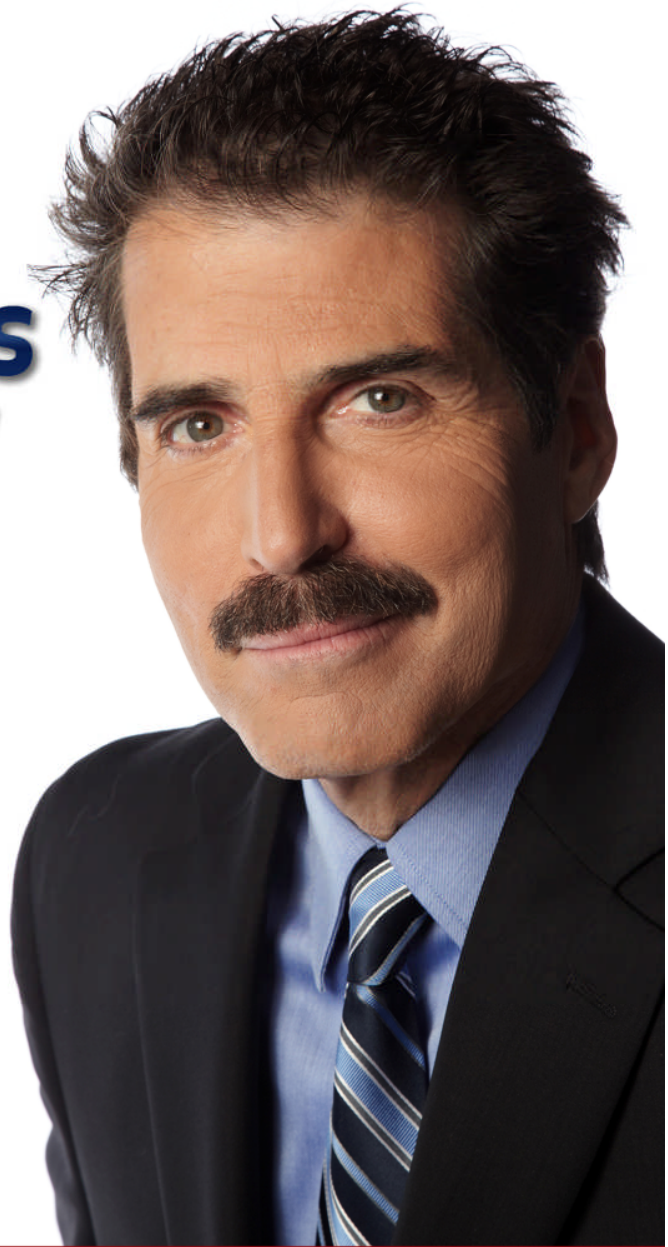




MAKING ECONOMICS COME ALIVE

**WITH
JOHN STOSSEL**

**INSTRUCTOR'S
MANUAL
to Accompany
Video Clips**



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How to use the video clips effectively

This manual provides teachers with materials that will help them use the video clips effectively. The manual contains the following items for each of the 18 clips in this edition:

1. a list of the concepts covered and lesson objectives
2. a preview question to introduce the clip in an exciting manner
3. a brief description of the video
4. discussion and analysis questions
5. an extension activity

The 18 clips are divided into six parts. A test bank of multiple-choice questions covering each of the parts is provided as a separate document (in PDF format) on the DVD. A slide presentation (in PDF format) related to the material in the videos is also provided in a separate file on the DVD. (Choose "Full Screen" or "Slide Show" from the Adobe Reader menus to view the file as a slide show.)

The preview questions are designed to attract interest and challenge students to think about important topics considered in the video. Many preview questions encourage the students to share their opinions prior to viewing the video. After the video is shown, the discussion and analysis questions provide suggested focal points for additional discussion. Suggested answers are included, but they are intended to help teachers focus on key points rather than providing definitive answers to the questions. These questions may also be used to assess student understanding of the topics covered in the video. The extension activity can be used to reinforce the content of the clip. In some cases, this material is also appropriate for use as a homework assignment.

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A Spanish version of this Instructor's Guide, a Test Bank of multiple-choice questions divided into six separate tests for Parts 1-6 (English and Spanish versions), and a slide presentation (English version only) are contained in accompanying files on the DVD.

Part 1: Economics of Property Rights

Clip 1: Private Ownership and Conservation

Length: 3:15

Concepts Illustrated:

- Property rights
- Tragedy of the Commons
- Conservation
- Endangered species

Lesson Objectives:

1. Illustrate that private ownership provides a strong incentive to practice conservation when the resource is expected to be highly valued in the future.
2. When resources are owned in common, people have an incentive to “grab” the resource before others do. Thus, common ownership often results in over-utilization of the resource.
3. Highlight that people have a stronger incentive to develop, maintain, and take care of things that are privately owned compared to those that are owned in common.

Preview Question:

“When resources are privately owned, is there an incentive to protect them and conserve them for future generations?”

Accept student answers without judgment. You may want to challenge students to think about how private ownership influences the incentive to develop and maintain a good or resource.

Description: Brian Yablonski from the Property and Environment Research Center (PERC) discusses how private ownership promotes conservation. At one time, 30 million bison roamed the American plains. When the number of bison fell to 1,000, ranchers moved some bison out of the common land to start private herds. The bison population is now growing. The segment also considers how private ownership has influenced the elephant population in Africa. Countries where there is private ownership have doubled their elephant population, while countries with common ownership have seen sharp reductions in the elephant population.

Discussion and Analysis Questions:

1. Do private owners have an incentive to conserve resources for the future?

Yes. If a resource is expected to be valuable in the future, private owners have a strong incentive to develop and expand the resource so they will be able to sell it at attractive prices in the future. This is now the case with the American bison. Private ownership brings personal self-interest and conservation into harmony. In contrast, when resources are owned in common, individuals have an incentive to “grab” the resource now before someone else does. The examples of both the American bison and African elephant illustrate this point.

2. What is the Tragedy of the Commons, and why does it occur?

Property that is commonly owned is likely to be abused and over-utilized. The term originated in England where there were common areas where people could graze their sheep. Soon over-grazing resulted, and the grass died. If a sheep owner did not graze as many animals, the grass would die anyway, because the other sheep owners would graze their sheep there. In contrast, a person who owns property wants to preserve it for the future and not abuse it.

3. Why has the elephant population grown in African countries where villagers privately own them?

When elephants are owned and the owners benefit from them, they will act as protectors. In several African countries, this has been accomplished by allowing limited hunting or by having photo safaris. In contrast, when the elephants are owned in common, there is very little incentive for anyone to protect and conserve them for the future.

4. Two centuries ago there were far more buffalo than cattle in the United States. Even though millions of cattle are now killed for beef consumption each year, there are now far more cattle than buffalo? Why?

Because cattle are privately owned and, until recently, buffalo were owned in common.

5. What would happen to the cattle population if Americans decided to eat substantially less beef?

Interestingly, the cattle population would decline. If Americans ate less beef, the price of beef cattle would fall, which would cause farmers to reduce the size of their cattle herds.

Extension Activity: A Property Rights Simulation

This activity illustrates the incentive structure present under systems of both common ownership and private property ownership.

1. Round 1: Ask for about ten volunteers. Put several paper clips on the floor. Tell the students you will give them one piece of candy for each paper clip they give you in the first 30-second period. If they wait until the second 30-second period, you will give them two pieces of candy for each paper clip. Only paper clips left over from the first period will be available to be picked up during the second period. Say “Go” and see what happens.

2. In almost all cases, all the paper clips are picked up in the first 30-second period, and there is no second period. Give the students one piece of candy for each paper clip they have.
3. Round 2: Now put ten sheets of 8.5x11 paper on the floor. Put a few paper clips on each sheet. Tell each student which sheet of paper he or she owns. Tell them you are the police officer, and anyone who touches another person's paper clips will receive no candy. Otherwise, the rules are the same as in Round 1.
4. Begin Round 2. Most, if not all, students will wait until the second 30-second period. Perhaps a student who is into instant gratification will pick up a paper clip in the first period, but it is unlikely. Give the students two pieces of candy for each paper clip they have.
5. Ask: "Why was there a difference between Rounds 1 and 2?"
6. Ask: "How did assigning property rights change the players' incentives?" (The students controlled [owned] their paper clips in Round 2, so they could wait and get more value for them. It wasn't clear who owned the paper clips in Round 1, so the students grabbed them before anyone else could.)

Clip 2: Property Rights and the Status of Native Americans

Length: 6:09

Concepts Illustrated:

- Incentives
- Private ownership and productivity of resource use
- Property rights and Native American poverty
- Property rights and resource management

Lesson Objectives:

1. Highlight the incentive structure accompanying private ownership. Private ownership encourages people to (a) maintain and develop resources others value highly, (b) take good care of things, and (c) conserve resources expected to be valuable in the future.
2. Explain why the incentive structure accompanying common ownership will lead to low productivity and over-utilization of resources.

Preview Question:

"Would people be better off if things were owned in common rather than privately owned?"

Description: Manny Jules, former Kamloops Indian Band Chief, and Terry Anderson from the Property and Environment Research Center (PERC) discuss how the absence of private ownership has contributed to the poverty of Native Americans. The privately-held land of native Americans is estimated to be 40–90% more productive than the land held in common. The clip shows a Google map for the Blackfeet and the Flathead Reservations to illustrate the difference between the privately held areas and those held in trust by the federal government.

Discussion and Analysis Questions:

1. Does it make any difference whether the land on Indian reservations is privately owned or owned in common by the members of an Indian tribe?

Yes. The productivity of the land that is privately owned is 40–90% higher than the land that is owned in common under the trusteeship of the government. Correspondingly, the income levels of Indians with private ownership rights are higher, and their poverty rates lower, than for Indians who have only commonly owned property. This is true for Indians residing in both Canada and the United States.

2. Can the owners of private property do anything they want with the things they own? Why or why not? What does private ownership allow the owner to do?

Owners cannot use their property in ways that invade or damage the property of others. For example, the owner of a hammer cannot use it to break the windows of a car or home owned by someone else. Owners are free to use their property as long as they do not damage the property of others. Essentially, private ownership provides one with protection against invasions by others.

3. Does private ownership encourage people to develop their property in ways that are highly valued by others and to engage in productive activities?

Yes. Development of resources in ways that are highly valued by others will lead to higher income levels. Thus, private owners have a strong incentive to engage in profitable activities: those that increase the value of the resources used.

4. Do the owners of private property have an incentive to care for and maintain their property? Why or why not?

Yes. If private owners do not take care and maintain their property, it will decline in value, and the private owner will bear this cost.

Extension Activity: Communal Ownership among American Indians

The purpose of this activity is to demonstrate by means of a case study on the Comanche Indians that American Indians established rules for ownership rights. Moreover, they often favored individual ownership rights over communal ownership. Distribute the following Handout to the class. After the students have read it, discuss it with the class, referring to the Questions for Discussion at the end of the Handout.

Handout: Property Rights among the Comanche Indians

Community Ownership: Myth or Reality?

American Indians are often thought to be people who favored communal ownership of resources. Books and movies about American Indians frequently suggest that private ownership was little known among American Indians, and that communal ownership was widespread.

Sitting Bull (1831–1890) was the principal chief of the Dakota Sioux. Here is what Sitting Bull is reported to have said regarding the relationship of the Native American peoples to the environment and ownership of land:

Behold, my brothers, the spring has come. The earth has received the embraces of the sun and we shall soon see the results of that love! Every seed is awakened and so has all animal life. It is through this mysterious power that we too have our being and we therefore yield to our neighbors, even our animal neighbors, the same right as ourselves to inhabit this land. My love of our native soil is wholly mystical.¹

—Chief Sitting Bull (Tatanka Iyotaka), Hunkpapa Sioux

Sitting Bull seems to suggest that the earth is owned in common. It is owned without distinction by humans and animals alike. The resources of the earth should be shared by all. This idea provides the foundation for the views of some modern day environmentalists.

Did Native Americans reject private ownership of property, preferring communal ownership? Or is this view simply a romantic myth?

Property Rights

Property rights are ownership rules. They are the rights to use, control, and benefit from the possession of a good or resource. An automobile owner can drive her car, leave it parked in her garage, or sell it for cash, depending on her preferences; her ownership rights give her those options. The key economic assumption is that when property ownership rights are clearly defined and enforced, people have an incentive to manage their resources responsibly and productively.

Perhaps you have noticed that people tend to take better care of things they own. You might take better care of your smart phone than you would care for a phone owned by a friend. People generally care for cars they own better than cars they rent. (Have you ever heard of anyone changing the oil in a rented car?) The reason in these cases is not merely a mysterious sort of pride in ownership, though that may be part of it. The underlying reason is that if you don't care for a phone or a car, it may get dinged up and deteriorate in value. And then, if it is *your* phone or car, the loss will be yours, too.

Given the importance of property rights, modern societies have established elaborate sets of rules to identify and enforce ownership. When you buy a car, you receive a title of ownership that is registered with the state. The Vehicle Identification Number (VIN) is clearly placed on the car, much like the brand or tag that ranchers use to mark their ownership of cattle. American Indian

groups did not develop formal rules of this sort to specify property rights. They did have rules, however; their rules were matters of common knowledge and were carefully enforced.

Property Rights among the Comanche

Like other societies, the Comanche had clear rules regarding property rights. But their rules differed from the rules of the American legal system. Like other Plains Indians, the Comanche did not recognize private ownership of land. This fact alone may have been the basis for the notion that the Comanche and other Plains Indians recognized no property rights whatsoever.

The decision by the Comanche to allow for communal ownership of land was not based on a general disavowal of private ownership. It was based more specifically on reasons related to the environment and culture of the Comanche. Land in the Great Plains was abundant, and the Comanche did not use it for farming. They had no reason, therefore, to mark off pieces of property to establish farm fields. They were hunters, however, and they did care about establishing individual rights to their hunting land. They developed a form of enforceable property rights related to hunting grounds. They knew that, without control over access to hunting territories, hunting grounds would soon become overrun by other groups and the survival of the tribe would be threatened. The hunting territories established among Plains Indians were known by all and were often marked by natural features such as mountains, ridges, and streams. The Comanche were well known for their ability to defend their hunting grounds from trespass by others.

While individual ownership of land meant nothing to the Comanche, the horse meant everything. The Comanche developed individual ownership rights to buffalo horses—horses used in the buffalo hunts—because these horses were critical for survival. Buffalo horses increased food supplies. By following buffalo across the plains, the Comanche coped with the problem of scarcity, obtaining an abundant supply of meat. Their diets changed; they ate fewer seeds, roots, and corn and ate more meat. And as hunting required less expenditure of time and effort than hunting buffalo on foot had, the Comanche gained more time for arts, crafts, and spirituality.

Plains Indians developed ownership rules and incentives to reward the best hunters. For example, individual hunters used arrows with distinctive marks. These arrows identified which hunter killed which buffalo. The hunter who killed the buffalo was given the best portions of the meat. Other portions were then divided among the butchers who followed the hunters.

Moreover, horses had monetary value to their owners; they could be bought and sold. A “millionaire” among the Plains Indians was a man who owned several strong buffalo horses. Horses required care: They had to be fed, groomed, exercised, and protected from theft. By allowing horse owners to benefit from their ownership, they had better reason to take good care of them. Providing ownership incentives for horses used in buffalo hunts benefitted not only the owners but others as well.

Private ownership was firmly established among the Comanche not only for horses but also for tools, food, weapons, clothing, jewelry, and other personal possessions. How were the rules enforced? Ownership rules among American Indians were enforced by the threat of ostracism and ridicule. In the case of horses valuable for buffalo hunts, the penalty might be torture and death.

Questions for Discussion

1. What are property rights? Why are they important?

Property rights are ownership rules. They are the rights to use, control, and benefit from the possession of a good or resource.

2. Did the Comanche establish any private ownership rights? Provide an example.

Yes. Private ownership was firmly established among the Comanche for horses as well as tools, food, weapons, clothing, jewelry, and other personal possessions.

3. How were ownership rights enforced by the Comanche?

Ownership rules were enforced by the threat of ostracism. In the case of the horse, the penalty might even be death.

4. Why would ownership rights be established in some instances but not in others?

It depended on the importance of the resource. Land was not regarded as having much value to the Comanche, so rights to individual ownership of land were not established. However, hunting grounds were important to the Comanche. Comanche groups did establish ownership of hunting grounds and protected their hunting grounds against outsiders. Horses were a very valuable resource within the Comanche culture. Rights to individual ownership of horses were established and strictly enforced.

Clip 3: *Atlas Shrugged*: Selfishness & the Economics of Exchange

Length: 6:27

Concepts Illustrated:

- Property rights
- Gains from trade and economic progress
- Eminent domain
- Personal liberty

Lesson objectives:

1. Explain the difference between win-win and win-lose transactions.
2. Compare and contrast how win-win and win-lose transactions will influence the growth and prosperity of the parties involved.

Preview Question:

“Will detailed government regulation weaken property rights and lead to corruption?”

Survey students with regard to the answer to this question. You may want to ask if any of your students have read *Atlas Shrugged* and pursue how they believe Rand would respond to this question.

Description: More than 50 years ago, Ayn Rand used her novel *Atlas Shrugged* to argue that big government, complex regulations, and a politically directed economy would lead to crony capitalism and corruption that would undermine entrepreneurship and prosperity. The lengthy book, more than 1000 pages, has sold more than 7 million copies. John Allison from BB&T bank discusses Rand’s concepts and how he has applied them. He believes that Rand’s ideas are about creating win-win relationships and “getting better together.” Allison explains that these principles helped him decide not to offer either subprime mortgages or loans for development of property acquired through eminent domain.

Discussion and Analysis Questions:

1. What is a “win-win” relationship? Explain why this relationship is the foundation for trade.

A win-win relationship is one where both parties gain from the action. Voluntary exchange provides an example. Unless both parties to an exchange believe they will gain, the transaction will not occur.

2. When Rand argues that selfishness is the proper motive for action, what does she mean by selfishness?

This is a point of controversy. As the clip notes, some perceive that Rand’s concept of selfishness means that one should never go out of their way to help another. For example, if it was inconvenient, one should not even throw a life jacket to someone who was about to drown. On the other hand, John Allison perceives that she means that while personal gain is the proper motivation for action, one should not engage in actions that manipulate or impose harm on another, because such win-lose relationships will undermine trust and will not be sustainable. Allison believes that Rand’s concept of selfishness merely involves the creation of long-term relations based on the “trader principle,” the creation of win-win relations that improve the well-being of both parties.

3. What is eminent domain?

Eminent domain is the Fifth Amendment clause of the U.S. Constitution that specifies that private property shall not be “taken for public use without just compensation.” Prior to the 1930s, this was understood to mean that government could take private property only for public purposes, such as construction of roads or schools, and only then when the previous owner was fully compensated for the value of the property. More recently, court decisions have permitted state and local governments to use eminent domain to take private property from one party and transfer it to another private owner for a wide range of activities, including industrial development and construction of shopping malls and country clubs. This weakening of private property rights and expansion in the powers of local officials has

already led to a number of crony capitalism relationships between government officials and developers, much like those discussed in Atlas Shrugged.

4. Why did BB&T refuse to extend loans for private development of property acquired through eminent domain?

Because the eminent domain clause was used to create a win-lose action—the taking of property from one private owner and transferring it to another. Allison believed this was in conflict with Rand’s ideas, because it violated the property right of the parties from whom the government seized the property through eminent domain.

5. How did Allison’s understanding of Rand influence his decision to prohibit BB&T from extending interest-only and negative amortization mortgage loans to customers?

He believed that such loans were not in the long-term interest of the borrower and that they would lead to financial troubles. Thus, they were based on a win-lose relationship that conflicted with Randian principles. He was correct and BB&T was one of only a few large banks that avoided financial troubles, because they refused to extend mortgage loans of this type.

Extension Activity: Is Money the Root of All Evil?

The purpose of this activity is to examine the idea of greed and selfishness and compare it to the “win-win” principle favored by Ayn Rand in *Atlas Shrugged*. Introduce the activity by asking the students the following:

Do you agree or disagree with the following statement: “Money is the root of all evil?”

Accept a variety of responses. Some students might suggest that money brings out the worst in people, encouraging selfishness. They might point to Wall Street bankers, who some accuse of causing the financial crisis of 2007, or payday lenders as examples. Others might suggest that what they most often observe regarding money is the sort of behavior they see in malls, large retail stores, and grocery stores, where people peacefully exchange money for goods and services they wish to obtain and often thank each other after a transaction is completed.

Distribute the following Handout to the students. After the students have read it, discuss it with the class referring to the Questions for Discussion at the end of the Handout.

Handout: Is Money the Root of All Evil?

Please read the following excerpt from *Atlas Shrugged* (1957), by Ayn Rand. Then respond to the following questions.

“So you think that money is the root of all evil?” said Francisco d’Anconia. “Have you ever asked what is the root of money? Money is a tool of exchange, which can’t exist unless there are goods produced and men able to produce them. Money is the material shape of the principle that men who wish to deal with one another must deal by trade and give value for value. Money is not the tool of the moochers, who claim your product by tears, or of the looters, who take it from you by force. Money is made possible only by the men who produce. Is this what you consider evil?”

When you accept money in payment for your effort, you do so only on the conviction that you will exchange it for the product of the effort of others. It is not the moochers or the looters who give value to money. Not an ocean of tears not all the guns in the world can transform those pieces of paper in your wallet into the bread you will need to survive tomorrow. Those pieces of paper, which should have been gold, are a token of honor—your claim upon the energy of the men who produce. Your wallet is your statement of hope that somewhere in the world around you there are men who will not default on that moral principle which is the root of money. Is this what you consider evil?”

Questions for Discussion

1. According to Francisco d’Anconia, what is money?
2. According to Francisco d’Anconia, what does money represent?
3. Do you agree with Ayn Rand’s explanation through the words of Francisco d’Anconia regarding the nature of money?

Questions for Discussion

1. According to Francisco d'Anconeia, what is money?

Money is merely a tool of exchange. Money is a device that allows people to exchange goods and services in a peaceful manner. It allows transactions to take place without the use of force or coercion.

2. According to Francisco d'Anconeia, what does money represent?

Money represents the goods and services that individuals can obtain from others. They are "tokens of honor" in the sense that people are respecting the property rights of each other and are conducting exchanges in ways that are free of coercion.

3. Do you agree with Ayn Rand's explanation through the words of Francisco d'Anconeia regarding the nature of money?

Accept a variety of responses. However, stress the idea that Rand is using money to illustrate the fundamental importance of voluntary exchange and protection of private property in a market economy.

Clip 4: Economics of the Military Draft

Length: 1:52

Concepts Illustrated:

- Property rights
- Opportunity cost
- Personal liberty

Lesson objectives:

1. Challenge students to think about the importance of the property right to their labor service.
2. Illustrate that the opportunity cost of labor service is still present even when personnel are forced to work in an occupation.
3. Explain why the draft was a highly inefficient method of acquiring military labor service.

Preview Question:

“Should the United States bring back the military draft?”

Survey students with regard to their response to this question. Make sure they understand what the military draft is. After all, we have not had a draft for four decades.

Description: John Stossel and David Boaz of the Cato Institute discuss the role of Milton Friedman in the abolition of the military draft and movement toward a voluntary military based on payment for service. They review a presidential commission hearing during which Friedman debated General Westmoreland about the merits of a mandatory draft.

Discussion and Analysis Questions:

1. Why was it necessary to draft people for military service for a quarter of a century following World War II?

Because the government was unwilling to offer potential military personnel a package of earnings and other job benefits that was sufficient to induce the desired number of people into military service.

2. How did the draft affect the property rights of people who were drafted into military service?

Most of us derive the bulk of our income from the property right to our labor service. When this property right is protected, each of us is permitted to sell our labor service to whomever we choose. The draftees were denied this property right.

3. Did the draft reduce the opportunity cost of national defense?

No. When people are drafted into the military, the opportunity cost of the service they would have provided in other sectors is lost, regardless of what wage they are paid. The budgetary cost of military service might have been lower, but the total cost, in terms of lost output, was much higher. Even the lower budgetary costs were doubtful, because people were drafted for periods such as two years and then replaced by new draftees. This meant that the military was spending a huge amount constantly training personnel, who would then be retained for only a relatively short period of time. Milton Friedman stressed all of these points in his argument against the military draft.

4. If a military draft makes sense, should people also be drafted into risky occupations such as police service and fire fighting?

We do not know of any argument for drafting people into the military that would not also apply to police services, fire fighting, and other similar occupations.

5. Would a draft that forced everyone to serve a spell in the military be fairer than paying people for military service?

When thinking about a response to this question, consider the following: Would it be fairer if everyone was required to work a spell as a sanitation or airport security worker? Is it fairer to impose a heavy cost on draftees than it is to pay the market wage for military personnel and to levy taxes to raise the required revenues?

Extension Activity: Congressman Charles Rangel versus Milton Friedman

The purpose of this activity is to analyze arguments for and against the military draft. The arguments summarized in this activity are those posed by Congressman Charles Rangel of New York and economist Milton Friedman. Distribute the following Handout to the students. After the students have read it, discuss it with the class, referring to the Questions for Discussion following the Handout.

Handout: A “Debate” between Charles Rangel and Milton Friedman

Background

A military draft, often called conscription, is a law that requires people to serve in the armed forces. The military draft has been used several times in American history. The American Civil War was the first time a national military draft was used. The draft was also used in World War I, World War II, and in the military conflicts in Korea and Vietnam. The United States abolished the military draft in 1973 and replaced it with an all-volunteer military.

Charles Rangel on the Draft

In 2010, U.S. Representative Charles Rangel of New York introduced a bill in the U.S. House of Representatives requiring that all Americans should have to sign up for a national service after reaching 18 years of age. He proposed a national service obligation—either military or civilian—for every citizen and permanent resident, male and female, of the United States, aged 18 to 42. Under his proposal, individuals would be inducted to perform *military* service only if a declaration of war is in effect or if the President declares a national emergency that necessitates the induction of persons to perform military service.

In a press release from Rangel’s office on July 15, 2010, Rangel said: “The test for Congress, particularly for those members who support the war, is to require all who enjoy the benefits of our democracy to contribute to the defense of the country. All of America’s children should share the risk of being placed in harm’s way.”

Rangel believes that the current all-volunteer military disproportionately puts the burden of war on minorities and lower-income families. He explains that troops today are recruited from large urban centers with high unemployment and from economically depressed small towns. He believes that these young men and women are carrying the heaviest burden of service. He said: “The 3.3 million military households, representing only one percent of American families, have become a virtual military class who are unfairly carrying the burden of war.”

Milton Friedman on the Draft

Milton Friedman argued for the abolishment of the military draft of the sort supported by Rangel. A conference on the draft was held in Chicago in 1966. The papers and discussions appear in a book edited by Sol Tax titled *The Draft: A Handbook of Facts and Alternatives*. At the conference, Friedman made the following statement:

“When a young man is forced to serve at \$45 a week, including the cost of his keep, of his uniforms, and his dependency allowances, and there are many civilian opportunities available to him at something like \$100 a week, he is paying \$55 a week in an implicit tax. ... [And] if you were to add to that the costs imposed on industry by the fact that they can only offer young men who are in danger of being drafted stopgap jobs, and cannot effectively invest money in training them; if you were to add to that the costs imposed on individuals of a financial kind by their marrying earlier or having children at an earlier stage, and so on; if you were to add all these up, there is no doubt at all in my mind that the cost of a volunteer force, correctly calculated, would be very much smaller than the amount we are now spending in manning our Armed Forces.”

Friedman also objected to the language used by some to describe a volunteer military based on “pay for service.” He said:

“Now, when anybody starts talking about this [an all-volunteer force] he immediately shifts language. My army is 'volunteer,' your army is 'professional,' and the enemy's army is 'mercenary.' All these three words mean exactly the same thing. I am a volunteer professor, I am a mercenary professor, and I am a professional professor. And all you people around here are mercenary professional people. And I trust you realize that. It's always a puzzle to me why people should think that the term 'mercenary' somehow has a negative connotation. I remind you of that wonderful quotation of Adam Smith when he said, 'You do not owe your daily bread to the benevolence of the baker, but to his proper regard for his own interest.' And this is much more broadly based. In fact, I think mercenary motives are among the least unattractive that we have.”

Questions for Discussion

1. Why Does Congressman Rangel support reinstating the draft?

Rangel believes that the current all-volunteer military disproportionately puts the burden of war on minorities and lower-income families.

2. How does Congressman Rangel characterize those who serve in the military?

He suggests that they are a “military class” more or less forced into military service.

3. Why does Milton Friedman oppose the draft?

Friedman’s case is founded on the view that people have a property right to their labor services and that conscription violates that property right and imposes a highly discriminatory tax on those who are drafted. He describes how the draft imposes several costs on individuals in terms of lost income, uncertain job status and disruption of family decisions.

4. How does Milton Friedman characterize those who serve in the military?

He describes them as volunteers, individuals making a choice to serve.

5. Who in your view has the strongest argument?

Accept a variety of responses. Some students might favor Rangel’s suggestion that the military burden be shared by all and that somehow people of low and moderate income are forced into serving. Friedman makes the case that fairly compensating individuals to serve in the military is a low cost option and is far less disruptive of people’s lives.

Part 2: Regulation and Unintended Consequences

Clip 5: Regulation: Louisiana Florist

Length: 4:37

Concepts Illustrated:

- Competition
- Barriers to entry
- Regulation
- Consumer protection

Lesson Objectives:

1. Illustrate that licensing requirements are often used as a tool to restrain entry and restrict competition.
2. Regulations that proponents argue will protect consumers sometimes have the opposite effect.
3. Good intentions do not necessarily lead to good regulatory outcomes.

Preview Question:

“Do consumers need regulators to tell them whether or not a producer is providing them with a quality product at an economical price?”

Poll student opinion on this topic and accept their responses without judgment.

Description: The licensing of florists in Louisiana is used to analyze the incentive structure that often underlies regulation. The license requirements are a barrier to entry for new florists and a form of protection for existing florists. Mike Rome from the Louisiana State Florists Association addresses the need for the licensing requirement. He claims the consumer is protected and will receive a better product because of the requirements. Monique Chauvin, an unlicensed florist who has been in business for more than ten years, disputes this claim.

Discussion and Analysis Questions:

1. How do consumers decide whether to purchase a good or service and which suppliers to patronize?

Consumers will compare the value derived from a good or service with its cost. They will only purchase those items that they perceive will make them better off—that is, those that provide value that exceeds costs. They will patronize those suppliers who provide them with the most value for the price.

2. Can regulators be counted on to follow licensing procedures that are in the best interest of consumers?

This is doubtful. Regulators will be influenced by political incentives. In the political arena, special interests will nearly always be better organized and therefore have more political clout than consumers. Thus, regulatory actions are more likely to reflect producer than consumer interests. Existing producers have an incentive to reduce entry and the competitive pressures in their market. They will seek to use the regulatory process to achieve this objective. The licensing procedures of florists in Louisiana illustrate these forces at work.

3. Will producers and the politicians serving their interest often use “protection of consumers” as an argument for regulations that will restrict entry and reduce competition in their market?

Absolutely. Licensing regulations nearly always involve a coalition of the naïve idealists and greedy opportunists. The naïve idealist supports such laws because they believe political officials are looking out for the interests of consumers. The greedy opportunists recognize that reduction in competition will help them generate larger profits, and they are willing to provide political support (contributions and other favors) to the political officials willing to impose the needed regulations. Both the producer interests and the politicians recognize that using “protection of the consumer” as the basis for their argument will strengthen their case.

4. Is the argument for some regulation of producers stronger in the case of services such as those provided by a physician than it is in the case of a product like floral arrangements, which are easier for consumers to evaluate and which do not involve safety considerations?

Yes. An error by a physician could exert a major and lasting impact on the welfare of the consumer. In contrast, consumers are likely to differ on the quality of floral arrangements and purchasing the product from the wrong supplier exerts little adverse impact on consumer welfare.

5. Suppose that Michael succeeds in convincing the city council that Information Services, Inc., is a monopoly with significant economies of scale and that price regulation should be imposed to protect the consumer. The Council creates a regulatory board that must be composed of “experts in the information field.” What might this imply regarding the board's treatment of the company?

To truly get experts from this field, the board members would have to come from the information industry, and they may even be former employees of Information Services. This would create a board sympathetic to the position of the company. Over the long-term, price

increases are likely to be approved and costs passed on to the firm's consumers. Michael may be happy that the firm is regulated, but he may not necessarily like the regulatory result.

Extension Activity: Blooming Nonsense

Provide students with the following Handout containing excerpts from an article by Dick M. Carpenter II, *Blooming Nonsense: Experiment Reveals Louisiana's Florist Licensing Scheme as Pointless and Anti-Competitive*, Institute for Justice (March, 2010).

Handout: Blooming Nonsense

Louisiana is the only state in the nation that requires florists to hold a license to work. To earn that license, aspiring florists must pass both a written and a practical test—the latter graded by already-licensed florists—in other words, competitors.

Why does Louisiana impose such regulatory burdens on florists? Protecting public health and safety cannot be the reason; in 49 other states, florists operate free of such regulations with no harm to consumers. The work of economists and sociologists who study occupational licensing suggests another possible purpose for Louisiana's law: Already-licensed florists reap financial rewards from fencing out competition.

Defenders of Louisiana's licensing regime, however, point to another justification for the law: maintaining professional standards and thereby ensuring better-quality floral arrangements for consumers.

But an experiment I conducted contradicts this claim. I asked practicing florists to judge a random line-up of floral arrangements from shops in regulated Louisiana and unregulated Texas. In judging those arrangements, not even licensed Louisiana florists identified any difference in quality that could be attributed to licensure. Floral arrangements from Texas, with no licensing regime, were rated essentially the same as those from Louisiana.

In the floral design experiment, judges were 18 randomly chosen florists—eight from Texas and 10 from Louisiana. All of the Louisiana florist-judges were licensed. Fifty floral arrangements were purchased from randomly selected retail floral stores. The retailers had no idea that their designs would be judged by other florists, which means the arrangements represented typical products purchased by consumers on any given day. Half of the arrangements came from Louisiana stores, and the other half were purchased from Texas shops. All florists were given a “theme” for the arrangements—sympathy—and some general parameters in which to work: Arrangements were to be within \$50 to \$75; the arrangements were to be in a basket, vase or bowl; and the arrangements were all to be different. Otherwise they were free to be creative in designing the arrangements.

The judges' ratings of floral arrangements were essentially the same no matter which state the arrangements came from, regulated Louisiana or unregulated Texas. Data were analyzed using multiple regression, a form of statistical analysis that tests the relationship between two variables—here, judges' scores and whether arrangements came from Louisiana or Texas—while controlling for the effects of other variables.

Almost all of the judges—including the licensed florists from Louisiana—expected no difference in the quality of arrangements because of Louisiana's licensing law. They noted that quality of work was a function of the standards set by individual businesses rather than a licensing regime. As one florist commented, “If you don't do good work, you're not going to have any business.”

Questions for Thought

1. Do you think consumers should be prohibited from buying from unlicensed suppliers? Why or why not?
2. Certification indicates that a party has completed certain educational or examination requirements. It differs from licensing, however, in that uncertified suppliers are not prohibited from operating. Certification provides consumers with information, but they are free to patronize uncertified operators if they want. Do you think that certification would be superior to licensing for most businesses and occupations? Why or why not?

Clip 6: The Unintended Consequences of the Ethanol Subsidies

Length: 4:15

Concepts Illustrated:

- Secondary effects and unintended consequences
- Subsidies
- Economic inefficiency

Lesson Objectives:

1. Illustrate the difference between the stated objectives of policies and the unintended secondary effects they often generate.
2. Help students to recognize that good intentions do not assure desirable results.

Preview Question:

“Should gasoline produced from corn-based ethanol be subsidized?”

Poll your students on this issue. Ask several students both for and against the subsidies to indicate the reason for their position and make a list of their views.

Description: Ethanol subsidies have been promoted by leading figures in both political parties. However, recent research and analysis has been more critical of ethanol use. General Wesley Clark from Growth Energy argues for continuation and expansion of the ethanol subsidies. David Boaz of the Cato Institute argues against the subsidies. Ben Schreiber from the environmental group Friends of the Earth reveals that ethanol is now believed to be worse for the environment than oil-produced gasoline. The clip highlights two important unintended consequences of the ethanol subsidies: higher feed prices for ranchers and higher prices for food produced from corn and other grain products.

Discussion and Analysis Questions:

1. As the ethanol subsidies were expanded during the Bush Administration, what impact did they have on the prices of feed grains and food products? Was this surprising?

The ethanol subsidies increased the demand for corn to produce ethanol. By 2010, approximately 40% of the corn output in the United States was directed toward ethanol production. This increase in demand for corn pushed its price up substantially. As the price of corn rose, land was shifted away from production of soybeans, wheat, oats, and other grains and toward corn production. This reduced the supply of feed grains, causing their prices to rise. None of this was surprising; it was merely a reflection of standard economics.

2. Who was harmed and who was helped by the ethanol subsidies?

The following groups were harmed: taxpayers, producers of goods that use corn and other grains in their production process, consumers of food products containing corn and other grains, low-income consumers in poor countries where corn and grain based products are a major source of food.

The groups helped would include farmers who produce corn and other grains, ethanol refiners, and truckers, because ethanol is corrosive and therefore cannot be transported through pipelines.

3. Why was it necessary to mandate that a certain percentage of gasoline be produced with ethanol and to subsidize the production of gasoline from corn-based ethanol?

Because it is far more expensive to produce gasoline from corn-based ethanol than from petroleum. The producers of the ethanol-gasoline blend would not be able to compete if they were not subsidized.

3. How did the regulations forcing gasoline producers to blend 10% ethanol into each gallon of gas affect economic efficiency?

As of 2010, it cost about \$2 to produce a gallon of petroleum-based gasoline, compared to about \$3.75 to produce a gallon of ethanol. Essentially, the regulations make it more costly to produce gasoline.

4. The Iowa Caucuses are the opening event of the presidential campaign. How do you think opposition to ethanol subsidies would affect a candidate's chances of making a good showing in the Iowa Caucuses?

Iowa is a major corn-producing state, and the subsidies benefit many farmers and agricultural communities in Iowa. Opposition to the ethanol subsidies would almost surely reduce a candidate's vote totals in this important kickoff election.

Extension Activity: Ethanol Mysteries

Provide students with the Handout on the following page.

Points to consider when discussing the Handout questions with students:

1. With regard to question 1, producers of ethanol are a politically powerful interest group in Wisconsin but not in states like New York and Florida.
2. Regarding question 2, ethanol subsidies are a special interest issue. The beneficiaries (ethanol producers) are easily identifiable, and they will feel strongly about this issue. In contrast, those harmed by the subsidies, primarily taxpayers and consumers adversely affected by the higher grain prices, are largely disorganized, and they may fail to make the connection between the ethanol subsidies and the higher taxes and grain prices.

Handout: Ethanol Mysteries

With today's higher fuel prices, there has been a resurgence of interest in alternative fuels such as ethanol. Ethanol is a fuel distilled from corn that can be mixed with gasoline. At first, people hoped that ethanol would reduce the amount of gasoline that Americans use. To encourage the use of ethanol, the federal government subsidized its production. A 1997 study by the General Accounting Office of the federal government found that the ethanol subsidy cost consumers billions of additional dollars and that the new fuel did little to either improve the environment or reduce petroleum imports.

Even Al Gore, one of the early crusaders for ethanol, has now changed his position. The following November 22, 2010, Reuters news story reports on Gore's views:

U.S. CORN ETHANOL "WAS NOT A GOOD POLICY" —GORE

By Gerard Wynn

ATHENS, Greece: Former U.S. vice-president Al Gore said support for corn-based ethanol in the United States was "not a good policy," weeks before tax credits are up for renewal.

U.S. blending tax breaks for ethanol make it profitable for refiners to use the fuel even when it is more expensive than gasoline. The credits are up for renewal on Dec. 31.

Total U.S. ethanol subsidies reached \$7.7 billion last year according to the International Energy Industry, which said biofuels worldwide received more subsidies than any other form of renewable energy.

"It is not a good policy to have these massive subsidies for (U.S.) first generation ethanol," said Gore, speaking at a green energy business conference in Athens sponsored by Marfin Popular Bank.

"First generation ethanol I think was a mistake. The energy conversion ratios are at best very small.

"It's hard once such a programme is put in place to deal with the lobbies that keep it going."

He explained his own support for the original programme on his presidential ambitions. "One of the reasons I made that mistake is that I paid particular attention to the farmers in my home state of Tennessee, and I had a certain fondness for the farmers in the state of Iowa because I was about to run for president."

U.S. ethanol is made by extracting sugar from corn, an energy-intensive process. The U.S. ethanol industry will consume about 41 percent of the U.S. corn crop this year, or 15 percent of the global corn crop, according to Goldman Sachs analysts.

A food-versus-fuel debate erupted in 2008, in the wake of record food prices, where the biofuel industry was criticized for helping stoke food prices.

Gore said a range of factors had contributed to that food price crisis, including drought in Australia, but said there was no doubt biofuels have an effect.

“The size, the percentage of corn particularly, which is now being (used for) first generation ethanol definitely has an impact on food prices. The competition with food prices is real.”

Consider the following mysteries:

1. In 2006, the state of Wisconsin passed a law requiring that all gasoline in the state be mixed with ethanol. Why would the Wisconsin legislature pass such a mandate? Why do you think that legislatures in states like New York and Florida have failed to pass a mandate like this?
2. In December 2010, Congress rejected Al Gore’s advice and passed legislation containing an additional \$7 billion in ethanol subsidies. Why does Congress continue these subsidies even though they have failed to promote either energy independence or the quality of the environment?

Clip 7: The Unintended Consequences of Minimum Wage Laws

Length: 4:33

Concepts Illustrated:

- Secondary effects and unintended consequences
- Impact of a price floor
- Unemployment

Lesson Objectives:

1. Illustrate the impact of price floors that set prices above the market equilibrium.
2. Illustrate how higher resource costs will affect producers and the measures they will take to minimize the effects of the higher resource prices.
3. Illustrate the unintended secondary effects that accompany minimum wages and other regulations that set prices above the market equilibrium.

Preview Question:

“Which option would you prefer for Drew, a teenager looking for work: A) accept a job making \$4.00 per hour, or B) not work at all? Why?”

Encourage students to think about the benefits of taking a job at \$4.00 per hour. What else does the teenager gain by having a job? Get students to offer alternatives about what Drew would do with his time if he were not working.

Description: The current federal minimum wage is \$7.25 per hour. Several states have minimum wage laws that require even higher hourly wage rates. Advocates of the minimum wage, like Christian Dorsey from the Economic Policy Institute, would actually like it to be higher and argue that it’s a fairness issue for employees. Critics, like Russ Roberts, an economist from George Mason University, argue that the minimum wage leads to higher unemployment, especially among teens, and eliminates some jobs from ever being created. John Stossel interviews Warren Meyer of Recreation Resource Management and discusses his response to higher minimum wage rates.

Discussion and Analysis Questions:

1. How will a higher minimum wage affect the number of low-skilled workers that will be employed?

The basic postulate of economics is that if something becomes more costly, less will be chosen. As this applies to the minimum wage, a higher minimum wage will make it more costly to employ low-skill workers. Predictably, employers will respond by hiring fewer such workers.

2. How will an increase in the minimum wage affect the training opportunities available to low-skilled workers?

The training opportunities of low-skill workers will decline. Employment arrangements involve the exchange of labor services for wage compensation and training opportunities. When the wage component is pushed up, the training component of the compensation package will be reduced.

3. Shortly after the implementation of the \$7.25 federal minimum wage in July 2008, the unemployment rate of teenagers rose to nearly 28%. Was this surprising?

Not really. Most teenagers are inexperienced, and their skill-level is lower than most other workers. Therefore, their employment opportunities will be substantially reduced by a higher minimum wage.

4. The fast food industry hires a large number of low-skilled, inexperienced workers. The wages of these workers are generally at or near the minimum wage. Can you think of any innovations this industry has taken to reduce the employment of low-skilled workers?

One innovation is the beverage service. Many restaurants simply give the customer a cup and have the customer fill their own ice and drink. This saves the restaurant from having an employee take the time to fulfill this service. Also, some restaurants have machines that move cups and dispense beverages according to size so that the employee need only push a button instead of actually filling the cup.

Extension Activity: What Is Seen and What Is Not Seen

Provide students with the following Handout.

Points to consider in the discussion:

The direct, easily observable effect of the minimum wage is the higher wage rates received by low-skilled workers. The less readily observable effects include less employment (and more unemployment) for those with few skills, greater difficulty for youthful workers trying to obtain experience and training, and higher cost for goods produced with a large proportion of low-skilled labor.

Handout: What Is Seen and What Is Not Seen

The following is an excerpt from Frederic Bastiat's "What Is Seen and What Is Not Seen." Bastiat was an economist who was also a member of the French parliament in the middle of the 19th century. Interestingly, the general issue he raises is still at the center of public debate.

In the economic sphere an act, a habit, an institution, a law produces not only one effect, but a series of effects. Of these effects, the first alone is immediate; it appears simultaneously with its cause; it is seen. The other effects emerge only subsequently; they are not seen; we are fortunate if we foresee them.

There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen.

Questions for Discussion

1. What is the "seen" in the case of the minimum wage? What is the "unseen" in the case of the minimum wage?
2. Do you think most people are aware of the "unseen?" How does this affect the political support for the minimum wage?

Part 3: Public Choice Economics and Crony Capitalism

Clip 8: Trade Restrictions and Crony Capitalism

Length: 2:05

Concepts Illustrated:

- Regulation
- Trade barriers
- Tariffs
- Political favoritism and crony capitalism

Lesson Objectives:

1. Illustrate that vote-seeking political officials often have a strong incentive to support the position of well-organized interest groups at the expense of the general welfare.
2. Note the difference between political and market allocation of goods and resources.
3. Explain why activist policies that favor some relative to others will promote crony capitalism.

Preview Question:

“What is the difference between free markets and crony capitalism?”

Pose this question to students and list their responses prior to showing the clip.

Description: Regulations, subsidies, and tax breaks have grown rapidly in recent years. They are often designed to favor some businesses and sectors relative to others. George Bush’s steel tariffs provide an example. A 30% tariff was imposed on foreign steel, which protected the U.S. steel industry but harmed manufacturers who used steel and increased prices for consumers. Tire manufacturers were also protected with a 35% tariff. Politicians engage in this type of crony capitalism as a means to obtain votes, contributions, and political support from organized interest groups at the expense of consumers and taxpayers. The welfare of the general populace would be better served by free markets and unbiased treatment of citizens.

Discussion and Analysis Questions:

1. What is crony capitalism?

Crony capitalism is when legislation and regulations are designed to provide favors to politically powerful groups in exchange for contributions, votes, and other forms of political support. Actions of this type generally favor well-organized business and labor groups, at the expense of the general populace. While enterprises remain private and markets are used to allocate goods and resources, the market process is corrupted by the political favoritism.

2. Why do political officials often take actions and impose regulations that favor some individuals and businesses relative to others?

Because they can derive political gain from doing so. Elected political officials have a strong incentive to favor projects that will help them win the next election. It is naïve to expect them to behave in any other way. Of course, they will speak of “serving the public interest,” “doing what is best for America,” and the like. But winning elections is the key to political success, and, therefore, this will be the top priority of almost all elected political officials. When well-organized groups derive substantial individual benefits from a political action that imposes a small personal cost on largely disorganized groups such as taxpayers or consumers, politicians will often derive political gain from support of the special interests, even if the project is inefficient. Thus, as the video clip indicates, much political action stems from this factor.

3. Was George Bush motivated to impose the 35% tariffs on steel primarily by a desire to serve the general welfare?

See what your students think. In discussing the issue, you might note that the steelworkers and firms were located primarily in Ohio and Pennsylvania, two states that were highly important for his 2004 re-election campaign.

4. Why will a government that is constantly imposing and modifying regulations, taxes, and spending in a manner that favors some individuals and businesses relative to others lead to crony capitalism?

Because political institutions of this type will encourage rent seeking (e. g., contributions to key political leaders, lobbying, and “schmoozing” of politicians), political action by well-organized interest groups, and short-sighted policies that are motivated by the pursuit of political gain. Institutions of this type will result in the shift of resources away from productive activities toward those designed to generate political advantage.

5. When regulations, subsidies, and tax breaks favor some groups relative to others, how will the general welfare be affected?

The general welfare will be adversely affected, because resources will be shifted away from productive activities that increase the value of resources toward counter-productive activities motivated by the desire to use the political process to gain an advantage over rivals.

Extension Activity: Trade War with Mexico?

The purpose of this activity is to consider another example of “crony capitalism” involving international trade. This time, however, the economic entity seeking protection is not steel or auto manufacturers. Instead, it is organized labor. Distribute the Handout to the students. After the students have read it, discuss it with the class referring to the Questions for Discussion at the end of the Handout.

Handout: The Trade War with Mexico

Regional Trade Agreements (RTAs) are a common way to reduce trade barriers between nations. There are nearly 500 RTAs worldwide. The United States has RTAs with 17 countries including Australia, Bahrain, Israel, Jordan, Peru, and Singapore. The RTA of greatest interest to Americans is the North American Free Trade Agreement (NAFTA). NAFTA was established in 1994 under President Clinton. The members are Canada, Mexico, and the United States. Canada is by far the top trade partner of the United States, followed by China and Mexico.

NAFTA has reduced trade barriers between the United States, Canada, and Mexico. But there have been occasional flare-ups in trade relationships among these three trade partners. For example, the *Wall Street Journal*¹ recently reported on a looming trade war with Mexico.

In the summer of 2010, Mexico announced new tariffs on 26 previously tariff-free items that it imports from the United States. The new tariffs were placed on Washington state apples, California oranges and pistachios, and cheeses from California and Wisconsin, among other things.

What is behind Mexico's actions? Why would it wish to make imported goods more expensive for its own citizens? Is this a case of crony capitalism?

Mexico has argued for 15 years that the United States has failed to keep its commitments under the NAFTA agreement by refusing to allow Mexican trucking companies to operate in the United States. U.S. trucking firms do operate in Mexico.

Mexico won an appeal before a NAFTA resolution panel in 2001, clearly making it legal for Mexican truckers to operate in the United States. In response to the unfavorable decision, the United States promised to conduct a pilot program, which allowed Mexican drivers to operate in the United States in 2007–2009. The program was reported as being a success. Mexican trucks were as safe as American trucks. But the program ended and has not been renewed.

Where is the problem? The *Wall Street Journal* suggests that it is pressure from the International Brotherhood of Teamsters that is blocking Mexican trucks. The union does not welcome competition from Mexican trucking companies.

Others counter the case posed by the *Wall Street Journal*. They say it is not about protecting union trucking jobs. Instead, it is a public safety issue. For example, the U.S. Department of Transportation reports that Mexico has inadequate trucking standards and fails to properly enforce them. Questions exist with regard to how many hours' truckers may drive, access to drivers' highway safety records, and access to drug-test records.

Who is at fault here? Is a trade war looming with Mexico?

¹ Source: The Teamster Tariffs, *Wall Street Journal*, August 21, 2010
<http://online.wsj.com/article/SB10001424052748704554104575435794277342012.html>

Questions for Discussion

1. What might be reasons that the United States won't honor its commitments under NAFTA to allow Mexican trucking companies to operate in the United States?

The United States might be acting to protect the jobs of union truck drivers or it may be acting to protect public safety.

2. Which do you think is the strongest argument?

Accept a variety of answers. Proponents of free trade, like most economists, might argue that unions are simply trying to reduce competition and preserve their jobs. Opponents of free trade might argue that this, indeed, is a public safety issue. The argument of the opponents, however, is weakened by the success of the 2007–2009 pilot program.

Clip 9: Stimulus Spending and Crony Capitalism

Length: 4:22

Concepts Illustrated:

- Incentives
- Political decision-making
- Rent seeking
- Government spending

Lesson Objectives:

1. Illustrate how the structure of incentives differ when goods are allocated by the political rather than the market process.
2. Explain why rent-seeking and political favoritism are a natural outgrowth of political allocation of resources.

Preview Question:

“Will government spending and regulations promote more efficient use of energy resources?”

Survey students on this issue. You may want to ask them if political statements favoring policies addressing popular causes, such as efficient use of energy and energy independence, will mean that the policies will be effective.

Description: The 2009 \$800 billion spending bill included funds for Serious Materials to promote production of energy efficient windows. Both the President and Vice President of the

United States visited the company and lauded it for its promotion of energy efficiency and green jobs. Serious Materials was the only manufacturer to receive such financial assistance and special treatment. The company vice-president for projects and policy is married to the government's overseer of weatherization program, who was in charge of \$16.8 billion in stimulus money. While all of this is legal, it is a reminder of how the political process alters incentives.

Discussion and Analysis Questions:

1. When goods are allocated by the political process, how will changes in incentives alter business behavior and the requirements for success?

Political allocation elevates the importance of connections and solicitation of political favors. Rent-seeking (e. g., contributions to key political leaders, lobbying, and "schmoozing" of politicians) becomes more important for business success, and production of quality products at economical prices become less important.

2. Can the level of political favoritism and crony capitalism be reduced by electing "better people" to political office?

This is unlikely. The favoritism and cronyism reflects the structure of incentives generated when a large share of the economy is directed by political forces. Both of the major political parties in the United States use their political powers to provide well-organized groups favors in exchange for political contributions and other forms of political support. Throwing out the rascals may alter this type of behavior temporarily, but it is likely to persist as long as government is heavily involved in the economy.

3. How do subsidies, tax credits, and other forms of political favoritism affect the efficiency of resource use and income levels of the general populace?

When allocated by political decision-making, resources will be shifted from productive activities into rent seeking. The political process does not have anything similar to profit and loss, which will consistently direct entrepreneurs toward projects that are highly valued relative to cost. As a result, countries with well defined and enforced private ownership rights that rely on markets to direct resources will achieve higher income levels than those that rely more heavily on government spending, political mandates, regulations, subsidies, tax favoritism, and other forms of political allocation.

4. When political officials are elected democratically, can they be counted on to pursue policies that promote the general welfare of the populace?

There is a tendency to believe that this is the case, but public choice economics indicates that it is much weaker than is generally recognized. Political officials have a strong incentive to pursue policies that will enhance their chances of winning elections. Catering to the views of well-organized interest groups and following policies that provide immediate, easily identifiable benefits at the expense of costs that are in the future and difficult to identify can often help one get elected, even when policies of this type are counter-productive. Public choice economics indicates that there is often a conflict between sound economics and winning politics. When this is the case, politicians will have a strong incentive to do what is necessary to get elected, even if it is in conflict with the general welfare.

5. Why are interest groups so effective at using the political process to gain advantages at the expense of economic efficiency?

Several factors explain why this is the case, including the weak incentive of voters to acquire information on the numerous programs that exert only a small impact on their personal welfare. Moreover, interest groups will often cast their favor-seeking in a manner that will attract support from naïve idealists. Note that Serious Materials stressed that it was promoting energy efficiency and green jobs. Similarly, the ethanol producers argue that they are improving the environment and reducing dependency on foreign oil. Thus, coalitions between naïve idealists and greedy opportunists are a strategy that has also enhanced the political clout of interest groups and promoted crony capitalism.

Extension Activity: Picking Clean Energy Favorites

This activity offers still another example of “crony capitalism.” Distribute the Handout to the students. After the students have read it, discuss it with the class, referring to the Questions for Discussion following the Handout.

Handout: Subsidies to Battery Manufacturers

Point: ZBB Energy Corporation: A Stimulus Winner?

On August 17, 2010, President Barack Obama visited ZBB Energy Corporation located in Menomonee Falls, Wisconsin. It was the first stop of a five-state tour to promote the President's clean energy initiative, funded with federal stimulus dollars. His message was that the United States must expand its use of clean energy. The President stressed that clean energy companies help promote manufacturing jobs in the United States and improve the environment.

ZBB Energy builds energy storage systems that can assist clean energy systems. For example, it builds batteries that will keep the power on when wind turbines stop turning or when the sun isn't shining.

ZBB has 30 employees and a large plant of about 75,000 square feet. It received a \$1.3 million loan from the American Recovery and Reinvestment Act. Management reported that this loan helped the company to retain nearly a dozen jobs. ZBB has plans to create another 80 jobs in the future.

Counter Point: ZBB Energy Corporation: A Business Loser?

Developing batteries and other systems to store energy to allow wind and solar power operators to store intermittent energy is an important technology. There are many private sector venture capitalists that are investing in such efforts.

But should the United States government be risking tax dollars? Is the government the right institution to decide which clean energy companies should be favored with special government loans and grants, even if it appears to be for a good cause?

Let's take a closer look at ZBB. According to the *Wall Street Journal*, ZBB has been "hemorrhaging money" since 2007. The firm lost \$4.9 million in 2008 and \$5.5 million in 2009. It lost \$6.9 million in the first nine months of 2010. It has a cumulative deficit of \$44.1 million.¹ ZBB's stock sold for \$6 in 2007. In January 2011, it was selling for \$1.28.

ZBB has restructured its management. Today's CEO is confident that the company will be part of the solution that will lead the nation in making solar and wind energy alternates competitive with fossil fuels.

Would you be willing to use your own money to buy shares of ZBB?

¹ Source: Uncle Sam, Venture Capitalist, *Wall Street Journal* August 17, 2010
<http://online.wsj.com/article/SB10001424052748704868604575433882374313148.html>

Questions for Discussion

1. What might be good reasons for the United States to provide stimulus dollars to help companies like ZBB?

Accept a variety of answers. Proponents of using stimulus dollars to provide grants and loans to businesses argue that these efforts help businesses to create new jobs and protect the environment.

2. What might be good reasons for the United States to refrain from providing stimulus dollars to help companies like ZBB?

Accept a variety of answers. Opponents believe that government cannot do this efficiently. It exposes the process of picking favorite businesses to possible corruption. There is no guarantee that the businesses using such funds will be successful in the market place. Finally, if a company has good potential for success, it should be able to attract private investors rather than government favors.

Clip 10: Political Versus Market Choices

Length: 1:32

Concepts Illustrated:

- Incentives
- Markets versus political allocation
- Bundle-purchase nature of political choices
- Voting and economic efficiency

Lesson Objectives:

1. Explain how the substitution of voting for markets influences the efficiency of resource use.
2. Illustrate that the market is a system of proportional representation, while the political process is a system of majority rule.

Preview Question:

“Would people be better off if voting was more widely used to determine what goods will be produced and consumed?”

Poll students on this question. Ask several to explain the reasoning underlying their response.

Description: Viewers are asked to think about how their welfare would be affected if they were forced to choose among the bundles of goods available in three alternative carts rather than buying the bundle they prefer when visiting the grocery store. This choice is similar to that confronted when choices are made by majority voting rather than through markets. When issues are decided by voting, the majority or their elected representatives will decide for everyone. With democratic voting, the majority imposes its preferences on the minority, and individuals in both groups will be required to consume and pay for many items they would not have purchased if they had been permitted to decide for themselves.

Discussion and Analysis Questions:

1. In what sense is voting among the candidates offered by the major political parties similar to choosing among two or three grocery carts with alternative bundles of goods?

When choosing among candidates, the choices of voters are limited to the bundle of positions represented among the two or three available candidates. Most voters will oppose many of the positions favored by even the candidate whom they choose to support. As in the case of the grocery carts, voters in both the majority and minority will be forced to consume and pay for many items that make them worse off, because they do not value them enough to voluntarily cover the cost of their production.

2. How do choices made through the market differ from those made by voting through the political process?

When choices are made through the market, individual consumers will choose only the options that they value more highly than the price they must pay for receipt of the good. Markets are a system of proportional representation: Each consumer can vote for and receive all of the goods for which they are willing to cover the cost. Producers will supply goods only when this is the case. In contrast, with political decision-making, the majority (either directly or through election of representatives) determines the outcome for everyone. Projects will be undertaken that make individual voters worse off. Units of many goods will be produced that are valued less than cost. Nonetheless, voters will be forced to pay for these inefficiencies. The result: The match between the preferences of individuals and the bundle of projects undertaken will be far less ideal with voting than with markets.

3. How will the total value consumers derive from goods compare when majority rule rather than markets is used to decide which goods will be produced and consumed?

The extension activity that follows will illustrate the answer to this question. The experiments performed by the authors indicate that the total value derived from personal choices coordinated by markets will be substantially greater than when majority rule decides for everyone.

Extension Activity:

Note: This experiment was initially developed by Joab Corey and James Gwartney of Florida State University. A note by Don Boudreaux of George Mason University provided the original idea and inspiration for the activity.

Political versus Market Choices: An Experiment

Voting for a representative in a two-party democratic system is much like picking between two shopping carts containing different goods, some of which you may desire, while others you don't care for. But when making the choice among candidates and the policy alternatives they represent, you must take the bad along with the good. In contrast, when making choices in the marketplace, consumers will only purchase those items that they value more highly than the price required for their purchase. Therefore, when choosing among private goods, voluntary choices in a market setting will lead to a better match than political decision-making between the preferences of consumers and the items available for their consumption. Thus, market choices will lead to larger gains for the group than will be derived from political choices based on majority rule.

Objective: Show students the difference between the allocation of goods and services via political decision-making based on majority rule and market choices where each individual purchases only the items that are valued more highly than price.

Materials: To conduct this experiment in class, all that is required is the following two-page "Political vs. Market Choices Student Activity Sheet." However, to make the example more visually stimulating and engaging, it may help to actually have the two baskets of goods at the front of the class.

Execution:

1. Hand out the student activity sheet and read through the instructions asking them to rate each item in the cart on a scale of -10 to 10. Carefully explain the meaning of the gradations of this scale. After rating each item, ask students to total up their evaluation of each cart (with negative values subtracting from the total and positive values adding to it).
2. Ask the students to vote on which cart they prefer by circling their choice (presumably, this will be the one with the highest value). They should write the value they received from this cart in the space provided.
3. Count the votes for each cart, and note that each student will receive the items in the cart chosen by the majority. Sum the total points derived by all students in the class from the items in the cart chosen by the majority.
4. Ask the students to go through both carts and choose which items they would buy. (This would be the items with positive values next to them but not those from which they would be made worse off as indicated by the negative value they assigned to the

- item.) Have each student record this value and then sum the values across all students in the class.
5. Poll the class with regard to which method of choice provided them with the most value. Compare the total value the class derived when each chose whether to purchase the item with the total value derived when the majority decided the bundle allocated to each member of the class. (Note: In the case of large classes, the instructor will probably want to collect the sheets, do the summations, and provide the results during the next class period.
 6. Some instructors may also want to have students do a written assignment analyzing the implications of the experiment, with regard to the ability of markets and political decision-making to allocate private goods efficiently.

Political versus Markets Student Activity Sheet

Name: _____

Market vs. Political Choices

Please take a look at the two baskets of goods listed below. For each item in the basket, please indicate how much you desire or value that particular item relative to the price that you would have to pay for it on a scale from -10 to 10, with 10 being the highest. For example, if you really desire the item, because you would gain an incredible amount of value from it even after paying the price for it then give it a positive number; the more you value the item, the closer this number should be to 10. If you don't value the item at all and would be extremely unhappy if you were forced to purchase this item, give it a negative number. The more upset you are with being forced to buy this item, the closer this number should be to -10. If you are indifferent with regard to purchasing the item, give that item a zero.

1. Please establish a value for each item in the cart and add up the total value for each cart.

CART 1		Price	Value
1.	Shampoo	\$3	
2.	Frisbee	\$4	
3.	Laundry Detergent	\$5	
4.	Johnson's Baby Formula	\$8	
5.	Fixodent Denture Cleanser	\$6	
6.	Skittles Candy	\$1	
7.	Tampax Tampons	\$7	
8.	Electric Beard Trimer	\$20	
9.	Kellogg's Frosted Flakes Cereal	\$3	
10.	Almonds (6 oz. can)	\$3	
TOTAL		\$60	

CART 2		Price	Value
1.	Toothpaste	\$2	
2.	Tennis Balls (3 pack)	\$3	
3.	Fabric Softener	\$3	
4.	Huggie's Diapers	\$13	
5.	Heating Pad	\$22	
6.	Snickers Candy Bar	\$1	
7.	Revlon Lipstick	\$6	
8.	Protein Bars (6 pack)	\$6	
9.	Kellogg's Strawberry Pop-Tarts	\$3	
10.	Extra Sugar-Free Gum (15 pieces)	\$1	
TOTAL		\$60	

2. You now have to vote for which cart you want. Your vote will be tallied up with all other student votes, and the cart that receives the most votes is the cart of items that you would get. Please indicate which cart you would like to vote for by circling your choice below:

Cart 1

Cart 2

What is the total value you received from that cart? _____

3. Now imagine that you could go through and choose which items to buy from both carts. This means that you can choose to buy only those things that give you a positive value and not buy those things that give you a negative value.

What would your total value be if you made choices in this way? _____

4. The method of choice described in Question 2 is what we experience when we vote on politicians who promise to provide a series of goods and services to everyone, regardless of who voted for them. The method of choice described in Question 3 is what we experience when we are allowed to make decisions for our self in the market place. Which method of choice gives you the highest value?

Part 4: Government Spending, Deficits, and Debt

Clip 11: Are We Headed Toward a Debt Crisis?

Length: 4:35

Concepts Illustrated:

- Federal budget deficit
- Government spending
- Interest paid on national debt
- National debt
- Political decision-making

Lesson Objectives:

1. Illustrate the size and growth of the national debt.
2. Differentiate between the federal budget deficit and the national debt.
3. Describe the consequences of a growing national debt.
4. Explain why federal spending is rarely decreased.

Preview Question:

“If the national debt is bankrupting the United States, why do politicians continue to increase government spending?”

Write the students’ answers on the board, but do not comment on their opinions. Tell them you will return to this issue later in the lesson.

Description: John Stossel and his two guests discuss the size, growth, and economic consequences of the national debt. When the segment was produced in 2010, the national debt stood at \$13.5 trillion. Even though 71% of Americans believe federal spending is too high, a majority of Americans do not want to cut entitlements such as Social Security and Medicare. These entitlements are the largest expenditures of the federal government. The panelists conclude that if interest rates are 5% and the debt continues to grow at the current rate, in 2080 Americans will spend 35% of GDP just to pay interest on the debt.

Discussion and Analysis Questions:

1. In 2010 the national debt was \$13.5 trillion. What is it today?

It will be larger than in 2010. Check the National Debt Clock at <http://www.usdebtclock.org> for up-to-date information. It also shows the amount of national debt each family owes.

2. How much is one trillion dollars?

One trillion dollars is a million million. It has 12 zeros behind a 1. Write \$1,000,000,000,000 on the board. If we divided a trillion dollars between everyone living in the United States, each person would receive \$3,270. Evidently, a trillion is the new billion.

3. How will the national debt affect your future life?

It will lower your standard of living. Interest paid on the debt is money that cannot be used for other government programs. If the debt is financed by creating new money, there will be inflation. Government spending will be cut or taxes will be increased. For a preview of possible consequences, check out Greece, Ireland, Spain, and California.

4. If the national debt is bankrupting the country, why don't politicians decrease spending or increase taxes?

There would be political as well as economic consequences. The beneficiaries of government programs do not want them cut. They are often well-organized business and labor organizations with considerable political clout. Government employees delivering the services are often at the forefront of those opposing spending reductions. Higher taxes impose a highly visible cost on voters, and they also affect people's incentives to work, save, and invest.

Extension Activity: Cutting the Budget

The purpose of this activity is to help students see how difficult it is to agree on budget cuts. The Handout is taken from the 2010 federal budget, a \$3.55 trillion budget with a \$1.5 trillion deficit. The Handout lists the budget's ten largest expenditures. Place the students in small groups, and tell each group to cut the budget by \$400 billion. If they are unable to cut this amount, they must raise it in new taxes. Ask each group to report its recommendations to the class. Conclude by asking how the government will cut the growth of the national debt.

Handout: Debt Buster

You have just been elected to the House of Representatives and have been assigned to a Congressional committee, which is to recommend ways to reduce the federal budget deficit and, ultimately, to slow the growth of the national debt.

The President has handed Congress a budget with expenditures of \$3.55 trillion. The projected budget deficit is \$1.5 trillion. The national debt stands at \$13.5 trillion. The 11 largest expenditures in the budget are the following:

Social Security	\$677 billion
Medicare	\$453 billion
Medicaid	\$290 billion
Defense	\$663 billion
Health and Human Services	\$78 billion
Transportation and Highways	\$72 billion
Department of Veterans Affairs	\$52 billion
Department of State and International Programs	\$52 billion
Housing and Urban Development	\$48 billion
Education	\$47 billion
Interest on the national debt (which you cannot control)	\$164 billion

Note: The figures in this budget are based on the 2010 federal budget.

Your job is to cut the budget by \$400 billion. If you are unable to cut \$400 billion, you will have to raise taxes. You will report your decisions to the class. In this report you should:

1. Explain which expenditures you cut and why.
2. Describe the short-run and long-run economic consequences of your spending cuts or tax increases.
3. List who is hurt and who is helped by your spending cuts or tax increases.
4. Explain why your decisions are realistic.

Clip 12: Can Government Spending Be Cut?

Length: 4:15

Concepts Illustrated:

- Government spending
- National debt
- Taxes

Lesson Objectives:

1. Identify the largest expenditures of the federal government.
2. Explain why most Americans agree that federal-government spending should be cut but cannot agree on which specific expenditures should be cut.
3. Identify specific expenditures of the federal government that can be cut.
4. Use cost/benefit analysis to decide which items in the federal budget are most beneficial and which are least beneficial for the typical citizen.

Preview Question:

“Most Americans believe the federal government spends too much money. Why does spending continue to rise?”

Briefly discuss possible answers with the class, and then tell the students to look for answers in the video clip.

Description: John Stossel discusses how there is widespread agreement that government spending should be reduced, but notes that this agreement breaks down when specific cuts are considered. The Third Way organization provides “A Taxpayer Receipt,” which identifies specific government programs paid for from the payroll tax on a typical worker. John mentions specific cuts offered by the liberal Center for American Progress, the libertarian Cato Institute, and the libertarian Reason TV. The dollar amounts are identified with graphics as John discusses them.

Discussion and Analysis Questions:

1. What percentage of GDP is currently spent on federal government programs? If federal spending continues to increase at the current rate, what percentage of GDP will federal spending be in 2081? Can this level of spending be sustained? (Note: As you pose this question, project the slide on this topic, included with the “Clip 12” slides, from the accompanying slide presentation included on your DVD.)

Federal government programs currently account for the spending of 22% of GDP. If spending continues to rise at the current rate, it will account for 70% in 2081, clearly an unsustainable level of spending.

2. Why were the Republicans in Congress evasive when asked where they would cut the budget?

People who favor the programs that would be cut might vote against them.

3. What happened when Canada reduced government spending across the board in the late 1990s?

The rate of economic growth increased.

4. In this segment, John Stossel says, “The less government does, the better off we all are.” Do you agree or disagree with that statement? Why?

Answers will vary.

Extension Activity: Where Does Your Tax Money Go? A Taxpayer’s Receipt

This activity is designed to show students where their tax money would go if they were adult taxpayers. Or you could say it will show them where their parents’ tax dollars go. The activity uses *A Taxpayer Receipt*, which was developed by Third Way. Third Way describes itself as “politically moderate” on the issues. Others call it “center progressive.” *A Taxpayer Receipt* is available at <http://www.thirdway.org/publications/335>

The receipt is for a typical taxpayer with a median income of \$34,140 who paid \$5,400 in federal income tax and Social Security (FICA) tax.

1. Provide each student with a copy of *A Taxpayer Receipt* and ask questions such as these:
 - a. Which expenditures surprise you the most?
 - b. Can the budget be cut if Social Security, Medicare, and Medicaid cannot be cut?
 - c. Which expenditures do you think are most useful? Which are least useful?
 - d. The 2011 Congress pledged to cut its salaries by 5%. How much will this help in balancing the budget?
2. Put the students into groups of about five. Each group must cut the budget by 10% overall. This means \$540 must be cut from the taxpayer receipt for the person in this example.
3. After the groups have finished, discuss where the cuts were made. Did the groups agree on some cuts or was there disagreement? Ask: If a group of 50-year-old adults were cutting this budget, would they cut the same items? Why or why not?

Clip 13: Growth of Government

Length: 1:49

Concepts Illustrated:

- Government spending
- Incentives
- Lobbying
- Political decision-making

Lesson Objectives:

1. Explain why government spending has increased so rapidly in recent years.
2. Describe recent societal changes that have pushed government spending upward.
3. Analyze how the incentives faced by voters, government officials, government employees, and special interest groups affect increases in government spending.

Preview Question:

“Has government spending increased by a greater or smaller percentage in the past 10 years compared to previous decades?”

Take a vote, and write the results on the board. At the end of the lesson, ask whether the initial class response was correct.

Description: The clip begins with recent spending items passed by Congress and quotes Thomas Jefferson who said, “The natural progress of things is for liberty to yield and government to gain ground.” A graphic illustrates federal spending per person since 1792 and shows exponential growth in recent decades. For most of the nation’s history, the federal government spent only a few hundred dollars per person, but today, the federal government alone spends \$10,000 per person. Federal, state, and local governments now spend about 40% of all the income generated in the United States.

Discussion and Analysis Questions:

1. How much does the federal government spend per person today?
\$10,000. (See the slide for Clip 13 in the slide presentation PDF file on your DVD.)
2. Why has government spending increased so much in recent years?
There are several reasons for this. First, the country is richer and can afford more government services. Second, special interest groups are richer and well organized and lobby for more government benefits. Third, the culture has changed; more people look to

government rather than the private sector for goodies. Most importantly, incentives facing voters, government officials, government employees, and special interest groups support policies that allow a few people to enjoy large benefits while many people pay small costs.

3. If Thomas Jefferson believed that the natural progress is for liberty to yield and government to grow, why did he expand government so much during his Presidency?

Jefferson faced the same incentives that politicians face today. Also, politicians know that they will be remembered for what they did, not for what they did not do.

4. If the national debt is bankrupting the country, why don't politicians decrease spending or increase taxes?

The political incentive structure makes it difficult to either reduce government spending or increase taxes. Well-organized business and labor groups benefiting from government spending will oppose spending cuts. Higher taxes will impose a highly visible cost on voters and affect people's incentives to work, save, and invest. If spending cannot be cut and taxes cannot be increased, the result will be growth of government debt.

Extension Activity: Congress in Action

1. The purpose of this activity is to show why there is so much growth in government spending. Half of the students in the class will play the role of Members of Congress. The other half will be divided into four small groups, each representing a special interest group. Each of these groups will ask Congress to support their projects. After all of the pitches have been made, Congress must decide which proposals to fund and which to reject. Members of Congress must also provide reasons for funding or rejecting a proposal.
2. Divide the class in half and tell one half that they are Members of Congress. Explain that Congress will have to fund or reject four proposals made by special interest groups. If they decide to fund a proposal, they must explain why the program is important and where they will get the money to do so. Sources could include higher taxes, more borrowing, or cutting other programs. Congress may approve as many or as few programs as it chooses.
3. Divide the other half of the class into four groups. Tell them that they are special interest groups and will urge Congress to fund their proposals. Give each group its information card, which you should cut from these directions. Tell the groups that they can add other information and arguments to their presentations to Congress. Have them discuss their presentations for five minutes.

Information Card A for the Clean Green Energy special interest group

You want Congress to fund windmills to generate clean energy. Although carbon-produced energy is more affordable, it may exert a more adverse impact on the environment. If the government pays for the windmills, the electricity produced would be as inexpensive as electricity produced by coal, oil, and natural gas. The initial cost of the windmills would be \$30 billion, although hundreds of billions of dollars would be required to produce as much energy as fossil fuels.

Information Card B for the No Hungry Child Left Behind special interest group

You want Congress to fund programs to make sure children do not go hungry in America. Children cannot learn if they are hungry. In addition, many children eat the wrong kinds of food. Childhood obesity is a major problem, and the medical costs associated with obesity are rapidly increasing. When these children grow up, they will be less productive as adults, and the nation's standard of living will fall. The cost of the program is \$20 billion.

Information Card C for the Dignity for Unemployed Americans special interest group

You want Congress to extend unemployment benefits for one year. The United States is in one of the worst recessions in 100 years. There are about 15,000,000 unemployed people, about 10% of the workforce. These people want to work but cannot find jobs. Now their unemployment benefits are running out. This not only hurts their families, but because they will be able to spend less, other families will also be hurt. It will cost \$200 billion to extend unemployment benefits for one year.

Information Card D for the Relief for Homeowners Now special interest group

You want Congress to provide relief to homeowners, so people can stay in their homes until they get back on their feet financially. Americans are losing their homes in record numbers. Because the price of homes has dropped so much, people owe more on their home mortgage loans than the homes are worth. Many of these people are unemployed and cannot afford to make their mortgage payments. The lenders foreclose, and people are out on the street. Your proposal requests an appropriation of \$100 billion to finance subsidies to homeowners with mortgage payments they cannot afford.

4. Have each special interest group make a five-minute presentation to Congress. Members of Congress may question the special interest groups to obtain the information they need to make a decision.
5. Congress votes on each of the proposals.
6. Discuss the results with the class with questions such as these:
 - a. Which proposals were funded? Why?
 - b. Which proposals were not funded? Why?
 - c. What additional information would you want if you really were voting on these proposals?
 - d. Why is there so much growth in government spending?
 - e. What are some of the consequences of the growth in government spending?
 - f. In what ways is the simulation realistic? In what ways is it unrealistic?

Clip 14: Spending, Taxes, and the Role of Government

Length: 4:06

Concepts Illustrated:

- Government spending
- National debt
- Taxes
- Redistribution of income and wealth

Lesson Objectives:

1. Define the role of government in the economy.
2. Compare and contrast the arguments for and against government redistribution of income and wealth from the rich to the poor through taxing and spending.
3. List and describe major taxes paid to local, state, and federal governments.

Preview Question:

“What major taxes do people pay to local, state, and federal governments?”

List the taxes on the board, and briefly describe each one.

Description: An interview with Columbia University Professor Marc Lamont Hill begins the clip and presents the perceived need for government spending. He advocates that government must provide national defense, housing, health care, and education. A long list of specific taxes that Americans pay is highlighted with interactive graphics. Arthur Brooks is interviewed at the end of the clip; he warns about changing America from a “maker nation” to a “taker nation.”

Discussion and Analysis Questions:

1. What percentage of GDP is spent by federal, state, and local governments?

Approximately 40%

2. What are some of the major taxes people pay to federal, state, and local governments?

Several are listed in the clip. Here is a partial list.

State and local taxes

Real-estate (property) tax

Excise taxes (on cigarettes, gasoline, alcohol, water, electricity, natural gas)

Sales tax

Personal-property tax

Individual income tax

Corporate income tax

License fees

Federal taxes

Individual income tax

Social Security (FICA) tax

Medicare tax

Corporate income tax

Excise taxes on many items

Estate and gift taxes

Customs duties (tariffs)

Capital-gains tax

3. Are there fewer or more taxes than you thought existed before you saw the clip?

Answers will vary, but probably there were more taxes identified in the clip than the students had thought previously.

4. Do you agree with Marc Lamont Hill that taxes should be imposed on those at the top of the economic ladder, in order to provide transfer benefits to those who are less well off?

Answers will vary.

5. Do you agree or disagree with Arthur Brooks that the fairest system of taxation is one which allows individuals to keep what they earn? (This question works well for a discussion of the morality of income and wealth redistribution, as well as the incentives involved in redistribution. Try to get the students to compare and contrast Hill’s views with Brooks’s views.)

Answers will vary.

Extension Activity:

Ask students to reflect on how grades are determined in your class. Then ask if they think it would be “fair” if you took some points from students with higher grades and gave them to students with lower grades

1. Ask those students who favor grade transfers to design a system to make the transfers. For example, a 20% tax might be imposed on the top third of students with the highest grades, transferring those points to the third of students with the lowest number of points.
2. Ask students to consider how the grade-point redistribution policy would affect their study habits. Will there be some unintended consequences of the grade redistribution policy?
3. Relate student responses to the arguments of Marc Lamont Hill and Arthur Brooks. Would redistributing grades turn the class from a “maker classroom” to a “taker classroom”? Ask if there is a difference between redistributing grades and redistributing wealth and income.

Part 5: International Trade and Trade Barriers

Clip 15: International Trade: Criticisms and Responses

Length: 7:41

Concepts Illustrated:

- Gains from international trade
- Trade barriers
- Comparative advantage
- Wages, output, and productivity

Lesson Objectives:

1. Illustrate how international trade affects the output and earnings of trading partners.
2. Show that trade will reflect comparative advantage: People will trade for things that would be expensive to produce for themselves and focus their production efforts on things for which they are a low-cost producer.
3. Challenge students to think about the relationship between voluntary exchange and peaceful relations among nations.

Preview Question:

“Would Americans be better off if they purchased less from foreigners?”

Before showing the clip, survey the class on the subject. You may want to poll the students to see how many answer “yes” and how many answer “no.”

Description: Free trade proponent Tom Palmer from the Atlas Economic Research Institute responds to a number of popular criticisms of free trade. Issues addressed are exploitation of workers in developing nations, protection of domestic industries, and the impact of trade on peaceful relations and economic progress.

Discussion and Analysis Questions:

1. Are foreign workers exploited by American firms that hire them at wages that are much lower than the wages earned by workers in the United States?

No. In order to attract workers, firms have to pay wages that are more attractive than the alternative jobs available to the worker. American firms operating in less developed countries generally pay wages that are well above the country's average wage. Far from

exploiting workers, the job and earning opportunities improve the welfare of the workers employed.

2. Why do you buy things from others rather than producing them for yourself? Why do Americans buy things from foreigners?

The answer to both questions is the same: When we can acquire things through trade rather than producing them for ourselves, we are able to focus our productive efforts on the things we do best, thereby producing a larger output and achieving a higher living standard than would otherwise be possible.

3. Would Americans be better off if we purchased less from foreigners?

When thinking about the answer to this question, ask yourself the following: Would you be better off if you produced goods like shoes, clothing, DVD players, iPods, and personal computers for yourself rather than outsourcing their production to others? We outsource production to others when it is cheaper to acquire the item via trade than it would be to produce it for ourselves. This specialization and trade makes it possible for the trading partners to expand their joint output and earn higher incomes. This is true for individuals, businesses, states, and nations. Economists refer to this as the law of comparative advantage.

4. If Americans purchased less from foreigners, what would happen to our sales to foreigners?

Our sales (exports) to foreigners would also decline. Foreigners use the dollars they acquire from their sales to us to purchase things from us. If they sell less to us, they will have fewer dollars and, therefore, will have to reduce their purchases of exports from us.

5. “When goods cannot cross borders, armies surely will.” Is this statement true?

There is reason to believe the statement is true. Trade is mutually advantageous. When there is considerable trade between people in different nations, they are likely to have greater understanding and appreciation of the people in another country with whom they are trading.

Extension Activity: Why Do People Trade?

The purpose of this activity is to demonstrate mutual gains from trade by playing a short simulation. Point out that since the end of World War II, the United States championed increasing international trade. The lessons of the 1930s were very much on the minds of policy leaders after the war. The Smoot-Hawley Tariff Act of 1930 raised tariffs on 20,000 imported goods. The result was that standards of living were reduced among all international trade partners, in the midst of the largest economic downturn in history.

While American policy has generally promoted free trade since World War II, there have been periods of serious retreat. In the 1970s, for example, the economies of Germany and Japan had recovered from the devastation of World War II. American industry faced increased international competition in such areas as steel, automobiles, TVs, textiles, and shoes. American automobile manufacturers and other groups lobbied for government protection from international competition. Even today, people still have lingering questions regarding the benefits of free trade.

Ask the students to participate in the following simulation and then discuss the results.

1. Distribute a small gift placed in a brown paper bag to each student. These gifts might include small items such as travel toothpaste, pens, pet food, hand sanitizer, small office supplies, and so forth. Some instructors give students a gift card from a variety of stores.
2. Ask the students to open their gifts.
3. Ask the students to assess how much satisfaction they gain from their gift, if any. Ask the student to rate their satisfaction on a 0 to 10 scale, with zero indicating they derive no benefit from the item and 10 indicating they are highly satisfied with it. Ask the students to write down the number representing their satisfaction on a sheet of paper and turn it in to you. Quietly add up the total points for this round, but don't share the total with the class yet.
4. Divide the class into small groups. Explain that students are free to trade their items to anyone in their group if they wish to do so. No one is required to trade. But students may not trade with people in other groups. Allow two or three minutes for this round.
5. Ask the students to again assess how much satisfaction they gain from the gift they now have, even if they did not make a trade. Ask the student to rate their satisfaction on the 0 to 10 scale, write it on a sheet of paper, and turn it in to you. Quietly add up the total points for this round, but don't share the total with the class yet.
6. If your class is not very large, you might ask the students to do a quick "advertisement" of the gift they now hold. This can help set the stage for the final open trading round.
7. Allow the students to trade one last time. This time they may trade with anyone in the room. Allow five minutes for this round.
8. Ask the students to again assess how much satisfaction they derive from the gift they now have, even if they did not make a trade. Have them rate their satisfaction on the 0 to 10 scale, write it on a sheet of paper, and turn it in to you. Add up the total points for this round.
9. Display the total points from each round. It might look something like this:

No trading = 75 points

Small group trading = 100 points

Open trading = 120 points

Questions for Discussion

1. Why did the ratings grow from round to round?

People exchanged items they valued less for items they valued more. Trade opportunities improved when it became possible to trade within the whole class. Stress that while there was no change in the items available, now they were held by people who valued them more.

Voluntary trade created gains in satisfaction just by moving the items to people who valued them more highly.

2. Ask the students to explain trades that took place.

Accept a variety of answers. It is fun to trace the movement of an item from one student to another. Stress how people valued the items differently, often for reasons that would have been hard to predict in advance.

3. Was everyone happy with the results?

Probably not. Some people did not find a trade they wanted to make. Others may have decided to keep their original gifts. Still others would have been willing to make a trade but could not reach an agreement with a potential trading partner. Stress that while everyone may not have benefited from trade, the total level of overall satisfaction increased from round to round.

4. Conclude the simulation by explaining the following:

- a. The no-trade round was meant to represent self-sufficiency.
- b. The small group trading was meant to represent trade within a relatively small region, such as a state or nation.
- c. The open trading round was meant to represent gains from trade over a larger region or group, such as might be derived from world trade. Note that as trade was allowed among a larger and larger group of traders, the gains from trade expanded.
- d. Finally, note that there was no expansion in production during this activity. The law of comparative advantage and gains from economies of scale indicate that trade will make it possible for the trading partners to produce a larger joint output than would otherwise be the case. This will lead to still more gains from trade.

Clip 16: Economics of Trade Deficits

Length: 6:18

Concepts Illustrated:

- Trade deficits and surpluses
- Foreign exchange market
- Capital flows and trade balances

Lesson Objectives:

1. Explain what is meant by trade deficits and trade surpluses.
2. Explain why there is a linkage between net foreign investment (inflow of capital) and trade deficits.
3. Indicate that trade deficits may be either good or bad, depending on their source.

Preview Question:

“When we import more from countries like China than we export to them, does this indicate that they are treating us unfairly?”

Before showing the clip, survey the students concerning their views on this issue. Keep a list of some of the views expressed on both sides of this question.

Description: The current U.S. trade deficit with China is over \$200 billion, and China is accused of manipulating its currency to increase their exports (our imports). John Stossel then poses the question of whether this trade deficit indicates that the Chinese are treating us unfairly. Don Boudreaux, an economist from George Mason University, is interviewed to explain the economics of trade deficits and the benefits they create. The myth that American manufacturing is on the decline is specifically addressed with a graphic.

Discussion and Analysis Questions:

1. What is a trade deficit?

A trade deficit is the term used to describe the situation when a country is importing more goods and services from foreigners than it is exporting to them.

2. If foreigners are investing more in the United States than Americans are investing abroad, how will this affect the trade balance?

Net foreign investment means that foreigners are buying more assets in the United States than Americans are purchasing abroad. The foreign exchange market will assure that this excess of asset sales to foreigners will be offset with net imports (an excess of goods and services purchased from foreigners relative to sales to them). Thus, a net inflow of capital implies a trade deficit.

3. “The foreign exchange market will bring the dollar purchases of Americans into equality with the dollar sales of Americans to foreigners.” Is this true?

Yes. Americans will demand foreign currencies in exchange for dollars when they buy things from foreigners, and foreigners will supply their currency in exchange for dollars when they buy things from Americans. The foreign exchange market will bring the dollar demand for foreign currency into equality with the dollar supply. In turn, this will bring the purchases from foreigners into line with the sales to them.

4. Is a trade deficit necessarily bad?

Not always. It depends on the source of the trade deficit. If the trade deficit results because the domestic economy is a good place for private investment, this inflow of capital is a good thing, and it will increase the future productivity of Americans. However, if the inflow of capital and accompanying trade deficit reflects large budget deficits and borrowing to finance an expansion in the size of government, it will tend to adversely affect future productivity and earnings.

5. Would Americans be better off if we tried to reduce the current trade deficit by subsidizing firms that export a lot to foreigners?

The answer to this question is almost certainly “No.” Political factors will determine the allocation of the subsidies, and the result will be more “corporate welfare” and crony capitalism. Predictably, businesses will spend more time trying to qualify for these subsidies and less time trying to produce goods that consumers value highly, relative to cost. Moreover, higher taxes will be necessary to finance the subsidies, and this will retard output in other sectors. Further, if foreigners buy more from us, we will acquire more foreign currency, which will be used to buy (import) more from them. Thus, the strategy will not even reduce the trade deficit. It may be popular with interest groups and the political class, but it reflects economic illiteracy.

6. Does the U.S. trade deficit with China indicate that the Chinese are cheating us?

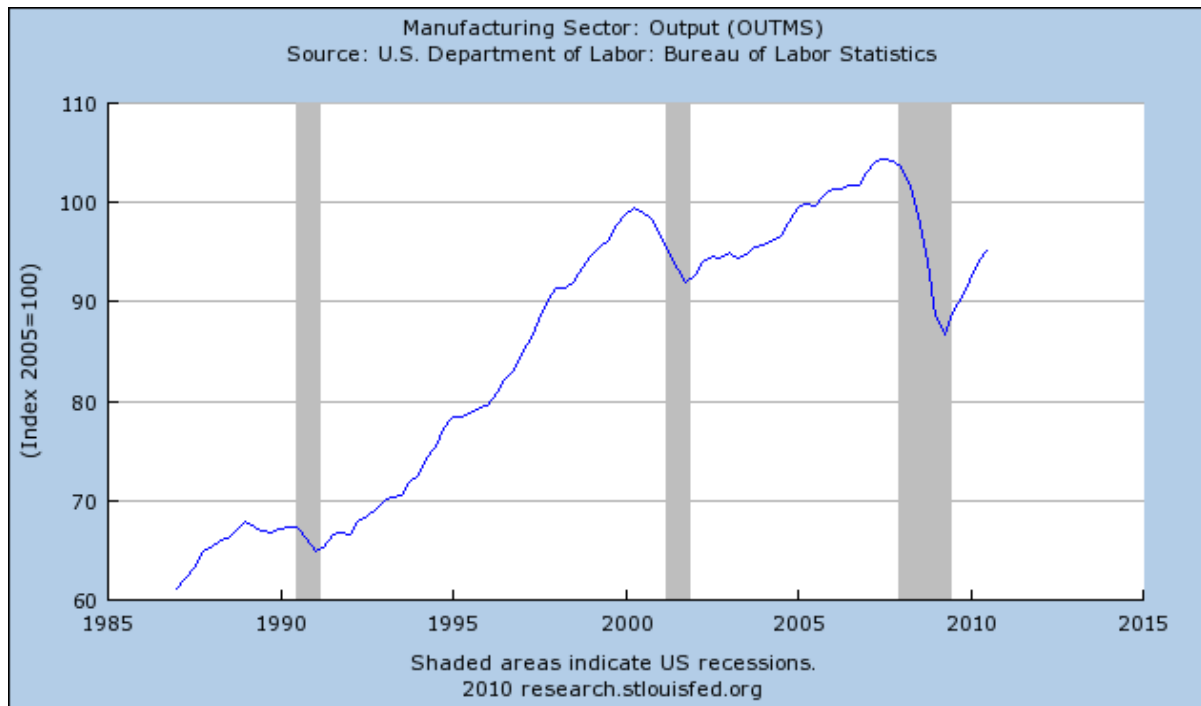
Something to think about: Are they cheating us by providing us with goods more economically than we could obtain them elsewhere? Moreover, while the foreign exchange market will bring the overall volume of purchases into balance with sales, there is no reason to expect that trade with any country will be in balance. Predictably, we will run trade deficits with countries that are low-cost producers of goods we import and buy few of the goods for which we are a low-cost exporter. This, along with our budget deficits that attract capital from China, is the primary source of our trade deficit with China.

Extension Activity: The Making Magic Marker Marks Simulation

The purpose of this activity is to address the myth of the decline of American manufacturing by playing a short productivity simulation. Students analyze data on manufacturing output, and volunteers participate in the simulation.

Display Figure 1 to the class. Ask the students to notice how manufacturing output has, by and large, been increasing since the 1980s, except in the recession in 2001 and, more severely, the recession of 2007-2009. Note the increased manufacturing production after the recession ended in 2009. Ask: How can the amount of manufacturing output increase when there are fewer jobs in the manufacturing sector?

Figure 1: Manufacturing Output, 1987–2010



Source: Federal Reserve Bank of St. Louis

<http://research.stlouisfed.org/fred2/graph/?s%5b1%5d%5bid%5d=OUTMS>

Invite the students to participate in the Making Magic Marker Marks Simulation:

1. Draw four large circles on the chalkboard (or on sheets of newsprint), spaced relatively far apart in the front of the classroom. Ask a student volunteer to be a worker. Give the student one magic marker. Tell the student to make as many marks as possible in a 20-second period, with the constraint that the student must make one mark in each of the four circles before starting the next round of mark making. In other words, an equal number of marks must be made in each circle. Say “go!,” and time the round.
2. When the time is up, ask the worker to count up how many total marks were produced in Round 1, and write down the number. Ask the worker to return to his or her seat, and have the class give the worker a round of applause.
3. Draw four new large circles on the chalkboard. Ask four new students to come to the front and give each of them one magic marker. Note that you have quadrupled the human capital and the physical capital of the magic marker mark factory by adding workers and markers. Assign each of the workers to their own circle. Tell them to make as many marks as they can in their circles for a second 20-second round. (Because the students do not have to move back and forth in Round 2, they will produce many more marks than were produced in Round 1.) Say “go!,” and time the Round.

4. When the time is up, ask the students to count up how many total marks were produced in their circle and write down the number. Ask the workers to return to their seats, and have the class give them a round of applause.
5. Now calculate the unit labor cost of production for each round, and write the results in Table 1, which you can display on the chalkboard. Explain that you are paying a hypothetical wage of \$5 to each worker.
 - a. In Round 1, for example, let's say that 25 marks were produced by the single worker. The unit labor cost (\$5 divided by 25 marks) equals 20 cents per mark.
 - b. For Round 2, we need to figure out the production per worker. Add up the total amount of marks produced by all 4 workers and divide it by 4 to get the average production per worker. In Round 2, let's say that the four workers produced 200 marks or 50 marks per worker, on average. The unit labor cost (\$5 divided by 50 marks) equals 10 cents per mark.

Table 1: Decreasing Unit Labor Costs

	Number of Marks Produced	Unit Labor Cost
Round 1		
Round 2		

6. Tell the students that this activity demonstrates the importance of gains from productivity. Productivity can be defined as the average output per worker in a given period of time. Productivity increased from Round 1 to Round 2, because the work was organized more efficiently. Because the unit labor cost of each mark declined when productivity increased, it would be possible for the firm to “sell” the marks at a lower price and still earn a profit.
7. Note that the productivity increases would make it possible to produce a larger output with fewer workers. Suppose that six workers had been making marks in each of the four circles as in Round 1, and they each produced 25 marks for a total output of 150. Note that, given their higher productivity, the four workers were able to produce a total output of 200 marks under the procedures of Round 2. There was a larger output (200) with just four workers in Round 2, compared to the output of 150 by six workers under the productivity conditions of Round 1. Thus, output in the magic marker mark industry expanded, even though employment declined. This is precisely what has been happening in manufacturing: Output has been increasing even though employment has been declining.
8. Ask the class to consider how we could obtain even more productivity gains in our factory. Students might suggest giving more markers to each worker—one for each hand, two for each hand, a tool that holds several magic markers that can be held in both hands. Someone will suggest using copy machines to produce marks. The copy machine would dramatically increase the number of marks the factory could produce and would require far fewer workers. Thus, more marks would be produced even as

employment decreased. As fewer factory workers are required, they would be released to work in other parts of the economy.

9. Explain that gains in productivity are a pattern that has been repeated many times throughout American history. American agricultural output has continued to increase, for example, even though the number of farm workers has continued to decrease. In addition, when production costs decrease, prices to consumers almost always drop, as producers compete to seek new customers. Cell phones, iPhones, and high definition televisions are just a few of the more recent examples.

Part 6: Why Some Nations Prosper and Others Stagnate

Clip 17: Why Do Nations Prosper?

Length: 4:55

Concepts Illustrated:

- Economic freedom
- Government planning
- Limitations of resource riches

Lesson Objectives:

1. Illustrate the importance of economic freedom as a source of long-term growth and high per capita income.
2. Highlight that democracy and abundant mineral resources do not assure that a nation will achieve high-income levels.
3. Illustrate that nations and regions with dense populations can nonetheless achieve prosperity.

Preview Question:

“Why do some nations grow and achieve high levels of income while others stagnate and remain poor?”

Survey students with regard to the answer to this question, and write their responses on the board. Let them know that you will return to their responses after viewing the video.

Description: Segment begins with a discussion of Milton Friedman’s classic book, *Free to Choose*. The book has been translated into 25 languages and has exerted a major impact on world leaders, including Ronald Reagan and Margaret Thatcher. The book argues that economic freedom is the key to growth and prosperity. The experiences of Hong Kong and India are compared and contrasted.

Discussion and Analysis Questions:

1. Does democracy lead to economic prosperity?

As John Stossel notes, India is democratic, but it is still poor. Mexico is also democratic and poor. On the other hand, Hong Kong is not democratic, but it is nonetheless prosperous. Singapore is also not very democratic, but it has a high per-person income level. While democracy is a good way to make political decisions, it does not assure economic prosperity.

2. If a nation has abundant natural resources, will its people achieve high-income levels?

Several countries, including Argentina, Nigeria, and Venezuela are rich with resources but relatively poor. The opposite is true for both Hong Kong and Japan. Natural resources can help, but they clearly do not assure economic growth and high levels of income.

3. Why are income levels high in the United States?

When discussing this question, encourage students to think about the incentives generated by free markets. Businesses have a strong incentive to supply goods and services that consumers value highly, relative to their costs. If they do so, they will earn profit. Failure to do so will lead to losses. Individuals have a strong incentive to develop skills that are highly valued by others, because this will lead to higher earnings. Trade and specialization will also lead to higher income levels. Businesses also have a strong incentive to innovate, discover better ways of doing things, and produce efficiently. All of these things will lead to higher income levels and improved living standards. The experiences of Hong Kong, Singapore, Canada, and the United States are consistent with the view that economic freedom and reliance on markets are key ingredients of growth and prosperity.

4. When goods, services, and resources are allocated by markets, what will a business have to do in order to be successful?

In a market economy, businesses can earn profit only by purchasing resources and combining them into goods and services that consumers value enough to generate revenues that exceed costs. Thus, in order to be successful, a business must increase the value of resources.

5. When government officials manage and direct business activity, can they be counted on to direct resources into productive projects?

The political process does not have anything like profit and loss to help direct resources toward productive and away from unproductive projects.

6. Why is per-person income so high in Hong Kong?

During the past 50 years, Hong Kong has had the world's freest economy. It is very easy to start a business in Hong Kong. There are virtually no tariffs or restrictions on international trade. Taxes are low, and government expenditures are about 15% of the economy—less than half the figure for the United States. The legal system of Hong Kong provides for protection of private property and even-handed enforcement of contracts. Hong Kong is densely populated. It has few natural resources. For more than a century, it has been governed by, first, the British and, now, China. Given these conditions, Hong Kong does not have much going for it other than economic freedom. Nonetheless, it has achieved rapid growth and now has an income level per person similar to that of high-income countries such as Canada, Australia, and the United States.

Extension Activity: Why Are Some Nations Richer than Others?

This activity shows students that a nation's wealth and prosperity are generated by economic freedom, not just by the random circumstance of having abundant natural resources. Although the "mystery nations" used in this activity were selected to make the point quickly, many

analyses would confirm the conclusions of the activity. It is best to conduct the activity before you show the clip, and the instructions present this strategy.

1. Tell the students that they are going to predict which nations are rich and which are poor, based on data about a nation's population and natural resources.
2. Divide the class into groups of 3-5 students and have each group choose a reporter. Distribute a copy of the following Handout to each student.
3. Ask each group to try to identify the countries and rank them from richest to poorest.
4. Ask the reporters to write their groups' results on the board, and have each group report to the class why they ranked the nations as they did. Population density and the amount of natural resources will probably be the main reasons behind their rankings.
5. Use the Visual to show the correct rankings. Explain to the students that economic freedom—not natural resources—is why some nations are richer than others. Economic freedom means that people are free to trade with others, compete in markets, buy what they want, earn a living in a job they choose, keep what they earn, and own things privately. Call attention to other conclusions such as:
 - a. The United States may be rich partly because of an abundance of natural resources, but Singapore illustrates that high-income levels can be achieved without an abundance of natural resources.
 - b. Because of markets, South Korea is much richer than North Korea.
 - c. Pakistan and Venezuela have vast natural resources but are poor because of a lack of economic freedom.
6. Show Clip 17, and follow up with the questions from the lesson.

Handout: Rich Nation or Poor Nation?

What causes some nations to be richer than others? Most of the world's six billion people are poor. Only about one million have become relatively prosperous. Data for six countries are provided below. Can you guess the name of the country for each group of data? After you have identified the countries, can you rank them in order from richest to poorest?

Country A_____

Population: 300 million

Population density per square mile: 84

Natural resources: Coal, copper, lead, phosphate, uranium, bauxite, gold, silver, zinc, tungsten, natural gas, oil

Country B_____

Population: 23 million

Population density per square mile: 497

Natural resources: Coal, copper, lead, gold, zinc, tungsten, graphite, pyrites, salt, hydropower, manganese, iron ore

Country C_____

Population: 26 million

Population density per square mile: 76

Natural resources: Extensive oil and natural gas, gold, bauxite, hydropower, iron ore, diamonds, other minerals

Country D_____

Population: 5 million

Population density per square mile: 18,645

Natural resources: Fish, deep-water ports

Country E _____

Population: 166 million

Population density per square mile: 551

Natural resources: Land, extensive natural gas, limited oil, coal, iron ore, copper, salt, limestone

Country F _____

Population: 49 million

Population density per square mile: 1,288

Natural resources: Lead, hydropower potential, coal, tungsten, graphite, molybdenum

Rank the Nations

Rank	Letter	Your guess at nation's name	Richest
1.	_____	_____	
2.	_____	_____	
3.	_____	_____	
4.	_____	_____	
5.	_____	_____	
6.	_____	_____	Poorest

Visual: The Rankings Revealed—Why Do Some Nations Prosper?

Rank	Letter	Nation	Per Capita GDP (in \$)	Life Expectancy (in years)	Infant Mortality (per 1000 live births)	ECONOMIC FREEDOM RANK
1	D	Singapore	\$54,700	82.06	2.32	2
2	A	USA	\$47,400	78.24	6.14	6
3	F	S. Korea	\$28,500	78.81	4.20	37
4	C	Venezuela	\$13,200	73.77	21.07	138
5	E	Pakistan	\$2,400	65.63	65.32	118
6	B	N. Korea	\$1,800	64.13	50.15	unmeasured

Data are for 2009 from CIA World Factbook: <http://www.cia.gov>

Economic freedom rankings are for 2008 from James Gwartney, Joshua Hall, and Robert Lawson, *Economic Freedom of the World 2010 Annual Report* (Fraser Institute)

Clip 18: Economic Freedom and Quality of Life

Length: 2:23

Concepts Illustrated:

- Economic freedom
- Relation between economic freedom and quality of life

Lesson Objectives:

1. Indicate the key ingredients of economic freedom, including consumer choice, voluntary exchange, freedom to enter and compete in markets, unbiased enforcement of laws, and protection of your person and property from the aggressive acts of others.
2. Indicate the countries where people have the most and the least amount of economic freedom.
3. Consider how the quality of life of people is influenced by the freedom of individuals to choose their occupation, decide how to spend their money, start a business, and other dimensions of economic freedom.
4. Clarify the distinction between policies that expand economic freedom from those that reduce it.

Preview Question:

“What is economic freedom, and how can you tell the degree to which it is present in a country?”

Ask students to give their opinions. You may also want to ask them their views about the difference between economic and political freedom.

Description: The segment considers how the quality of life differs in the world’s freest economies (e.g. Hong Kong, Singapore, New Zealand, and the United States) compared to countries like the Congo, Zimbabwe, and Venezuela. Milton Friedman argues that free economies prosper because individuals will achieve their objectives more fully when they are left free to choose for themselves. Friedman states that “nobody spends someone else’s money as carefully as they spend their own.”

Discussion and Analysis Questions:

1. What are the major elements of economic freedom?

The four cornerstones of economic freedom are: (a) Personal Choice: Individuals are free to choose how they will earn a living, spend their income, choose where they will live, and make similar choices; (b) Voluntary Exchange: Trade with others at mutually agreeable prices; (c) Freedom to Compete: Freedom to enter and compete in business and occupations of one’s choice; and (d) Protection of Property Rights: Legal protection against others who would use force, fraud, or theft to take one’s property.

2. According to the Fraser Institute, what is the freest economy in the world? List three countries with a high degree of economic freedom. List three economies with very little economic freedom.

The Fraser Institute data indicates that Hong Kong is the world’s freest economy. Countries with a high degree of economic freedom include Singapore, New Zealand, Switzerland, Chile, the United States, Canada, and Australia. Countries with little economic freedom include the Republic of Congo, Venezuela, Angola, Myanmar, and Zimbabwe.

3. Indicate how each of the following will influence economic freedom: (a) an \$8 minimum wage law, (b) an increase in taxes, (c) a mandate that requires you to purchase a specific health insurance policy, and (d) a law that prohibits you from buying a product from a foreign producer.

All four of these examples will reduce economic freedom, because they will reduce your ability to either choose for yourself or engage in voluntary exchange.

4. What is the difference between economic freedom and democracy?

Democracy has to do with the procedures used to make political choices, while economic freedom is about the consistency of political institutions and policies with regard to voluntary exchange, as well as the protection of people and their property from aggressors. Economic freedom is present when adults are free to consume, produce, and trade with others, as long as their actions do not harm the person or property of another party. Political democracy is present when all adult citizens are free to participate in the political process (e.g., to vote, lobby, and choose among candidates) and when political outcomes are

determined through fair and open elections. Political choices conflict with economic freedom when they impose restrictions that inhibit personal choice, voluntary exchange, the opportunity to compete, and the right of individuals to keep what they earn. This is true whether the restrictions are adopted by democratic or non-democratic procedures.

5. Explain why you either agree or disagree with Milton Friedman's view that nobody spends someone else's money as carefully as they spend their own.

Issues to think about: If someone gave you money and asked you to buy them some groceries, how carefully would you spend the money? How would you know what meats, vegetables, and other food products they like? If someone asked you to go grocery shopping for yourself and to just send them the bill, how would this affect the amount you would spend? Would you have much incentive to economize?

Extension Activity: Researching Economic Freedom and the Quality of Life

Seeing is believing. People's quality of life is improved when they can choose their occupations, decide how to spend their money, enter and compete in markets, have their person and their property protected, and trade freely. To illustrate this fact, have the students research the impact of economic freedom on a nation's quality of life.

1. Use the ranking of nations from the *Economic Freedom of the World 2010 Annual Report* at <http://www.fraserinstitute.org> or from "What Is Economic Freedom?" by James Gwartney at <http://www.teacheconomicfreedom.org> Make a copy of the list for each student.
2. Divide the class into two groups, and give each student a copy of the list of nations. Have each student in one half choose a nation in the top 10 or top 20 for economic freedom. Have each student in the other half choose a nation ranked in the bottom 10 or bottom 20.
3. Have the students go to the online version of the *CIA World Factbook* at <http://www.cia.gov/library/publications/the-world-factbook> to research their nations. They should focus on the economy, government, and people. They should particularly look for statistics on economic growth, per capita GDP, infant mortality rate, life expectancy, literacy rate, and inflation rate. Encourage them to go to other web sites that compare the quality of life in different countries.
4. Have the students write a short report on the quality of life in their nations.
5. Using this information, conduct a class discussion, comparing and contrasting the quality of life in nations with high levels of economic freedom to the quality of life in nations with low levels of economic freedom.
6. A great way to represent the levels of economic freedom worldwide is to display a copy of the 24 x 36-inch map, which is color-coded to show the amount of economic freedom around the world. The map is accompanied by six lesson plans that use the map in the classroom. These materials are available from the Fraser Institute at <http://www.fraserinstitute.org> at a reasonable cost.

7. To teach more about economic freedom, check out the papers and hands-on classroom activities available at the web site of the Freedom and Prosperity Academy:
<http://www.teacheconomicfreedom.org>