

Chapter 3 - Benefits of Free Enterprise



OBJECTIVES

- Describe the tradition of free enterprise in the United States and the constitutional protections that underlie it.
- Explain the basic principles of the U.S. free enterprise system.
- Identify the role of the consumer in the U.S. free enterprise system.
- Describe the role of the government in the U.S. free enterprise system.

Andrew Carnegie? John D. Rockefeller? Bill Gates?

- Each of these men started with an idea, and through persistence, vision, and effort built that idea into a huge business success.
 - Made themselves into the richest people of their time
 - Managed entire industries that helped fuel and grow the national economy
 - Contributed vast sums of money to programs and charities for the public good (*philanthropy*)
 - Made the most of the economy in “the land of opportunity”
 - “the American Dream”
- Today there are over 18 million unincorporated businesses in America.
 - 3 million minority-owned businesses.
- “The land of opportunity”
 - A place where anyone from any background could achieve success through hard work.
 - Immigration – “streets paved with gold”
- What special opportunities allow business people to be so successful and contribute to our overall economic prosperity?
- Why has America been such an economic success (historically)?
 1. Open land and natural resources
 2. Uninterrupted flow of immigrants with different backgrounds and experiences
 3. The American tradition of *free enterprise* –
- The social and political commitment to giving the people the freedom and flexibility to try out their business ideas and compete in the marketplace.
- The U.S. Constitution guarantees important rights that allow people to engage in business activities.

- Property Rights
 - **Fifth Amendment**: No person “*may be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation*”
 - **Fourteenth Amendment**: Includes a due process clause extending these same limitations to the state governments
 - Prevents the government from taking property away from an individual except when there is a public reason – *eminent domain* – must pay fair value
 - These rights apply to corporations – “corporate entities”
- Taxation
 - Congress has rules to how they can tax citizens
 - **Sixteenth Amendment** – legalizes Income Tax
 - Constitution guarantees the right to make binding contracts – government cannot pass a law changing the terms of someone’s business agreement

Free Enterprise in America is founded on ideas so basic to our culture that we tend to take them for granted (p. 52).

1. **Economic Freedom**

- Individuals have the right to choose their occupations and to work wherever they can find jobs.
- Businesses can make decisions: whom to hire, what to produce, how much to produce, how much to charge for products.

2. **Competition**

- Producers have the right to engage in rivalries to gain business – incentive to create new and better products.
- Gives consumers more economic choices.

3. **Private Property**

- Individuals and businesses have the right to buy and sell as much property as they want.
- Property owners may prohibit others from using their property.

4. **Contracts**

- Individuals and businesses have the right to make agreements to buy and sell goods – legally binding – may be written or oral.

5. **Self-interest**

- Consumers and producers may make decisions on the basis of their own benefit.

6. **Voluntary Exchange**

- Producers and consumers may freely buy and sell goods.
- Both parties expect to gain from their transaction.

7. **Profit Motive**

- American Free Enterprise is driven by the desire for **profit** – the gain that occurs during financial dealings.
- Profit is a powerful incentive – leads entrepreneurs to accept the risk of business failure

Profit Motive – the force that encourages people and organizations to improve their material well-being.

- Business owners and managers must exercise financial discipline – they are economically responsible for their own success or failure.
- Rewards innovation – lets creative companies grow and improves productivity

Open Opportunity – the concept that everyone can compete in the marketplace

- Economic mobility, up-or-down – no matter how much money you start out with, you can end up wealthier or poorer

Basic Principles of Free Enterprise:

- **Economic Rights**
- **Legal equality** – the concept of giving everyone the same rights – maximizes a country's use of its human capital
- **Private property rights** – the concept that people have the right and privilege to control their possessions as they wish
- **Free contract** – the concept that people may decide what agreements they want to enter into
- **Voluntary exchange** – the concept that people may decide what and when they want to buy and sell
- **Competition** – the rivalry among sellers to attract customers while lowering costs

The Role of the Consumer:

- Free enterprise gives consumers the freedom to make their own economic choices.
- When consumers buy products, they signal to producers what to produce and how much to make.
 - We vote with our dollars!

Consumer Sovereignty

- **Interest group** – a private organization that tries to persuade public officials

The Role of the Government:

- Free Enterprise:
 - The government is expected to carry out its constitutional responsibilities to protect property rights, contracts, and other business activities.

Americans expect protection from problems – even if they are not explicitly spelled out in the Constitution.
- **Information & Free Enterprise**
 - **Public Disclosure Laws** - Laws that require companies to provide consumers with important information about their products

Examples: fuel efficiency of automobiles, side-effects of medication, etc...
- **Protecting Health, Safety, and Well-being**
 - **Public Interest** - Both state and federal governments' involvement in concerns of the public as a whole.

Examples: environmental protection, sanitary food production, etc...
- **Negative Effects of Regulation**
 - Government regulatory agencies
 - *See the chart on p. 55

Chapter 3 -Promoting Growth and Stability

OBJECTIVES

- Explain how the government tracks and seeks to influence business cycles.
 - Analyze how the government promotes economic strength.
 - Analyze the effect of technology on productivity.
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- Macroeconomics - the study of the behavior and decision making of entire economies.
 - Business cycle – a period of expansion followed by a period of contraction.
 - We are always at some point in the business cycle.
 - Cycles can last less than a year or continue for many years
 - Gross Domestic Product (GDP). GDP is the total value of all final goods and services produced in a particular economy.
 - Economists follow the country's GDP and other key statistics to predict business cycles.
 - Free enterprise systems are subject to business cycles because economic decisions about factors (prices, production, and consumption) are made by individuals and businesses acting in their own self-interest.
 - The government plays a role – tries to prevent wild swings in the business cycle.

Should GDP be a nation's only measure of success?



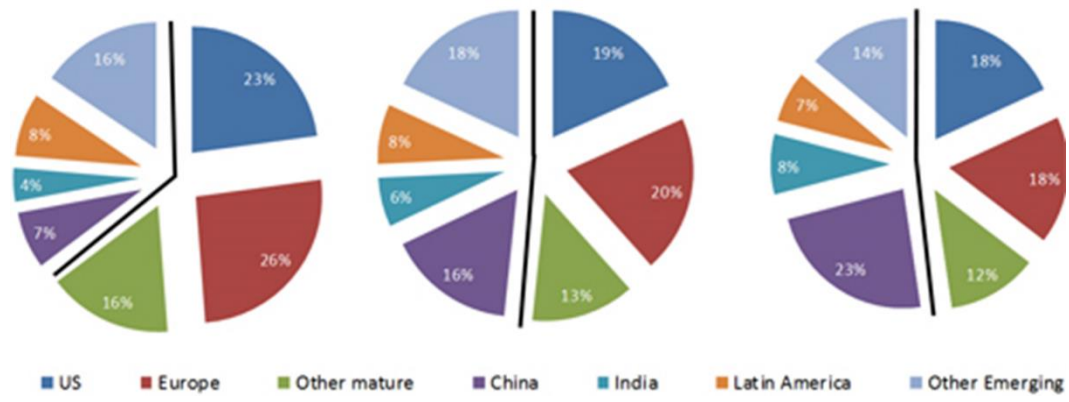
UNITED STATES GDP GROWTH RATE



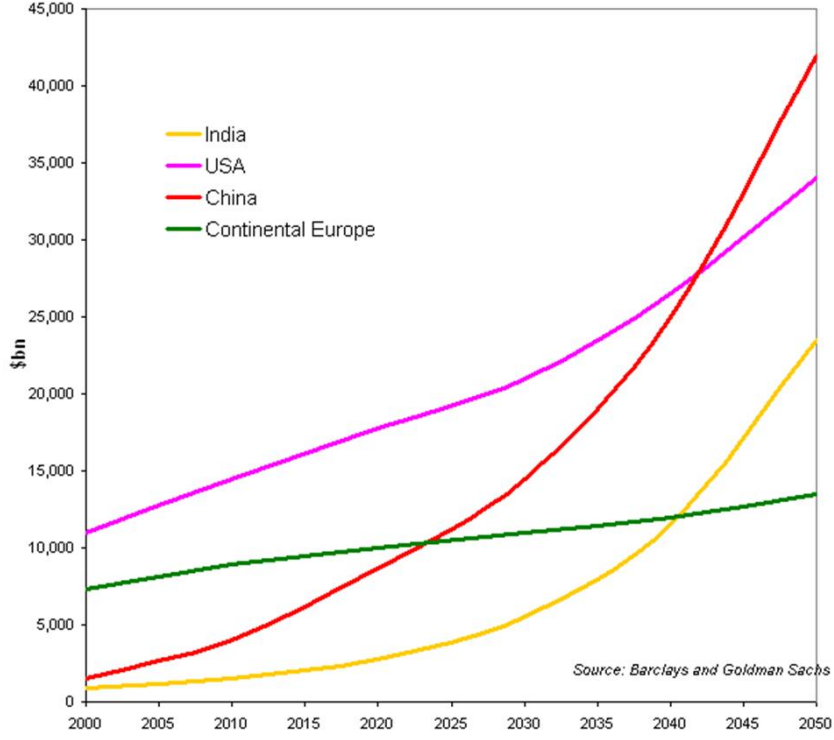
2000

2012

2025



Projected GDP



Promoting Economic Strength

- Because the market is vulnerable to business cycles, the government creates public policies that aim to stabilize the economy.
- Policymakers pursue three main outcomes as they seek to stabilize the economy:
 - High Employment
 - Steady Growth
 - Stable Prices
- Employment – To provide jobs for everyone who is able to work.
 - What is a desirable unemployment rate? Between 4%-6%.
- Growth – For each generation of Americans to do better than previous ones.
 - The “American Dream”
- Stability – Gives consumers, producers, and investors confidence in the economy.
 - Indicators of economic stability:
 - General price levels
 - Health of financial institutions (banks, etc...)

Productivity:

- One way to preserve and maintain a high GDP and standard of living is by increasing productivity.
 - When we produce more, there is a greater chance that standard of living and overall economic success increases
 - How to increase productivity?
- *Work Ethic* – a commitment to the value of work and purposeful activity.
- Improved *technology* – the process used to produce a good or service.

How does the government encourage innovation?

The government encourages the development of new technologies in several ways:

- Federal agencies fund many research and development projects.
- New technology often evolves out of government research.
- A patent gives the inventor of a new product the exclusive right to produce and sell it for 20 years.

Chapter 3 – Providing Public Goods

OBJECTIVES:

- **Identify examples of public goods.**
 - **Analyze market failures.**
 - **Evaluate how the government allocates some resources by managing externalities.**
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- A *public good* – a shared good or service for which it would be impractical:
 - (1) to make consumers pay individually
 - (2) to exclude nonpayers

- Public goods are funded by the public sector, the part of the economy that involves transactions of the government.
 - *Why is individually paying for public goods impractical?*
 - The government collects taxes to simplify the funding of government projects in the public interest.
 - *How would you like to receive a bill for your share of a space launch?*
 - *Why is it impractical to exclude nonpayers?*
 - We live in a society that believes certain facilities or services should be available to everyone.
 - *Excluding nonpayers from highways would be a nightmare!*

Scenario 1: What if the government decided to leave the business of road-building up to private citizens?

Scenario 2: What if parks were owned and maintained by private citizens?

- *What problems could arise from these scenarios?*
- Characteristics of public goods:
 - Any number of consumers can use them without reducing the benefits to any single consumer.
 - Increasing the number of consumers does not increase the cost of providing the public good (for the most part).
- Cost/Benefit of public goods:
 - When a good or service is public:
 1. The benefit to each individual is less than the cost that each would have to pay if it were provided privately.
 2. The total benefits to society are greater than the total cost.
- Public Goods - study Figure 3.5 on pg. 64:

Does the dam-building project meet the criteria for a public good?
- Public goods are financed by the *public sector* – a part of the economy that involves the transactions of the government.
 - *Private sector* – the part of the economy that involves the transactions of individuals and businesses.
- *Free rider* – someone who would not choose to pay for a certain good or service, but who would get the benefits of it anyway if it is provided as a public good.
 - Free riders consume what they do not pay for.
 - If the government stopped collecting taxes and relied on voluntary contributions, many public services would have to be eliminated.
 - Examples: local fire department, state highways, military helmets, etc...
- *Market Failures* – situation in which the market, on its own, does not distribute resources efficiently.
- How should a successful free market operate?
 - Choices made by individuals determine what goods get made, how they get made, and who consumes the goods.

- Profit incentives attract producers who can provide goods and services that consumers need at a price they can afford.

Would the free market ensure that roads are built everywhere they are needed?

- It's doubtful. Neither could individuals afford to pay for a freeway.
- Simply put: A market failure fails to meet our needs or wants.

- *Externalities* – economic side effects of a good or service that generates benefits or costs to someone other than the person deciding how much to produce or consume.
 - *Positive Externalities* – cause part of the benefit of a good to be gained by someone who did not purchase it.

- *Which sector creates more positive externalities? Public or private?*

- Examples:

Dynamo computers hiring and training employees

Neighbor cleans up an eyesore home on your block

- *Negative Externalities* – cause part of the cost of producing a good or service to be paid for by someone other than the producer.

- Examples:

Pollution from a mill

When externalities are present we have a market failure!

- *Understanding externalities helps us see how the government functions in the American economy.*

1. The government encourages the creation of positive externalities.
 - Examples: Education – benefits students and society as a whole. Educated workers are more productive. How does the government encourage more of this positive externality?
2. The government aims to limit negative externalities.
 - Examples: Pollution from coal plants or auto emissions can create acid rain in the atmosphere. This damages the health of the environment, wildlife, and citizens. How does the government respond to this negative externality?

Chapter 3 – Providing a Safety Net

OBJECTIVES

- Summarize the U.S. political debate on ways to fight poverty.
- Describe the main programs through which the government redistributes income.

Why Study Poverty?

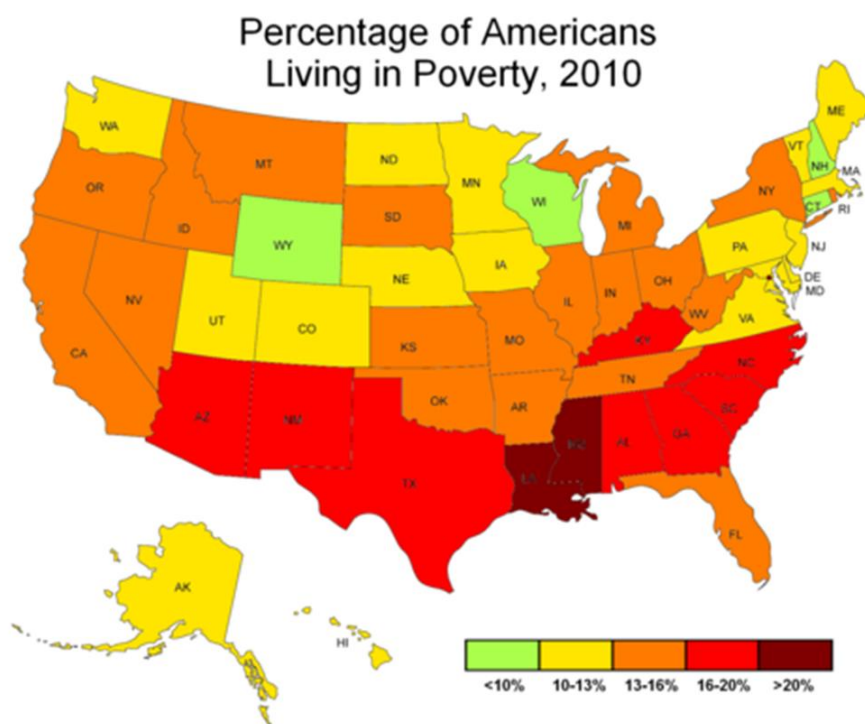
Is poverty the real problem and we treat only the symptoms?

Where and when would you rather be poor?

Is Poverty Learned?

Who Needs a Safety Net?

- The Main Idea:
Sometimes the United States has to step in to create programs to aid poor, disabled, and elderly people.
- Poverty affects not only the poor but society in general.
- Poverty can strike anyone – the young, the old, the disabled.
- Because poverty affects the marketplace, the government recognizes the need to attack poverty and raise the standard of living throughout society.



poverty in America

The Census Bureau uses a set of money income thresholds that vary by family size and composition to determine who is in poverty. If a family's total income is less than the family's threshold, then that family and every individual in it is considered in poverty.

The poverty rate for children is higher than for any other age group. 19% of all children in this country are living in poverty.

Over 35 million Americans experience food insecurity each year, which means they do not have enough food due to lack of financial resources.

In 2007, the poverty rate was 24.5% for blacks, 21.5% for Hispanics, 10.2% for Asians, and 8.2% for whites.

NUMBER OF PEOPLE IN POVERTY BY STATE 2007 - 2008 AVERAGE

CA	4,966,000
TX	3,869,000
NY	2,746,000
FL	2,310,000
OH	1,502,000
IL	1,413,000
GA	1,386,000
NC	1,354,000
PA	1,304,000
MI	1,174,000

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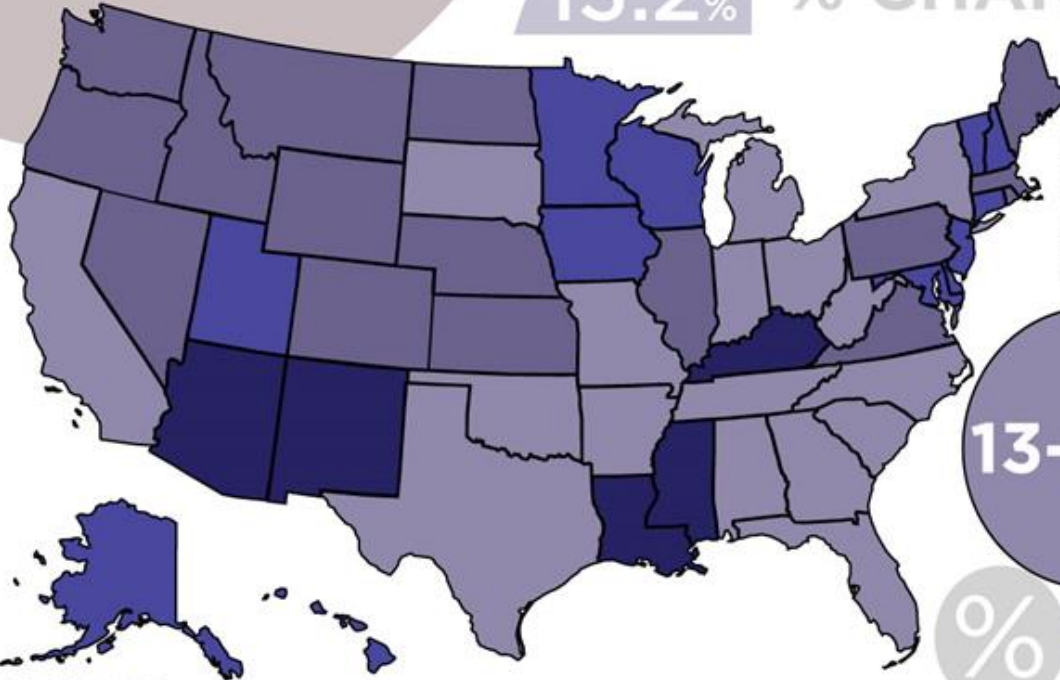
SOURCE: soundoffforpoverty.org

2008
Total %
of poverty
in America
13.2%

AZ: 1.8
IN: 1.8
GA: 1.5
SC: 1.4
ID: 1.3
SD: 1.2
WA: 1.2
NM: 1.2
CA: 1.2
RI: 1.1

AK: -0.04
OK: -0.08
D.C.: -0.09
TX: -0.3
WV: -0.4
OR: -0.6
IA: -0.04
UT: -0.8
AR: -1.2
MS: -1.3

% CHANGE OF POVERTY RATES



BREAKDOWN
percentage of people
living at or below the
poverty line in each
State.



SOURCE: US Census Bureau

- *Poverty threshold*...an income level below that which is needed to support families or households.

2014 Federal Poverty Level

	100%	133%	150%	200%	250%	300%	400%
1	\$11,670	\$15,521	\$17,505	\$23,340	\$29,175	\$35,010	\$46,680
2	\$15,730	\$20,921	\$23,595	\$31,460	\$39,325	\$47,190	\$62,920
3	\$19,790	\$26,321	\$29,685	\$39,580	\$49,475	\$59,370	\$79,160
4	\$23,850	\$31,721	\$35,775	\$47,700	\$59,625	\$71,550	\$95,400
5	\$27,910	\$37,120	\$41,865	\$55,820	\$69,775	\$83,730	\$111,640
6	\$31,970	\$42,520	\$47,955	\$63,940	\$79,925	\$95,910	\$127,880
7	\$36,030	\$47,920	\$54,045	\$72,060	\$90,075	\$108,090	\$144,120
8	\$40,090	\$53,320	\$60,135	\$80,180	\$100,225	\$120,270	\$160,360

Source: Health and Human Services | Calculations by Health Partners America

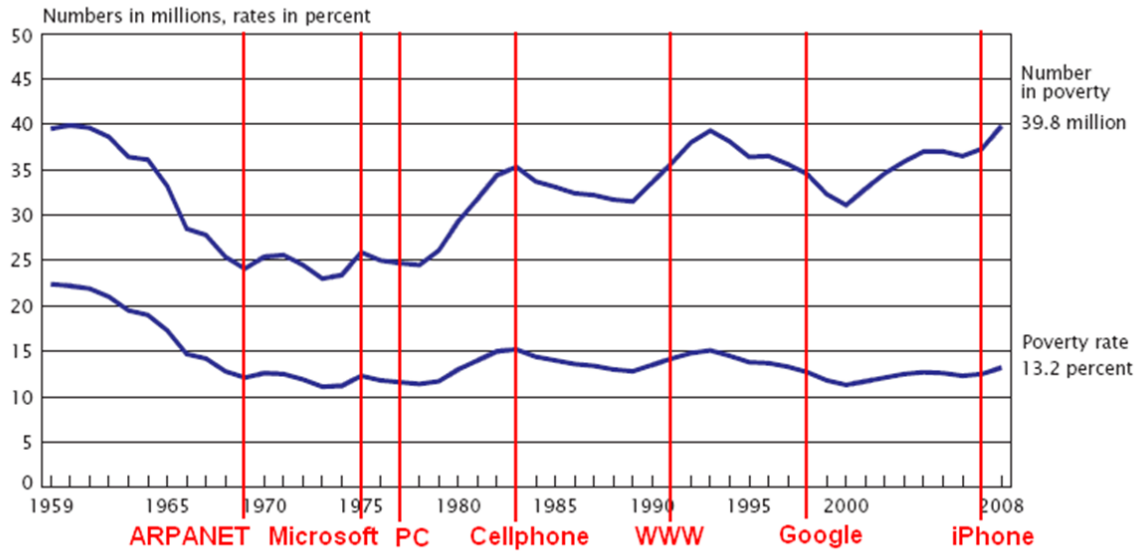
- *Poverty threshold*...an income level below that which is needed to support families or households.
 - 2015 poverty threshold (Dept of Health & Human Services):
 For a family of 3 - \$20,090
 For a family of 4 - \$24,250
- The poverty threshold is determined by the federal government and is adjusted periodically.
- *Welfare* is a general term that refers to government aid to the poor.

Federal poverty guidelines, 2008¹

Persons in family or household	48 contiguous states and D.C.	Alaska	Hawaii
1	\$10,400	\$13,000	\$11,960
2	\$14,000	\$17,500	\$16,100
3	\$17,600	\$22,000	\$20,240
4	\$21,200	\$26,500	\$24,380
5	\$24,800	\$31,000	\$28,520
6	\$28,400	\$35,500	\$32,660
7	\$32,000	\$40,000	\$36,800
8	\$35,600	\$44,500	\$40,940
For each additional person add:	\$3,600	\$4,500	\$4,140

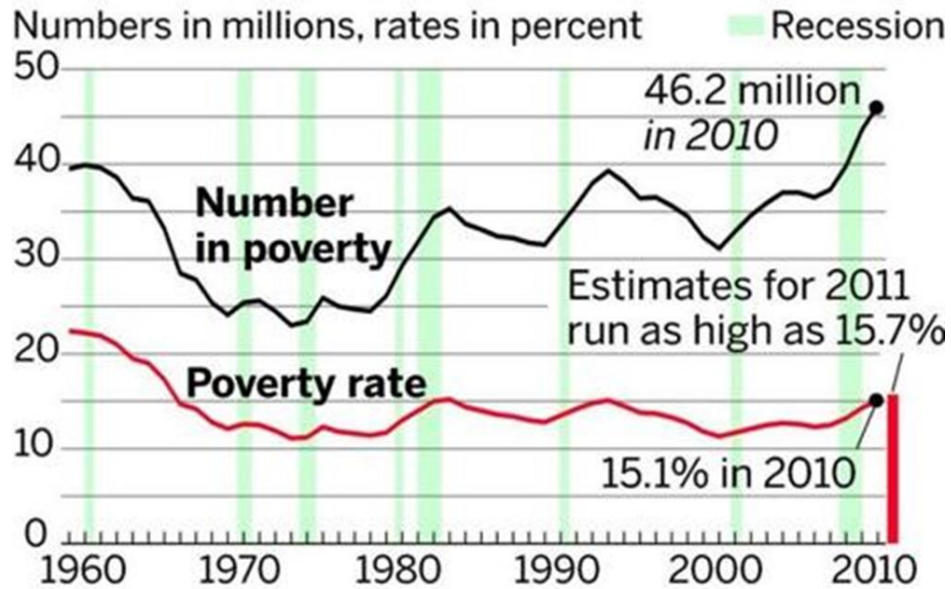
© National Center for Children in Poverty (www.nccp.org)
 Measuring Poverty in the United States

Number in Poverty and Poverty Rate: 1959 to 2008



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Federal poverty statistics



SOURCE: US Census Bureau, Current Population Survey

GLOBE STAFF

Redistribution Programs:

Cash transfers are direct payments of money to eligible people.

Temporary Assistance for Needy Families (TANF):

individual states allowed to decide how to best use federally provided funds. (No more than 5 years) (\$9 Billion in 2009)

Social Security:

Social Security provides direct cash transfers of retirement income to the nation's elderly and living expenses to the disabled.

Stability Unemployment compensation:

provides money to eligible workers who have lost their jobs.

Workers' Compensation:

provides a cash transfer of state funds to employees injured while on the job.

Other Redistribution Programs:

Besides cash transfers, other redistribution programs include:

In-kind benefits

- In-kind benefits are goods and services provided by the government for free or at greatly reduced prices.

Medical benefits

- (Medicare) Health insurance for the elderly
- (Medicaid) Health insurance for the poor

Education benefits

- Federal, state, and local governments all provide educational opportunities for the poor.