owned, users will have to pay the opportunity cost of the resource if they want to use it.*

Discussion and Analysis Questions:

1. What is eminent domain?

2. A Florida city recently used eminent domain to take the houses of some residents and transfer the land to a private developer wanting to build a shopping mall and yacht club. Could these facilities have been developed without the use of eminent domain? Will the use of eminent domain for purposes like this influence the degree of political corruption? Why or why not?

3. "Eminent domain was intended to make it possible for the government to undertake things like road construction and flood control projects that provide widespread benefits for the general public. It was never intended to allow public officials to take property from one private party and transfer it to another." Evaluate this statement.

4. "When resources are privately owned, resource users will have to bid them away from their alternative uses. Private ownership is important because it forces businesses to face the opportunity cost of the resources that they use." Evaluate this statement.

5. "If other potential owners value an asset more than the current owner, they will be able to acquire it via trade. When used for private development, eminent domain is merely an effort by private developers to use the political process to take the property of another without paying full value for it." Evaluate this statement.

Multiple-Choice Questions:

1. Eminent domain is the ability of government to
   a. levy property taxes.
   b. enforce contracts.
   * c. take private land for public use.
   d. take public land for private use.
2. Private property rights involve

a. the right to exclusive use of the property.
b. legal protection against those who would seek to use or abuse the property without the owner's permission.
c. the right to transfer, sell, exchange, or mortgage the property.
* d. all of the above.

3. When private ownership rights are well-defined and enforced, owners of capital assets
   a. have no incentive to consider the desires of others.
   * b. bear the opportunity cost of ignoring the wishes of others.
   c. are not responsible if the use of their assets imposes harm on others.
   d. have little incentive to take care of their assets.

4. When private ownership of a resource is clearly defined and enforced, the private owner
   a. has little incentive to consider the wishes of others when deciding how to employ the resource.
   b. has little incentive to take care of the resource.
   * c. has a strong incentive to use the resource wisely and to consider seriously the wishes of others when deciding how to employ the resource.
   d. has a strong incentive to consume the resource during the current period rather than conserving it for future use.

Extension Activity: Was Justice O'Connor Right?

Distribute the following handout to your class and ask them to respond to the Questions for Discussion.

Was Justice O'Connor Right?

In a market economy, individuals and businesses–not the government–own most of the resources. Private property ownership means that individuals can benefit from the ownership of their property, including their labor. Private ownership means that people and businesses are able to obtain, use, and transfer property as they see fit. Private property rights provide an incentive for people to save, invest, innovate, exchange, and care for property. Private ownership is a key factor in promoting economic growth. There are numerous examples of the benefits of private ownership:

- Private ownership provides incentives for people to take care of their property because it can gain in value. For example, people take better care of their own homes than rental apartments. People take better care of cars they own than cars they rent.

- The threat that private property may be taken without the consent of the owner discourages people from investing in their property including homes and businesses, or even their own education. Business owners in nations such as Cuba and North Korea that do not respect private property have little incentive to start and manage businesses. Why bother? The government could nationalize their business at any time.

- The threat that private property may be taken without the consent of the owner discourages people from saving and investing. Individuals who live in nations such as Argentina that have a history of nationalizing savings held in local banks have little incentive to save and invest. Why bother? The government could nationalize their savings at any time.

- Private property owners must have confidence that the courts will protect their rights or they will not make productive use of their property. In some countries legally operating businesses are taken over by the police or military and turned over to other owners. If the courts do not defend individual private ownership rights against the police or military, where can an individual turn? Nowhere. This arbitrary taking of property discourages people from starting businesses or running them well.

In the 2005 case of *Kelo v. City of New London,* the Supreme Court ruled that it was proper for private property to be taken for the use of a private company. Justice Sandra Day O'Connor disagreed with this controversial opinion. She argued that if the decision stands, "Nothing is to prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory."

Questions for Discussion

1. In a market economy, who owns most of the property?

2. What does private ownership permit the owner to do?

3. What are the main advantages of private ownership of property?

4. What was the ruling in the case of *Kelo v. City of New London*?

Point to consider: *In essence, the Supreme Court ruled that it was permissible for the government to take private property from some owners and transfer it to others who they thought would do a better job of developing the property.*

5. Why did Justice O'Connor disagree with this ruling?

Property rights, eminent domain, and the role of government

Multiple-Choice Questions:

1. Eminent domain is the ability of government to

   a. levy property taxes.
   b. enforce contracts.
   c. take private land for public use.
   d. take public land for private use.

2. Private property rights involve

   a. the right to exclusive use of the property.
   b. legal protection against those who would seek to use or abuse the property without the owner's permission.
   c. the right to transfer, sell, exchange, or mortgage the property.
   d. all of the above.

3. When private ownership rights are well-defined and enforced, owners of capital assets

   a. have no incentive to consider the desires of others.
   b. bear the opportunity cost of ignoring the wishes of others.
   c. are not responsible if the use of their assets imposes harm on others.
   d. have little incentive to take care of their assets.

4. When private ownership of a resource is clearly defined and enforced, the private owner

   a. has little incentive to consider the wishes of others when deciding how to employ the resource.
   b. has little incentive to take care of the resource.
   c. has a strong incentive to use the resource wisely and to consider seriously the wishes of others when deciding how to employ the resource.
   d. has a strong incentive to consume the resource during the current period rather than conserving it for future use.

Property rights, eminent domain, and the role of government

Was Justice O'Connor Right?

In a market economy, individuals and businesses–not the government–own most of the resources. Private property ownership means that individuals can benefit from the ownership of their property, including their labor. Private ownership means that people and businesses are able to obtain, use, and transfer property as they see fit. Private property rights provide an incentive for people to save, invest, innovate, exchange, and care for property. Private ownership is a key factor in promoting economic growth. There are numerous examples of the benefits of private ownership:

- Private ownership provides incentives for people to take care of their property because it can gain in value. For example, people take better care of their own homes than rental apartments. People take better care of cars they own than cars they rent.

- The threat that private property may be taken without the consent of the owner discourages people from investing in their property including homes and businesses, or even in their own education. Business owners in nations such as Cuba and North Korea that do not respect private property have little incentive to start and manage businesses. Why bother? The government could nationalize their business at any time.

- The threat that private property may be taken without the consent of the owner discourages people from saving and investing. Individuals who live in nations such as Argentina that have a history of nationalizing savings held in local banks have little incentive to save and invest. Why bother? The government could nationalize their savings at any time.

- Private property owners must have confidence that the courts will protect their rights or they will not make productive use of their property. In some countries legally operating businesses are taken over by the police or military and turned over to other owners. If the courts do not defend individual private ownership rights against the police or military, where can an individual turn? Nowhere. This arbitrary taking of property discourages people from starting businesses or to running them well.

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Questions for Discussion

1. In a market economy, who owns most of the property?

2. What does private ownership permit the owner to do?

3. What are the main advantages of private ownership of property?

4. What was the ruling in the case of *Kelo v. City of New London*?

5. Why did Justice O'Connor disagree with this ruling?

Clip 12: Is government too big?

Length: 4:56

Concepts Illustrated:

Size and growth of government
Taxes
Fiscal policy

Description:

The overriding theme is that taxes are high and placed on numerous goods in order to fund all of the projects in which government is currently involved. The segment begins by documenting some of the goods and services that government is involved in that most people probably don't realize. Examples include product inspections, subsidies for TV and radio, railroads, and subways. By using a roofing worker in St. Louis as an example, many of the daily taxes that average Americans pay are illustrated. The taxes include sales tax, electricity tax, personal property tax, gas tax, and payroll tax. In aggregate, Americans pay more in taxes than they do for food, clothing, and shelter combined.

Preview Question:

"Do you know what taxes you pay?"

Discussion and Analysis Questions:

1. How many different taxes do you pay?

2. List the services provided by local governments that are financed with taxes. How does the value of these services compare with your tax bill? Do the same for the services provided by the federal government.

3. Americans pay more in taxes than they do for food, clothing, and shelter combined. To the extent that taxes are the cost of government, do we derive good value for them? Why or why not?

4. Do politicians have an incentive to conceal the cost of taxes? Why or why not?

5. "I think business should shoulder a larger share of the tax burden." Have you ever heard a politician make a statement like this? When politicians make statements like this, what are they trying to do? Is there something called "business" that pays taxes or are all taxes paid by people?

Multiple-Choice Questions:

1. In 2003, the combined expenditures of federal, state, and local governments in the United States were approximately 34 percent of gross domestic product (GDP). Approximately what percentage of GDP were government expenditures in 1930?
   * a. 9 percent.
   b. 19 percent.
   c. 29 percent.
   d. 39 percent.

2. Total government spending (federal, state, and local) sums to approximately
   a. 10 percent of the U.S. economy.
   b. 20 percent of the U.S. economy.
   * c. 33 percent of the U.S. economy.
   d. 50 percent of the U.S. economy.

3. During the last four decades, the composition of federal spending has
   a. been virtually unchanged, but federal spending as a share of GDP has declined substantially.
   b. been virtually unchanged, but federal spending as a share of GDP has increased sharply.
   * c. shifted away from national defense and toward spending on income transfers and health care.
   d. shifted away from health care and income transfers and toward spending on national defense.

Extension Activity: What Is a Good Tax?

Taxes should be evaluated beyond whether they are high or low. In this activity the students will provide a report card on key taxes. The criteria for grades are:

1. **Equity or Fairness**
   People differ on what "fairness" is. Most people agree that regressive taxes that tax the poor at a higher rate than the rich are not fair. Some people believe a fair tax is a progressive tax, which taxes the rich at a higher percentage than the poor. Progressive taxes are based on the idea that the rich have a greater ability to pay than the poor. Others favor a flat or proportional tax, which taxes everyone at the same rate. Finally, some people believe taxes should be based on the benefits people receive from the government program. When the students grade equity, they should defend their position on what grounds they believe the tax is fair or unfair.

2. **Simplicity**
   A tax should be simple. Taxpayers should understand what they must pay and why. It should be easy to calculate the tax owed. Increased complexity causes people to make mistakes, promotes cheating, and builds resentment.

3. **Neutrality**
   A good tax is neutral on the economy and does not interfere with the efficient allocation of resources. If a tax discourages people's incentives to work, save, and invest, the tax is not neutral. If the tax favors some groups over others, the tax is not neutral.

4. **Revenue Productivity**
   A good tax collects enough revenue to fund the government program it is designed to pay for. Also, it should not cost a lot to administer the tax because high administrative costs will leave less money to fund the program.

After explaining these criteria of a good tax to the students, have them grade some of the more important taxes in the United States. After they have graded the taxes, discuss the reasons for their grades to help them understand taxes better. You may wish to add taxes to this list.

TAX REPORT CARD

TAX	EQUITY	SIMPLICITY	NEUTRALITY PRODUCTIVITY	REVENUE	TOTAL GRADE
Federal income tax					
Social Security tax					
State sales tax					
Gasoline excise tax					
Sin taxes (cigarettes, alcohol)					
Property tax					

Grading Key: The grade is not as important as the reasoning behind it. Following are some points to bring up as you discuss the taxes:

Federal Income Tax

Equity–Progressive

Simplicity–Complex with complicated deductions, rates, and calculations

Neutrality–The high marginal rates for the wealthy could hurt incentives to work, save, and invest

Revenue Productivity–Brings in the most revenue of all federal taxes

Social Security Tax

Equity–Proportional and then regressive because it is paid on income up to a determined limit

Simplicity–Simple payroll tax

Neutrality–Does not affect the economy but may affect individual saving

Revenue Productivity–Does not bring in enough revenue to pay future benefits

State Sales Tax

Equity–Most are regressive because the rich save more of their money rather than buy goods exempting food from the tax makes it less regressive

Simplicity–Simple because it's added on to purchases and collected from businesses

Neutrality–Incentive to reduce consumption

Revenue Productivity–Does not fluctuate as much as income taxes

Gasoline Excise Tax

Equity–Regressive

Simplicity–Simple and hidden

Neutrality–Provides an incentive to use less gas

Revenue Productivity–Produces most revenue for highway construction and mass transit

Sin Taxes

Equity–Regressive

Simplicity–Simple and hidden

Neutrality–Provide an incentive to buy less of the products taxed

Revenue Productivity–Produce significant, but not great, revenue

Property Tax

Equity–Proportional

Simplicity–Complex and depends on assessments of a property's value

Neutrality–Creates an incentive not to improve one's property

Revenue Productivity–Revenue does not increase as much as with income tax because assessments lag behind increases in income and property value.

Is government too big?

Multiple-Choice Questions:

1. In 2003, the combined expenditures of federal, state, and local governments in the United States were approximately 34 percent of gross domestic product (GDP). Approximately what percentage of GDP were government expenditures in 1930?

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   b. 19 percent.
   c. 29 percent.
   d. 39 percent.

2. Total government spending (federal, state, and local) sums to approximately

   a. 10 percent of the U.S. economy.
   b. 20 percent of the U.S. economy.
   c. 33 percent of the U.S. economy.
   d. 50 percent of the U.S. economy.

3. During the last four decades, the composition of federal spending has

   a. been virtually unchanged, but federal spending as a share of GDP has declined substantially.
   b. been virtually unchanged, but federal spending as a share of GDP has increased sharply.
   c. shifted away from national defense and toward spending on income transfers and health care.
   d. shifted away from health care and income transfers and toward spending on national defense.

Is government too big?

What Is a Good Tax?

TAX REPORT CARD

TAX	EQUITY	SIMPLICITY	NEUTRALITY PRODUCTIVITY	REVENUE	TOTAL GRADE
Federal income tax					
Social Security tax					
State sales tax					
Gasoline excise tax					
Sin taxes (cigarettes, alcohol)					
Property tax					

Clip 13: Size and growth of government

DVD Clip: Government Growth

Length: 1:47

Concepts Illustrated:

Size and growth of government

Role of government

Description:

The segment discusses and uses an enlightening graphic image to document the size and growth of the U.S. government since 1800. Despite politicians' claims to reduce spending, government spending has increased dramatically since the mid-1930s. In the early 1800s, government costs averaged about $20 per person per year. Until WWII, the average was less than $500. Today the average is about $10,000 per year. The fundamental roles of government such as protecting rights and defending the country are identified toward the end of the clip.

Preview Question:

"How large should government be? Is it bigger today than during earlier periods of American history?"

Discussion and Analysis Questions:

1. How large is government in the United States today compared to a century ago? Have the basic functions of government changed? If so, in what way?

2. Thomas Jefferson warned, "The natural progress of things is for government to gain and liberty to yield." What do you suppose Jefferson meant by that?

3. "Today government is primarily about gaining income transfers and other favors and getting others to pay for something you would like. The days of government as an unbiased rule maker and evenhanded referee are gone forever." Evaluate this statement.

4. "Even though the total benefits derived from government are almost certainly greater than the total cost, it is also virtually certain that the marginal benefits derived from government are less than the marginal cost." What does this statement mean? Do you agree or disagree with it?

5. "When big government controls what is bought and sold in an economy, the first thing that will be bought and sold will be the legislators." Is this statement true? Indicate why you either agree or disagree with it.

Multiple-Choice Questions:

1. In 1789 the U.S. government cost about $20 per person, adjusted for inflation. Today the government costs about
   a. $100 per person.
   b. $500 per person.
   c. $5,000 per person.
   * d. $10,000 per person.

2. Measured as a share of the economy, government spending
   a. has been between 10 and 15 percent of the U.S. economy since 1930.
   b. has been between 20 and 25 percent of the U.S. economy since 1930.
   * c. rose from less than 10 percent in 1929 to nearly 35 percent in 2002.
   d. declined from more than 50 percent in 1929 to approximately 25 percent in 2002.

3. Compared to the situation during the first 125 years of the United States (1790-1915), today total government expenditures are _____ share of the economy, and a greater proportion of those expenditures take place at the_____ level(s).

a. a smaller; federal
b. about the same; federal
* c. a larger; federal
d. a larger; state and local

Extension Activity: Federal Spending over Time

Distribute the following handout to the class. Ask the students to determine if the federal government was running a surplus or a deficit for each year. They should write the amount of the surplus or deficit in the column farthest to the right. Then they should complete the Questions for Discussion.

	FEDERAL RECEIPTS, OUTLAYS (BILLIONS OF DOLLARS)[1]		
FISCAL YEAR	**RECEIPTS**	**SPENDING**	**SURPLUS (+) OR DEFICIT (-)**
1950	39.4	42.6	(-3.1)
1960	92.5	92.2	(+0.3)
1970	192.8	195.6	(-2.8)
1980	517.1	590.9	(-73.8)
1990	1,032.0	1,253.1	(-221.1)
2000	2,025.2	1,789.1	(+236.2)
2005 (est.)	2,052.8	2,479.4	(-426.6)

[1] *Economic Report of the President: 2005 Report,* Spreadsheet Tables: Table B-78- Federal Receipts, Outlays, Surplus or Deficit, 1939-2006.

Questions for Discussion

1. How would you characterize the levels of federal spending since 1950?
2. In how many of these years has the federal government run a deficit?
3. Are the federal deficits getting larger or smaller?
4. Why might running such large deficits be a problem?
5. What would elected officials in the federal government have to do to reduce federal spending?

Size and growth of government

Multiple-Choice Questions:

1. In 1789 the U.S. government cost about $20 per person, adjusted for inflation. Today the government costs about

   a. $100 per person.
   b. $500 per person.
   c. $5,000 per person.
   d. $10,000 per person.

2. Measured as a share of the economy, government spending

   a. has been between 10 and 15 percent of the U.S. economy since 1930.
   b. has been between 20 and 25 percent of the U.S. economy since 1930.
   c. rose from less than 10 percent in 1929 to nearly 35 percent in 2002.
   d. declined from more than 50 percent in 1929 to approximately 25 percent in 2002.

3. Compared to the situation during the first 125 years of the United States (1790-1915), today total government expenditures are _____ share of the economy, and a greater proportion of those expenditures take place at the_____ level(s).

   a. a smaller; federal
   b. about the same; federal
   c. a larger; federal
   d. a larger; state and local

Size and growth of government

Federal Spending over Time

Determine if the federal government was running a surplus or a deficit for each year. Write the amount of the surplus or deficit in the column farthest to the right.

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FISCAL YEAR	RECEIPTS	SPENDING	SURPLUS (+) OR DEFICIT (-)
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Clip 14: Pork barrel spending

Length: 4:26

Concepts Illustrated:

Collective decision-making
Voting and economic efficiency
Special interests and political power

Description:

Voting behavior and collective decision-making are the two major concepts addressed. By using the example of a proposed $200 million bridge in Ketchikan, Alaska, the segment illustrates the ability of special interests to obtain government funding for projects that benefit a small number of people. The irony of the situation is that most of the local residents seem to be opposed to the bridge. Even so, the Alaskan congressman is pursuing the funding. It provides an excellent illustration of the economics of collective decision-making in action.

Preview Question:

"In a democracy, can elected officials be counted on to direct resources to the greater good?"

Discussion and Analysis Questions:

1. What is a special interest issue?

2. From the viewpoint of economic efficiency, does representative democracy do a good job of handling special-interest issues? Why or why not?

3. What is a pork barrel project? Are pork barrel projects often attractive to elected political officials? Is this a defect of the democratic political process?

4. Some economists argue that a supra-majority, a two-thirds majority, for example, should be required for approval of spending projects at the federal level. Do you think this is a good idea? Why or why not?

5. If the power of special-interests was reduced, for example, through the adoption of a supra-majority voting rule, would economic efficiency improve? How would contributions to political campaigns be affected? Do you think politicians are very interested in curtailing the power of special interests? Why or why not?

Multiple-Choice Questions:

1. The term "pork barrel spending" refers to
   a. government spending programs financed with user charges.
   b. favors exchanged between elected officials to gain mutual support of legislation.
   * c. a package of questionable projects that benefit local areas and are is financed by federal taxes.
   d. spending for basic national defense projects such as increased salaries for people serving in the armed forces.

2. Why is legislation such as the bill to build the bridge in Ketchikan, Alaska, passed when most everyone knows that it is "pork"?
   * a. The benefits are concentrated among constituents in a part of Alaska while the costs are spread out over millions of taxpayers.
   b. The benefits are diffused to millions of taxpayers and the costs are concentrated among special-interest groups.
   c. Such legislation will create permanent jobs and expand the local economy.
   d. When it comes to federal spending, members of Congress often ignore the interests of their home districts.

3. A special-interest issue is one that
   a. allocates the cost of the activity in accordance with the benefits received.
   * b. benefits a small, well-organized interest group at the expense of taxpayers or consumers.
   c. benefits everyone and imposes a cost on everyone.
   d. benefits a small, well-organized interest group but makes that group pay for the cost of the program.

4. If a federal agency requested funds to build a dam on an Idaho river to irrigate nearby farmland used for growing potatoes, the most active support for the project probably would come from
   a. potato farmers who own land that wouldn't be irrigated by the project.
   b. taxpayers who would pay for the project.
   c. consumers of potatoes who might benefit from an expansion in supply and slightly lower potato prices.
   * d. potato farmers who own the land to be irrigated.

Extension Activity: Milking Voters on the Farm

Distribute the following handout to your class and ask them to respond to the Questions for Discussion.

Milking Voters on the Farm

The MILC (Milk Income Loss Contract) program is a subsidy program intended to help dairy farmers. Under the program dairy farmers receive a federal subsidy whenever the price of milk in Boston falls below $16.94 per hundredweight. The subsidy is applied to the first 2.4 million pounds of milk produced. This is roughly the annual production of a herd of 140 dairy cows. Most dairy farms in Wisconsin have about 75 cows. Wisconsin has 15,000 dairy farmers. In 2002 Wisconsin dairy farmers received $413 million in subsidies from the MILC program.

Questions for Discussion

1. Who benefits from the MILC program?

2. Do people in other states derive much benefit from the MILC program? (Not much. Wisconsin and California are the largest dairy-producing states.)

3. If you knew that your taxes would increase by a few cents because Wisconsin dairy farmers have a subsidy, would you vigorously protest the action to your members of Congress?

4. Do you think that Wisconsin dairy farmers are likely to vote for members of Congress who support the MILC program?

5. Imagine that Representative Lisa Olson is a newly elected member of Congress. Her district is in the heart of Wisconsin's dairy land. She thinks that she can do a great deal of good for the people in her district and hopes to serve them for many years. She prides herself on being a fiscal conservative and dislikes what many people call "pork barrel" spending programs. Do you think Representative Olson will vote in favor of the MILC program? Explain your answer.

Pork barrel spending

Multiple-Choice Questions:

1. The term "pork barrel spending" refers to

   a. government spending programs financed with user charges.
   b. favors exchanged between elected officials to gain mutual support of legislation.
   c. a package of questionable projects that benefit local areas and are financed by federal taxes.
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Pork barrel spending

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Clip 15: Competition and efficiency of government

DVD Clip: Jersey City Water Department

Length: 2:11

Concepts Illustrated:

Government versus private-sector firms
Cost efficiency
Role of profit and loss
Privatization

Description:

Through the example of city water in Jersey City, New Jersey, private versus public production is the theme of the segment. When the water was administered by the city, the pipes were rusted, the water failed tests, and the price was rising. Since the contract was put with a private company, the water is cleaner and the price is falling.

Preview Question:

"Do the firms and agencies that produce government goods and services have strong incentives to produce efficiently?"

Accept a variety of responses. Here are some relevant points to bring up:

- *Producers in government do not face competition in the same way that producers in the private sector do.*
- *Producers in the private sector seek to earn a profit.*
- *The desire to earn a profit provides a strong incentive to produce efficiently.*

Discussion and Analysis Questions:

1. Why do private firms have a strong incentive to produce at a low cost?

2. What happens to government firms that produce inefficiently and have high per-unit costs? If this were true of a private firm, what would happen?

3. Do government-operated firms confront anything similar to profits and losses in the private sector? Does this make any difference? Why or why not?

4. Do the managers of government enterprises have as strong an incentive to innovate, produce efficiently and cater to the views of consumers as their private sector counterparts? Why or why not?

Multiple-Choice Questions:

1. Which of the following best explains why managers of government agencies have little incentive to achieve operational efficiency?

* a. Public-sector managers have no fear of bankruptcy when operational efficiency is not achieved.
b. Public-sector managers face fierce competition.
c. It is relatively easy for voters to detect operational inefficiency in the public sector and do something to correct it.
d. All of the above explain why government agencies have little incentive to be efficient.

2. When the government both provides a good and covers its costs through taxation,

a. the government enterprises producing the good have a strong incentive to supply it at low cost.
* b. consumers acting through markets are in a weak position to either discipline the suppliers or alter the quantity or quality of the service provided.
c. goods and services will only be supplied if consumers are willing to pay an amount sufficient to cover their production costs.
d. the invisible hand will direct consumers and producers toward an efficient level of output.

3. What incentive do private-sector producers have that encourages them to provide goods and services at the lowest possible price?
   a. Desire to earn the praise of government officials.
   b. Desire to help the community.
   c. Desire to increase cooperation.
   * d. Desire to earn a profit.

Extension Activity: What Should the Role of Government Be in Providing Goods and Services?

Distribute the following handout to your class. Ask the students to read the information which follows and then complete the chart.

The Role of Government in Producing Goods and Services

Almost all of the things we consume are produced by the private sector. Clothing, houses, apartments, books, cars, tools, airplanes, medicine–nearly everything is produced by people in private business. But government produces some goods and services.

Why does government produce some things and not others? Most of the time, when individuals purchase something, they receive the benefits. But some goods and services are different. It is these differences that may result in some goods and services being produced by government. Here are three questions to consider when deciding whether a good or service should be produced by government or by the private sector.

1. Does the good or service convey benefits to both payers and nonpayers? When individuals can obtain goods and services without paying for them, this is called a "free-rider" problem.

2. Is it impossible to exclude nonpayers from receiving the benefits?

3. Does the good or service allow for shared consumption or will one person's consumption of a good or service reduce its usefulness to others?

On the table below, identify and explain whether the goods and services should be provided by government or by the private sector.

GOOD OR SERVICE	PRIVATE? PUBLIC?	WHY? CAN NONPAYERS BE EXCLUDED? DOES CONSUMPTION BY ONE REDUCE USEFULNESS FOR ANOTHER?
A spring-break Caribbean cruise	(Private)	(It is easy to exclude nonpayers. If spring-breakers could obtain cruises whether they paid or not, there would be no incentive for business to produce them.)
Police protection	(Public)	(When police patrol a neighborhood, all the neighbors benefit. It is difficult to exclude nonpayers. Consumption by one neighbor does not diminish consumption by another.)
Flood control	(Public)	(It is difficult to exclude nonpayers from benefiting. Consumption by one household does not diminish consumption by another.)
i-Pods	(Private)	(It is easy to exclude nonpayers. If consumers could use i-Pods whether they paid or not, there would be no incentive for business to produce them.)
Armed forces	(Public)	(It is difficult to exclude nonpayers. Consumption by one citizen does not diminish consumption by another.)
Apartments	(Private)	(It is easy to exclude nonpayers. If renters could obtain apartments whether they paid rent or not, there would be no incentive for business to produce them.)

Competition and efficiency of government

Multiple-Choice Questions:

1. Which of the following best explains why managers of government agencies have little incentive to achieve operational efficiency?

   a. Public-sector managers have no fear of bankruptcy when operational efficiency is not achieved.
   b. Public-sector managers face fierce competition.
   c. It is relatively easy for voters to detect operational inefficiency in the public sector and do something to correct it.
   d. All of the above explain why government agencies have little incentive to be efficient.

2. When the government both provides a good and covers its costs through taxation,

   a. the government enterprises producing the good have a strong incentive to supply it at low cost.
   b. consumers acting through markets are in a weak position to either discipline the suppliers or alter the quantity or quality of the service provided.
   c. goods and services will only be supplied if consumers are willing to pay an amount sufficient to cover their production costs.
   d. the invisible hand will direct consumers and producers toward an efficient level of output.

3. What incentive do private-sector producers have that encourages them to provide goods and services at the lowest possible price?

   a. Desire to earn the praise of government officials.
   b. Desire to help the community.
   c. Desire to increase cooperation.
   d. Desire to earn a profit.

Competition and efficiency of government

What Should the Role of Government Be in Providing Goods and Services?

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