

ECONOMICS U\$A
21st Century Edition

PROGRAM #1

MARKETS: DO THEY SERVE OUR NEEDS?

AIRSCRIPT

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Final Transcript

Annenberg Learner (Logo and Music)

NARRATOR: FUNDING FOR THIS PROGRAM IS PROVIDED BY ANNENBERG LEARNER

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DAVID SCHOUMACHER: World War II was over. The GI's were home, raising the roof and hoping to raise a family. But how could they realize the American dream...a home of their own? When foreign steelmakers were pricing America's largest steel mills out of the market, how could a minimill hope to compete? Baseball...for millions a pastime, for a few, a paycheck. Why was the paycheck for a rookie pitcher, fifteen million dollars?

DAVID SHOUMACHER: A visit to a farmers market like this reminds us that in some places time seems to stand still. Unfortunately I can't say that about myself. When we began this series in the early 1980's economists mostly thought they had the know how and the tools to manage the economy. By 2010, they were having second thoughts. So we begin this series again with Markets: Do They Serve Our Needs? With the help of economic analysts Richard Gill and Nariman Behravesh we'll examine that question on this 21st Century Edition of Economics U\$A. I'm David Schoumacher.

(MUSIC PLAYS – SERIES OPENING TITLES)

(MARKETS: DO THEY SERVE OUR NEEDS? appears on screen.)

PART I

DAVID SCHOUMACHER: The American economy, the sum total of what goes on in shopping malls, car dealers, supermarkets, stock exchanges, 7-Elevens, and gas stations all around the country. Millions of buy and sell decisions every day...trillions of dollars worth every year...and those decisions affect every part of our lives from the cars we drive to the homes we live in. But how are those decisions made? Who decides between a room with a view and a house in the suburbs? In our demand and supply economy, who demands and who supplies?

1945. World War II was over. Millions of ex-GI's came home, fell in love, got married, and started families. And there was one thing they all needed...

VETERAN: "Well, of course when I got out of the service I had a young wife and primarily we wanted a place to live. It was like looking for a needle in a haystack...and eventually we found a place...a converted house where the upstairs was converted into an apartment."

DAVID SCHOUMACHER: In 1947, Judge Paul Widlitz was an ex-GI and a young Long Island lawyer just starting out.

JUDGE PAUL WIDLITZ: "We had the normal problems that you would have when they convert a one family house to a two family house and put steps going upstairs...where every time you walk it's heard down below or every time somebody cries upstairs...the baby...when it's heard down below."

DAVID SCHOUMACHER: Newman Baum and Jerry Worthing were also in the flood of ex-GI's with young families, combing New York for a place to live.

NEWMAN BAUM: "I left the service in November, 1945, and one of the first things I had to do was to renew my love life and get married to Helga...but we had to have a

place to live. We lived in a furnished room in a single family house, and we had to eat every meal...all 3 meals out.”

JERRY WORTHING: “When we got married, there were very few houses around to rent. We lived in the same house with my parents...then oh, a little more than a year later, we decided, well, we ought to look around and buy a house.”

DAVID SCHOUMACHER: Families needed homes. But homes were not easily come by. Depression and war had put homebuilding on hold for almost 20 years. What housing there was was not cheap...beyond the means of most young vets with new jobs and new families. Young families were looking for low cost housing...Homebuilders needed customers. It was demand in search of supply. For most people the American dream included a house and a car. Henry Ford had made the dream come true for cars. Were there any Henry Fords in the postwar homebuilding business?

WILLIAM LEAVITT: “We believe that every family in the United States is entitled to decent shelter. We believe that private enterprise should provide that shelter...”

KENNETH JACKSON: “The Levitt Organization, I think, was the most famous...It was the prototype...He was the Henry Ford of the housing market. They recognized the housing shortage which was so acute in the late 1940s...”

DAVID SCHOUMACHER: Professor Kenneth T. Jackson of Columbia University, a specialist in the history of the suburbs...

KENNETH JACKSON: “They built upon their experience in the 1930s...They built upon the experience of a couple of Levitts in building war workers’ housing. One of them worked with the Seabees in the Pacific in World War II. All of these things were teaching them how to really mass produce and build quickly.”

WILLIAM LEVITT: “I remember distinctly saying to a lot of fellow officers there...’When this war is over, you beg, borrow or steal whatever you can and build housing because there’s going to be a huge backlog...and it turned out. It was simple economics, that’s all. People have to have roofs over their heads and there weren’t any roofs being built.”

DAVID SCHOUMACHER: Backed by the promise of VA and FHA mortgages, Levitt put his money where his judgment was. He laid out 6,000 lots on low cost, Long Island potato fields and poured 6,000 concrete slabs. Specialized construction teams hit Levittown streets like commandos.

WILLIAM LEVITT: “Instead of having a carpenter do all the carpentry...we specialized. He did only framing...Another carpenter only did roof rafters...we began delivering 150 houses every five days...approximately 18 before noontime and another 18 or 17 after noon.”

DAVID SCHOUMACHER: But as with the Model T, assembly line methods could mean assembly line sameness. In a nation dedicated to individualism, would mass production houses have mass appeal? The houses were built. The ads were placed. The case went to the jury. The verdict was not slow in coming in.

JUDGE PAUL WIDLITZ: “Housing...they needed a place to live. They were coming from all over the country...Coming out of New York and Brooklyn. All over the place they were coming out. Long Islanders were in the minority because they couldn’t get there fast enough.”

DAVID SCHOUMACHER: Newman Baum’s home movies captured the time for people like the Baums, the Worthings and the Widlitzs. New families in a new community.

WILLIAM LEVITT: “Regardless of what the place looked like, it filled a need for these young people that needed housing, needed roofs over their heads...”

KENNETH JACKSON: “For those people who moved to Levittown, and those people who moved to Levittown type developments in every major city in the country...it paid off financially. But the psychological payoff was perhaps even more important. It gave these families a stake in their community, a stake in their country. It gave them an anchor in kind of a restless and rootless world...a little piece of the universe that they could call their own.”

DAVID SCHOUMACHER: Scientists say that nature abhors a vacuum...Well, so does the marketplace. It was the unprecedented demand by World War II veterans for affordable housing that drew William Levitt and thousands of other builders into the low cost housing market and built the foundation for postwar prosperity. We asked Richard Gill for an economic analysis of the forces that drew William Levitt and the World War II vets together.

(MUSIC IN – COMMENT & ANALYSIS I)

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RICHARD GILL: There was a large potential demand for housing in the postwar period and William J. Levitt supplied that demand. Simple question: How does the market system work? Simple answer: Through the great laws of supply and demand. If you go to a professional economist and ask how markets work, you are likely to get a somewhat more complicated response. Even worse, he’s likely to draw you a graph. Not just a graph, but the graph...the most famous in our subject. The graph of supply and demand. And there it is. A fairly harmless looking contraption actually, though in fact it took economists quite a long time in the 18th and 19th centuries to come up with this particular diagram. So how would such a diagram help us with the Levittown story? First, what does the graph mean? We measure the quantity of product along the horizontal axis...in this case, number of houses. Along the vertical axis, we measure the price of that

product...the price of an average single family home. Our demand curve is here, our supply curve is here. What the law of supply and demand tells us is that the price of the product will be determined where these two curves intersect. At a price of \$9,000 per home, the quantity of homes supplied and demanded in our diagram will be equal. Let us now show how the use of one of these curves clarifies the Levittown story. We have said that there was a great demand for housing in the postwar period as the veterans returned. But that way of speaking is too imprecise. What we really mean to say is that there was a great demand for inexpensive housing. The effective demand for housing in the marketplace depends on the price of housing. And this is exactly what our diagram tells us in the simplest possible way. The DD curve slopes downward to the southeast. At a high price here very few houses are demanded. It is only down here...at a low price...that the effective demand for houses is high. In a market economy, demand...and supply too...depend on price. These curves are nothing but the simplest possible expression of that important principle.

PART II

DAVID SCHOUMACHER: Steel is synonymous with strength. A thousand blast furnaces across America forged ribbons of steel into victory in war. For 75 years, U.S. steel producers had the steel market to themselves. They ran the big so called “integrated mills.” They made their own steel from iron ore and processed it into a full range of products. They set their own prices and their own rules. In the 60s and 70s, as labor and energy costs rose, steel prices rose even more...until foreign steel began to underbid American steel on American buildings and bridges. In the U.S., plants closed...Workers were laid off.

STEEL WORKER: “Five thousand men laid off. I don’t see how we’d be able to get any more employment, in this area anyhow. I’ll probably have to leave.”

DAVID SCHOUMACHER: The market’s verdict on $\frac{3}{4}$ of a century of industrial complacency. What could be done to rebuild the faltering steel industry? With

America's biggest steel companies taking it on the chin, how could a small steel company compete? NUCOR was one of the Americans' steel users which had turned away from high priced American steel to foreign producers. But Kenneth Iverson, President of NUCOR, wondered if low cost steel couldn't be made in America.

KENNETH IVERSON: "We went to Europe and we spent about three weeks roaming through a number of countries and steel mills to find out the way they produced steel and to determine...If we used those methods in the United States, could we manufacture steel as cheaply as we could buy it from overseas? We decided we could...We made a deal to buy this technology...And that's the way we started in our first steel mill."

DAVID SCHOUMACHER: Iverson rebuilt NUCOR as a steel minimill, using Europe's latest technology.

KENNETH IVERSON: "A minimill is defined as...First of all we're starting from scrap...We don't start from ore. Secondly, we melt it in electric furnaces and then we continuously cast it to come out with a billet that then, eventually is rolled into the rounds, the channels, the flats, the smooth bars that we supply to customers. It's really much more economical than ingot casting."

DAVID SCHOUMACHER: Technology had helped NUCOR lower costs. But what about the cost of labor? The lower prices of foreign steel makers were based on lower wages. Could NUCOR make low price steel with highly skilled and highly paid American workers?

KENNETH IVERSON: "It's not what you pay an employee that's important...It's what he produces. And if he produces a great deal, you can afford to pay him a great deal...If he produces nothing, you can't afford to pay him a dime. The average hourly worker in Darlington, South Carolina, in our steel mill there, had earnings last year of more than \$30,000 a year...and we had melters who earned more than \$35,000...which compares reasonably with what unionized workers in the integrated mills earned last year. Now if

you look at what we produced though, we produced last year some 850 tons per employee, where the average for the integrated producers was something like 350 tons per employee.”

DAVID SCHOUMACHER: NUCOR wasn't the only steel company using minimill techniques to turn red ink into black. Dr. Robert Crandell, an economist with the Brookings Institution...a Washington D.C. think tank...

ROBERT CRANDELL: “In the case of the steel industry, a small scale minimill industry is growing up to replace the much less efficient integrated firms. We are likely to have...10, 15, 20 years from now...50, 75, firms, each producing two million tons of steel a year rather than these giant companies which may produce as much as 20 or 25 million tons a year. These smaller firms are more efficient. They'll produce steel more efficiently than the large companies and as a result ought to provide us with a healthier steel industry.”

DAVID SCHOUMACHER: The high technology used in the minimill revolution couldn't save the whole steel industry. Steel for Ibeams and auto bodies still must be made in the larger integrated mills...But there was a lesson the big steel companies could learn from the minimills.

KENNETH IVERSON: “If we modernize our steel mills, then we can have a steel mill that can compete with any steel company in the world. We'll have a somewhat smaller, but much more efficient, much more productive steel industry than we've had in the last 15 or 20 years. People in the steel industry...executives...say. ‘We can't compete.’ And I don't care what reason they give...lower labor costs, government subsidies, more high, better technology, more efficient. That's not important. We can compete. We have all the elements here in this country to compete with foreign countries. We just have to realize that we can and dedicate ourselves to doing it.”

DAVID SCHOUMACHER: For years the American steel industry assumed it was strong enough to sail through the market storm warnings, and it almost foundered. But NUCOR and other minimills paid attention to the signs and used new technology and creative management to follow the market's beacon to the high seas of higher profits. What kept NUCOR on the right course when its competitors lost the way? We asked economic analyst Richard Gill.

(MUSIC PLAYS – COMMENT & ANALYSIS II)

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RICHARD GILL: One of the most interesting things about markets is that they can produce the unexpected. They can stimulate innovations...new products or new ways of producing products. The introduction of the minimills in the steel industry was such an unexpected innovation. The supply and demand curves for our domestic steel industry in the 1970s looked something like this. Because of foreign competition, demand for domestic steel was low. We have illustrated this by placing our demand curve far to the left in the diagram. The price of steel was here, the quantity produced here, both low by historical standards. Why, we might ask, didn't the domestic steel industry simply lower its prices and sell more steel? After all, as we know from the Levittown story, the quantity of a product demanded usually increases at lower prices. The basic answer is that they couldn't expand like that because of costs. In most industries, as you expand your production, your costs tend to go up. This, in fact, is why we have drawn the supply curve for steel as we earlier did for houses, sloping upwards toward the northeast. Because of higher costs it isn't generally possible for business to supply more of a product unless they can get a higher price for it. Or unless they can lower costs. And this is where the minimills came in. The minimills lowered the costs of making steel and this produced a downward shift in the whole supply curve of domestic steel producers. Price now could be lowered and the quantity of steel produced domestically increased. Of course, minimills haven't been the complete answer to the problems of our woefully ailing steel industry. Such innovations do, however, represent an important way in which markets can respond to economic pressures.

PART III

DAVID SCHOUMACHER: Baseball...For the fans, a game...But for the players, a job. For the star, rare talents meant high pay, but for the average player or for the minor leaguer, it was a different story. Thousands of high school, college and minor league players were waiting in line to play “big league” ball. And like everywhere else, a big supply equaled low prices.

Even in the major leagues, salaries were held down by a player’s inability to take his services elsewhere. Then, in 1975, a contract dispute, an arbitrator’s ruling, and the birth of the free agent. It was a new ballgame.

Future Hall-of-Fame pitcher Jim “Catfish” Hunter, the first headline free agent, signed with the New York Yankees for \$300,000, the equivalent of \$1.3 million today. Then it was another future Hall-of-Famer, Reggie Jackson—“Mr. October, “signed for five years by the Yankees for twice as much as Hunter.

DAVID SCHOUMACHER: The Yankees won the World Series in Jackson’s first year and in three of the five years of Jackson’s ground-breaking contract. Bowie Kuhn was commissioner of baseball at the time of the Reggie Jackson signing.

BOWIE KUHN: “Reggie puts people in ballparks. He has some of the elements of a Ruth...He has a certain strut and style... makes him a great ball player... He’s Casey at the bat. If he stays healthy, and you can play him enough...a problem with a better ball player...then you can probably generate this many extra people in your ballpark.”

DAVID SCHOUMACHER: Free agency has created a market for baseball players. What is that market saying? What makes players like Hunter and Jackson and more recently, Stephen Strasburg, a rookie pitcher for the Nationals, worth so much?

DAVE SHEININ: “You pay players big bucks to win games for the purpose of making money. It is after all a business....It is a very finite number of chances a great baseball player has to affect a game, and so those players are at such a premium, their talent is at such a high level, that they are worth the type of expenditure for an owner. It’s all about selling tickets, and marketing, merchandise, concession stands. So these players, you know, make it back for the team owners.”

DAVID SCHOUMACHER: Scott Boras, one of the most successful big-money sports agents, translated it into numbers.

SCOTT BORAS: “Well in the free agent market, there are probably, of the 800 or so Major Leaguers, there are probably only 150 to 175 of them that are free agents, and of those 175 I would estimate that annually there are five or six free agents that may have extraordinary value.”

DAVID SCHOUMACHER: Hunter and Jackson were just the beginning of the bull market for baseball players

Pitcher Greg Maddux, \$28 million over five years. Barry Bonds, almost \$44 million for six years. Manny Ramirez, \$160 million over eight years. And Alex Rodriguez, A-Rod, ten years, \$275 million. All proven stars.

DAVID SCHOUMACHER: And then in 2009, a \$15 million contract to a pitcher with no major-league record at all, no professional record at all, Stephen Strasburg. What made a college player worth \$15 million? Strasburg’s agent, Scott Boras said that Strasburg was not only a rare talent. He was one of a kind.

SCOTT BORAS: “Steven Strasburg is the best collegiate player that I have seen, based upon his ability, his velocity. His command of his pitches, where he can throw it with location, his breaking ball, his curve ball, his changeup, he is able to command, throw different strikes....”

So that's what made him extraordinary on entrance.

DAVID SCHOUMACHER: And the fans agreed.

FAN 1: "Well you see he's a rare type of pitcher, with a fast ball that gets all the way up to 100, and then the movement on his curve ball, it's just a rare combination."

FAN 2: "Yeah! He puts people in the seats. People come to watch him."

FAN 3: "Because he's one of the best young pitchers out there, he's got a lot of time."

FAN 4: "And he's one of the best looking pitchers (LAUGHTER.)"

DAVID SCHOUMACHER: But would the \$15 million dollar investment pay off?

DAVE SHEININ: "Well at Strasburg's first game, it was one of the most remarkable baseball events that I have ever witnessed. The crowd would rise to their feet whenever there was two strikes, in anticipation of another strike out, and when the strike out came they would just erupt...."

CROWD CHEERING

DAVID SCHOUMACHER: And then, a severe injury to his arm took Strasburg out of the game.

DAVE SHEININ: "It really was unfortunate the way his season ended because he had a chance to do something historic in his rookie season, and I suppose now we will never know, but during the time that he was on the mound, there were very few pitchers in baseball who could do what he did."

DAVID SCHOUMACHER: The multi-million, multi-year contracts that players sign today take our breath away. Just as Reggie Jackson's did back in the 1970's. It is a lot of money for playing a game. But the calculations on both sides are strictly business. An employee offering a rare skill and a following of paying customers can demand a high salary. Just why is there such a difference between the incomes of different people? That's the question we asked economic analyst Nariman Behravesh.

(MUSIC PLAYS – COMMENT & ANALYSIS III)

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NARIMAN BEHRAVESH: Why do star major league baseball players earn so much? Well there are fewer of them around and their product is highly valued by the market.. The laws of supply and demand we've been talking about in connection with the prices of products like steel and houses can also be applied to the prices of our services...our wages and salaries. If public demand is high for certain kinds of rare skilled labor...long ball hitters, rock stars, neurosurgeons...then customers and employers will be willing to pay a lot extra. Unfortunately, the market, operating in this way does not always produce a result we find personally agreeable. Should a seven foot basketball player earn four or five times as much as the President of the United States? Markets are potent but not always ideal.

DAVID SCHOUMACHER: We speak of the market's decisions, but no market really makes any decisions. We...consumers, merchants, employers, employees, manufacturers, we all make the decisions in response to the forces of supply and demand. The market takes our decisions, pulls them together and renders the ultimate judgment on economic success or failure...profit or loss. For this 21st Century Edition of Economics U\$A, I'm David Schoumacher.

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