

Common Sense Economics:
What Everyone Should Know About Wealth and Prosperity
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Reading Guide

Part III. Economic Progress and the Role of Government



Government Promotes Economic Progress by Protecting the Rights of Individuals and Supplying a Few Goods That Are Difficult to Provide Through Markets.

1. Thomas Jefferson stated that the sum of good government was: “A wise and frugal government, which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvements, and shall not take from the mouth of labor the bread it has earned.” State in your own words what Jefferson meant. Do you believe that Jefferson would believe that government in the United States today was “wise and frugal”? Why or why not?
2. Describe the *protective* and *productive* functions of government.
3. When resources are privately owned, users will have to confront the opportunity cost of employing resources. Why is this true and why is it important?
4. Identify the characteristics of public goods. Explain why it is so difficult for private businesses to produce them.
5. Give some examples of public goods. Do many goods have public good characteristics that would make them difficult to provide through markets? Governments are often heavily involved in the supply of education and health care services. Are these items public goods? Discuss.
6. In a democracy, is it important for citizens to have a realistic view of both the potential and limitations of what can be achieved through political action? Do Americans have a romantic view of government? Cite evidence to support your response to this question.

Allocation Through Political Voting Is Fundamentally Different from Market Allocation, and Economic Analysis Indicates That the Latter Is More Consistent with Economic Progress.

7. If a project or policy is favored by a majority of voters, does this mean that it will be productive? Why or why not?
8. What are the fundamental differences between allocation of resources through markets versus allocation through government (voting)? How important are these differences?
9. Is there reason to believe that voters will be well informed about candidates and issues when they make political choices? Compare and contrast the incentive of voters to cast a well-informed vote with that of consumers to make well-informed choices when purchasing goods in the marketplace.
10. “Government allocation results in a ‘one size fits all’ outcome, while markets allow different individuals and groups to vote for and receive desired options.” Explain the meaning of this statement. How will this characteristic affect the ability of people to obtain goods and services consistent with their preferences when they are supplied through the political process?
11. When goods and services are allocated through markets, will profit and loss provide decision-makers with a strong incentive to undertake productive projects and refrain from counterproductive ones? Does the political process have a similar incentive structure? Discuss.
12. “When unconstrained by constitutional limits, elected officials gain votes by taking resources from some and using them to ‘buy’ the votes of others in order to form a majority.” Is this descriptive of the behavior of politicians? Discuss.

The Costs of Government Are Not Only Taxes.

13. Why will taxes understate the cost of government? What are the three categories of costs incurred when the government levies taxes and provides goods and services?
14. What are some of the costs associated with the enforcement of tax laws and collection of tax revenues? How large are these costs?
15. Do politicians have an incentive to conceal the true cost of government programs? Why or why not? Can you provide examples where politicians substantially understated the cost of a project or new program they favored?
16. Do businesses pay taxes? Can part of the tax burden be transferred from individuals to business firms? Why or why not?

Unless Restrained by Constitutional Rules, Special-Interest Groups Will Use The Democratic Political Process to Fleece Taxpayers and Consumers.

17. Indicate the characteristics of a special interest issue. Give an example of a special interest issue. Do politicians have a strong incentive to support the positions of well-organized interest groups? Why or why not?
18. Explain the meaning of the following quote in your own words: “The fleecing of taxpayers and consumers in order to provide benefits to identifiable and politically active voting blocs has become the primary business of modern politics.” Do you agree or disagree with this statement? Explain.
19. What is “logrolling”? How does logrolling affect the ability of well-organized interest groups to use the political process to derive benefits at the expense of taxpayers and other citizens?
20. Why is the price of sugar so much higher in the United States than in other countries around the world? Has government action in this area improve the well-being of Americans? Why or why not?
21. Did the framers of the U.S. Constitution seek to limit the political power of special-interest groups? If so, how?
22. How do logrolling and pork-barrel spending projects affect the efficient use of resources? Explain your answer. Many politicians who specialize in “bringing home the bacon” for constituents have long careers and are often admired as great Americans. Do you think these people help make America great? Discuss.

Unless Restrained by Constitutional Rules, Legislators Will Run Budget Deficits and Spend Excessively.

23. What is a budget deficit? What is the difference between the budget deficit and the national debt? What is the relationship between the two?
24. Why does Professor James Buchanan believe that politicians will find it attractive to run budget deficits and finance current government spending through borrowing? Explain why you either agree or disagree with Professor Buchanan?
25. Explain how the Keynesian revolution changed people’s ideas regarding budget deficits and government debt. How did Keynesians think an increase in government spending financed by borrowing would affect the economy?
26. What has happened to the size of the federal budget deficit during the past 50 years? What has happened to the federal debt as a share of the economy during the past decade?

27. Do members of Congress have a strong incentive to minimize the size of the budget deficit? Why or why not? Indicate why there is so little incentive for a legislator to be a “spending watchdog”.
28. What is the “shortsightedness effect?” How does it influence the attractiveness of budget deficits to politicians? Explain.
29. The federal government financed approximately 40 percent of its expenditures during 2009 and 2010 by borrowing? How has this affected the outstanding debt of the federal government? As the baby boomers move into the retirement phase of life in the decade immediately ahead, how will this affect the budget deficit and the federal government’s outstanding debt?
30. If the federal government continues to run large budget deficits and its debt grows as a share of the economy, what will eventually happen?
31. Indicate a number of institutional changes that would reduce both the incentive and ability of politicians to borrow and spend? Why is institutional change probably going to be necessary if the federal government is going to control its spending and debt in the future?

Government Slows Economic Progress When It Becomes Heavily Involved in Providing Favors to Some at the Expense of Others.

32. What are the two major ways that individuals can acquire income? From the standpoint of economic efficiency, does it make any difference how individuals acquire income? Why or why not?
33. When the government becomes heavily involved in plunder – when it takes from some in order to provide favors to others, how will this affect the resources involved in productive activities? How will it affect the quantity of resources channeled into lobbying, political campaigns, and other forms of favor seeking from the government?
34. How will an expansion in income transfers affect the growth rate of an economy? Explain.
35. How large are transfers and subsidies as a share of the federal budget?
36. What percentage of Americans pays no federal income tax? If a substantial share of voters pays little or no federal taxes, how will this affect their incentive to vote for candidates wanting to restrain federal spending?
37. Alexander Tytler did not think that democracy could exist as a permanent form of government. Why did he believe unconstrained democracy would eventually fail?

The Net Gain to Those Receiving Government Transfers Is Less, and Often Substantially Less, Than the Amount They Receive.

38. Was the poverty rate increasing or decreasing prior to the war on poverty? As income transfer programs accompanying the war on poverty increased beginning in the latter half of the 1960s, what happened to the poverty rate?
39. Why is it difficult to transfer income to a group of recipients in a manner that will improve their long-term well-being? Do the secondary effects of the transfers explain why this is true?
40. Indicate three factors that will undermine the effectiveness of transfer and subsidy programs. Explain the impact of each.
41. Because income transfers to the poor typically increase their marginal tax rate, will a \$1,000 additional transfer payment cause the income of poor recipients to rise by \$1,000? Why or why not?
42. How will government subsidies for insurance premiums in hurricane prone areas influence the damage that will result from hurricanes? Explain your response.
43. “Higher unemployment compensation benefits will lead to higher rates of unemployment.” Evaluate this statement.
44. If young people complete high school (at a minimum), work full time, and get married before having a child, are they likely to spend much time in poverty? Explain.
45. How does the poverty rate of single-parent households compare with that of two-parent households?
46. Is the ineffectiveness of transfer programs ranging from farm subsidies to anti-poverty programs surprising? Why or why not?

Central Planning Replaces Markets with Politics, Which Wastes Resources and Retards Economic Progress.

47. Describe the five major reasons why the authors proclaim that central planning and political allocation will do more harm than good.
48. In a democratic setting, will the allocation of government funding to various projects be determined primarily by the likelihood of the project success? Why or why not?
49. Will central planners be more likely than private investors to allocate investment funds into wealth creating projects? Why or why not?

50. Consider the quotation from Adam Smith at the beginning of Element 8 of Part III. What is the meaning of this statement? Does it highlight the importance of getting the structure of incentives right?
51. “When government controls what is bought and sold in an economy, the first thing that will be bought and sold will be the legislators.” Evaluate this statement.
52. “When a government moves beyond its protective function and begins to subsidize various activities, operate enterprises, direct various sectors, and, in the extreme case, centrally plan the entire economy, invariably it will create a situation where individuals pursuing their own interest will simultaneously waste resources, undermine national prosperity, and cause living standards to fall well below their potential.” Indicate why you either agree or disagree with this statement.
53. How will the incentive structure confronted by a firm differ when its revenue is derived from customers choosing to purchase its products compared to when it receives a substantial share of its revenues from government sources? Under which scenario are consumers and society as a whole likely to be best served?
54. How is the incentive structure generated by the common ownership of fish in the sea similar to that of government spending? Explain why an excessive level of the activity will be the outcome in both cases.

Competition Is Just As Important in Government As in Markets.

55. Is there competition among governments? Does competition among governments help consumers to obtain public services and taxes more in line with their preferences? Discuss.
56. How does the incentive of the managers of government enterprises and agencies to operate efficiently and provide desired services economically compare with the incentive of private operators to perform these tasks?
57. Will local governments prefer to operate in a competitive environment? Why or why not?
58. When local governments are largely dependent on federal and state governments for their funding, how will the competitiveness among local governments be affected?

Constitutional Rules That Bring the Political Process and Sound Economics into Harmony Will Promote Economic Progress.

59. Walter Lippmann stated, “The predominant teachings of this age are that there are no limits to man’s capacity to govern others and that, therefore, no limitations ought to be

imposed upon government.” Do you believe that Lipmann is correct? Do Americans still believe in the constraints imposed on government by the U.S. Constitution? Discuss.

60. When the political process becomes heavily involved in providing favors to some at the expense of others, will democracy lead to efficient allocation of resources? Why or why not?
61. Do you believe the United States needs a Bill of Economic Rights? Why or why not?
62. Does it make any difference whether government action is based on agreement or majority rule? If the majority favors a project, does this assure that it will be productive?
63. Did the framers of the U.S. Constitution get the general structure correct? Did the structure limit and enumerate the powers of the federal government. Did it provide for a competitive process among state and local governments? Did it protect individuals and their property from aggression by others and from the government itself? Cite sections of the Constitution in your response.
64. Evaluate the proposed Economic Bill of Rights presented in the final section of this part of the book. Indicate why you would favor or oppose each of the proposals, and explain why.
65. Do you believe that a constraint should be imposed on the total spending of the federal government? If so, how do you think this can best be achieved? Explain your response.
66. Is there often a conflict between “good economics” and “good politics”? Would the Proposed Economic Bill of Rights help reduce this conflict? Why or why not?