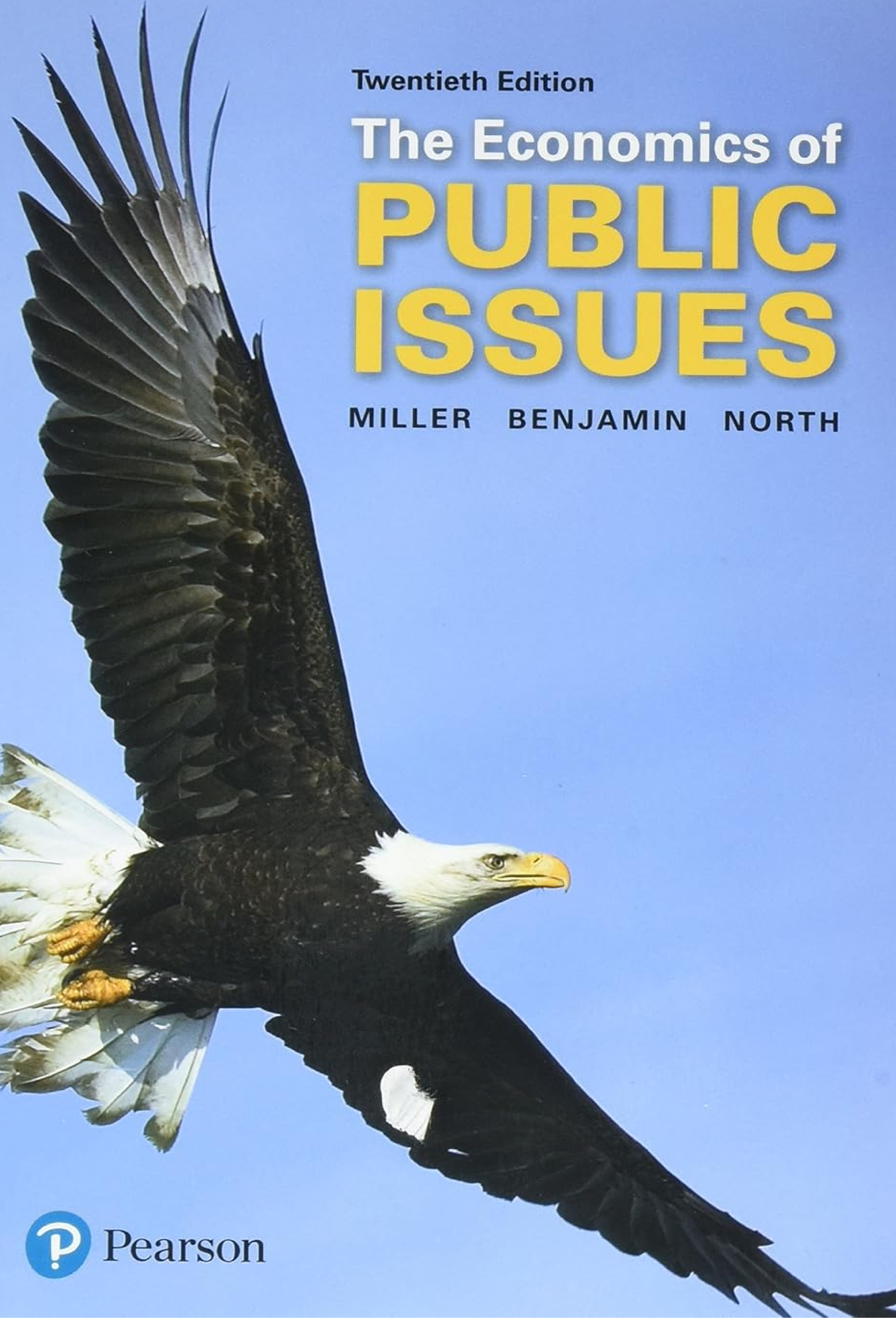
Twentieth Edition

The Economics of PUBLIC ISSUES

MILLER BENJAMIN NORTH



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The Economics of
Public Issues

TWENTIETH EDITION

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To

Max and Sara,

Strong climbers make strong leaders.

Continue on!

R.L.M.

To

Gini Ozenne,

With admiration for your extraordinary courage,

and gratitude for your kindness and steadfast friendship.

D.K.B.

Contents

Suggestions for Use

At the request of our readers, we include the following table to help you incorporate the chapters of this book into your syllabus. Depending on the breadth of your course, you may also want to consult the companion paperback, *The Economics of Macro Issues,* 8th edition, which features macroeconomic topics and a similar table in its preface.

Economics Topics	*Recommended Chapters in* The Economics of Public Issues, *20th Edition*
Introduction to Economics	1, 6, 7, 9, 10, 12, 13, 27, 28
Opportunity Costs and Scarcity	1, 3, 5, 7, 10, 19, 20, 23
Demand and Supply	6, 7, 8, 15
Demand and Supply Applications	1, 8, 9, 10, 12, 13, 16, 17, 18, 20, 22
The Public Sector and Public Choice	1, 2, 4, 6, 9, 10, 11, 12, 14, 17,18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 31
Taxes, Transfers, and Public Spending	11, 12, 14, 19, 20, 21, 22, 23, 27
Consumer Behavior	3, 5, 10, 17, 19, 20, 21
Elasticity of Demand and Supply	6, 7, 8, 9, 10, 11, 18, 19, 20, 22, 27, 28, 30, 31
Rents, Profits, and the Financial Environment of Business	2, 4, 11, 16, 18, 27, 31
Firm Production and Cost	1, 2, 3, 12, 13, 15, 20, 27
Perfect Competition	23
Monopoly	15, 16, 17
Monopolistic Competition	3, 15, 18
Oligopoly	3, 15, 16
Regulation and Antitrust	1, 3, 13, 15, 18, 21
Unions and the Labor Market	11, 12, 13, 14, 15, 31
Income, Poverty, and Health Care	2, 4
Environmental Economics	8, 9, 20, 21, 25, 26, 27, 28
International Trade	30, 31
International Finance	29, 30

Preface

The times are certainly changing. It was true when Nobel Prize winner Bob Dylan said so almost fifty years ago and it's true today. But changes in who occupies the White House and which party has the majority in Congress do not alter the way economists think about the world around them. You will discover in this short, but jam-packed volume that economic analysis applies to the public issues, the policies, and the politics of all times and in all places.

Take, for example, our analysis of the Affordable Care Act (ACA), passed in 2010. This act, otherwise known as Obamacare, upended our healthcare industry. Right after the ACA was enacted, we laid out in an earlier edition of this book the features of the law that would lead to its failure. Then and now we have analyzed its impact using simple, straightforward economic analysis. We show how people, whether they are healthcare consumers or providers or government officials, have reacted to the alterations in the *incentives* facing them. The new President and Congress have said they will change the ACA for the better. Change they may bring, but whether this change yields improvement will hinge on whether the politicians recognize and heed the incentives people face. The beauty of economics is that it enables us to see what is and will be, regardless of what we or anyone else might wish for or want things to be.

The guiding principle that ties together the issues in this new edition is that they illustrate the power of economics in explaining what goes on around us. Along the way, we have sought to make the application of economic science to public issues entertaining.

New to This Edition

Selecting new public issues for each edition of our book presents a recurring challenge. After all, there are literally hundreds, if not thousands, of important public issues from which to choose. What we have done is to select those topics that possess a sense of immediacy. As a consequence, we believe that they will be of most interest to our readers.

- The Economics of Obesity *(the economic causes and consequences of packing on the pounds)*
- The Platform Economy *(why Super Bowl tickets can cost $25k)*
- Student Loans *(why you borrow, who will pay)*
- What to Do About the Climate? *(what does—and doesn't—make sense)*

- The Death of Recycling *(the rise and fall of our favorite environmental program)*
- Numerous chapters have undergone major updates that reflect new evidence and explain how the incentives people face have changed.

Chapters That Have Undergone Major Revisions

The following chapters have been extensively revised, either to bring in important new evidence on the issue, or to incorporate recent legal or institutional changes that have altered the incentives people face, and thus the decisions they make.

- Chapter 1: Death by Bureaucrat
- Chapter 6: Sex, Booze, and Drugs
- Chapter 8: Kidneys for Sale
- Chapter 11: *Das Kapital* in the Twenty-First Century
- Chapter 13: The Effects of the Minimum Wage
- Chapter 19: Health Insurance for All . . . Or Maybe Not
- Chapter 26: Save That Species
- Chapter 30: Globalization and the Wealth of America

And of course, all remaining chapters have been updated so that your students will see the most current evidence on each topic in this book.

End-of-Chapter Questions

We continue to provide a significant set of end-of-chapter questions because instructors have told us they use them extensively. The range of difficulty remains wide, but we always include questions about the basics of the material covered in each chapter.

Selected Readings

As with previous editions, we have included a list of selected readings for each chapter at the back of the book. These selected readings include those that we found useful in our research as well as others.

Glossary

There is a glossary at the back of the book, as usual. Within each chapter, terms included in the glossary are boldfaced the first time that they are used.

INSTRUCTOR'S MANUAL

An Instructor's Manual accompanies this 20th edition. It is available online to all adopters of the book from the Instructor's Resource Center (**www.pearsonhighered.com**). We have attempted to incorporate the very best of the teaching aids that we use when we teach from *The Economics of Public Issues*.

For each chapter, this manual contains:

- A synopsis that cuts to the core of the economics issues presented in the chapter.
- A concise exposition of the "behind the scenes" economic foundations of the text. Often this exposition is supplemented with one or more diagrams.
- Answers to all of the end-of-chapter discussion questions. Most suggest new avenues of discussion.

SPECIAL THANKS AND ACKNOWLEDGMENTS

First, we would like to thank the reviewers from the last edition whose comments were helpful in preparing this edition. In addition to Cyril Morong, who is a steady source of suggestions and improvements, they are: Ninos Malek, San Jose State University and Tina Esparza, Hartnell College. Of course many other users of the last edition offered valuable suggestions and will see many of their comments included in this 20th edition.

We also thank David Alexander, Christine Donovan, and Kathy Smith for all of their efforts in shepherding this project. We thank Sue Jasin for her expert manuscript preparation and Robbie Benjamin, whose editorial skills once again have improved the final product. All errors remain, of course, solely our own.

R.L.M.
D.K.B.
D.C.N.

Part One

The Foundations of Economic Analysis

Chapter 1

Death by Bureaucrat

How would you rather die? From a lethal reaction to a drug prescribed by your doctor? Or because your doctor failed to prescribe a drug that could have saved your life? If this choice sounds like one you would rather not make, consider this: Employees of the U.S. Food and Drug Administration (FDA) make that decision on behalf of millions of Americans many times each year. More precisely, FDA bureaucrats decide whether or not new medicines (prescription drugs) should be allowed to go on sale in the United States. If the FDA rules against a drug, physicians in America may not legally prescribe it, even if the drug is saving thousands of lives each year in other countries.

A Brief History of the FDA

The FDA's authority to make such decisions dates back to the passage of the Food and Drug Safety Act of 1906. This law required that medicines be correctly labeled as to their contents and that they not contain any substances harmful to consumers' health. Due to this legislation, Dr. Hostatter's Stomach Bitters and Kickapoo Indian Sagwa—along with numerous rum-laden concoctions, cocaine-based potions, and supposed anticancer remedies—disappeared from druggists' shelves. In 1938, the law was expanded with the passage of the Food, Drug, and Cosmetic Act, which forced manufacturers to demonstrate the safety of new drugs before being allowed to offer them for sale. (This law was prompted by the deaths of 107 people who had taken Elixir Sulfanilamide, an antibiotic that had been errantly mixed with poisonous diethylene glycol, a chemical cousin of antifreeze.)

The next step in U.S. drug regulation came after a spate of severe birth defects among infants whose mothers during pregnancy had taken a sleep aid known as thalidomide. By the time these birth defects first became apparent, the drug was already widely used in Europe and Canada, and the FDA was nearing approval for its use in the United States. In fact, about 2.5 million thalidomide tablets were already in the hands of U.S. physicians as samples, though none had been distributed. The FDA ordered the samples destroyed and prohibited the drug's sale in the United States. This incident led to the 1962 Kefauver–Harris Amendments to the 1938 Act, radically altering the drug-approval process in the United States.

THE IMPACT OF THE 1962 AMENDMENTS

Before the 1962 amendments, the FDA was expected to approve a new drug application within 180 days, unless the application failed to show that the drug was safe. The 1962 amendments added a "proof of efficacy" requirement and also removed the time constraint on the FDA. The FDA was given free rein to determine how much and what type of evidence it would demand before approving a drug for sale, and thus could take as long as it wanted before either granting or refusing approval.

The 1962 amendments drastically increased the costs of introducing a new drug and markedly slowed the approval process. Before 1962, for example, the average time between the filing and approval of a new drug application was seven months. By 1967, it was thirty months, and by the late 1970s, it had risen to eight to ten years. The protracted approval process involved costly testing by the drug companies—now more than $2.5 billion for each new drug—and delayed the receipt of any potential revenue from new drugs. Because the delays and the higher costs reduced the expected profitability of new drugs, fewer of them were brought onto the market.

Debate continues over how much FDA regulation is needed to ensure that drugs are both safe and efficacious, but there is little doubt that the 1962 amendments resulted in a U.S. "drug lag." In short order, drugs took far longer to reach the market in the United States than they did in Europe, a lag that grew and then persisted for more than three decades. Admittedly, it takes time to ensure that patients benefit from, rather than are harmed by, new drugs, but regulation-induced drug lag can itself be life threatening. Dr. George Hitchings, a winner of the Nobel Prize in Medicine, estimated that the five-year lag in introducing Septra (an antibiotic) to the United States killed 80,000 people. Similarly, the introduction of a class of drugs called beta blockers—a drug used to treat