

PAGE ONE ECONOMICS NEWSLETTER

the back story on front page economics

“The Legacy of the Olympics: Economic Burden or Boon?”

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Classroom Edition

An informative and accessible economic essay with a classroom application.

*Includes the full version of the Page One Economics Newsletter,
plus questions for students and an answer key for classroom use.*

Common Core Standards (see page 8)



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The Legacy of the Olympics: Economic Burden or Boon?

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“The true legacy of London 2012 lies in the future...I am acutely aware that the drive to embed and secure the benefits of London 2012 is still to come. That is our biggest challenge. It’s also our greatest opportunity.”

—David Cameron, Prime Minister of the United Kingdom

The Olympic Games are considered the foremost athletic competition in the world. The modern games have reached a scale that their ancient Greek founders could scarcely dream of. More than 10,000 athletes and 5,000 coaches and team officials, collectively representing nearly every country in the world, will convene in London for the 2012 Summer Games. Hosting over half a million spectators each day for 16 straight days requires nearly a decade of preparation and an extensive investment by the host nation and city. Despite these demanding obligations of time and money, no fewer than 7 cities have bid to host each of the past 4 Summer Olympics; in fact, the 2008 games had 11 bidding cities. Clearly, there are economic benefits associated with the games that these accommodating hosts deem more valuable than the expected costs.¹

When considering the *economic* costs and benefits of hosting the Olympics it is important to differentiate between *explicit* and *implicit* costs and benefits. Examples of explicit costs include direct spending on the construction of the Olympic facilities. Implicit costs stem from the *opportunity cost* of the explicit costs; the opportunity cost of the funds spent to host the Olympics is the benefit the host city and country would have received from the best alternative use of the funds. Explicit benefits are the direct revenue gained from ticket sales, advertising rights, tourism, as well as new jobs in the local economy (see chart on p. 3). Implicit benefits are less tangible and include increased civic pride in the host city and higher international esteem.

Costs associated with hosting the Olympics begin with the bidding process. Interested cities spend up to \$100 million to “woo” the delegates of the International Olympic Committee (IOC) to vote for their city. During the bidding process, cities estimate their perceived economic costs to host the games. These estimates are often understated because of the competitive nature of the bidding process.²

Once the winner of the bidding process has been chosen, the host city has almost a decade to prepare for the Olympics. During this time the city must expend resources to construct the sports venues and the Olympic Village and to make improvements to infrastructure (roads, public transportation, and telecommunications networks). These investments require the government to increase taxes and/or divert existing resources from other projects, so there are clearly opportunity costs.

Early in the modern history of the Olympic Games, host countries routinely used public funds for the entire cost of the games. This model of funding proved unsustainable and ended

in 1976 with the Montreal Summer Games.³ Breaking from the Montreal model, the 1984 Los Angeles organizing committee sought to repurpose existing facilities and attract corporate sponsorship. This marked the beginning of the commercialization of the Olympics and shifted some of the financing burden to private sources. The 1984 Summer Games were a fiscal success; the games yielded explicit benefits of \$335 million. This renewed global interest and dramatically increased the number of bids for following games. Despite the new financing model, few of the later hosts accrued the same level of explicit benefits.⁴

The *opportunity cost* associated with the explicit costs is an important factor in the cost-benefit analysis of hosting the Olympics. For example, instead of hosting the Olympics, a nation could fund public works projects, launch new or improve existing social programs, or save the funds. The best alternative use of industrial services and land use should also be considered as an opportunity cost. The large-scale construction projects associated with hosting the games increase business activity in the local construction industry. However, these projects crowd out⁵ other construction projects that would have been undertaken if not for the increased demand in preparation for the games.⁶ Additionally, many host cities are large urban centers with scarce land to accommodate the needs of the Olympic complex. Building the facilities could put upward pressure on land values and raise the price of housing for the community.

Hosting the Olympics has several economic benefits for the host city. The host city earns the explicit benefits of revenue from ticket sales, broadcast privileges, and increased tourist spending. This source of revenue is diminished to a certain degree because almost half of this revenue is retained by the international federations, the national Olympic committees, and the IOC itself. In addition, while total tourist spending will certainly increase because of the games, some of this spending is not truly *additional* spending. For example, some travelers will choose to avoid visiting London during the 2012 Games because of the expected increased congestion in the city.

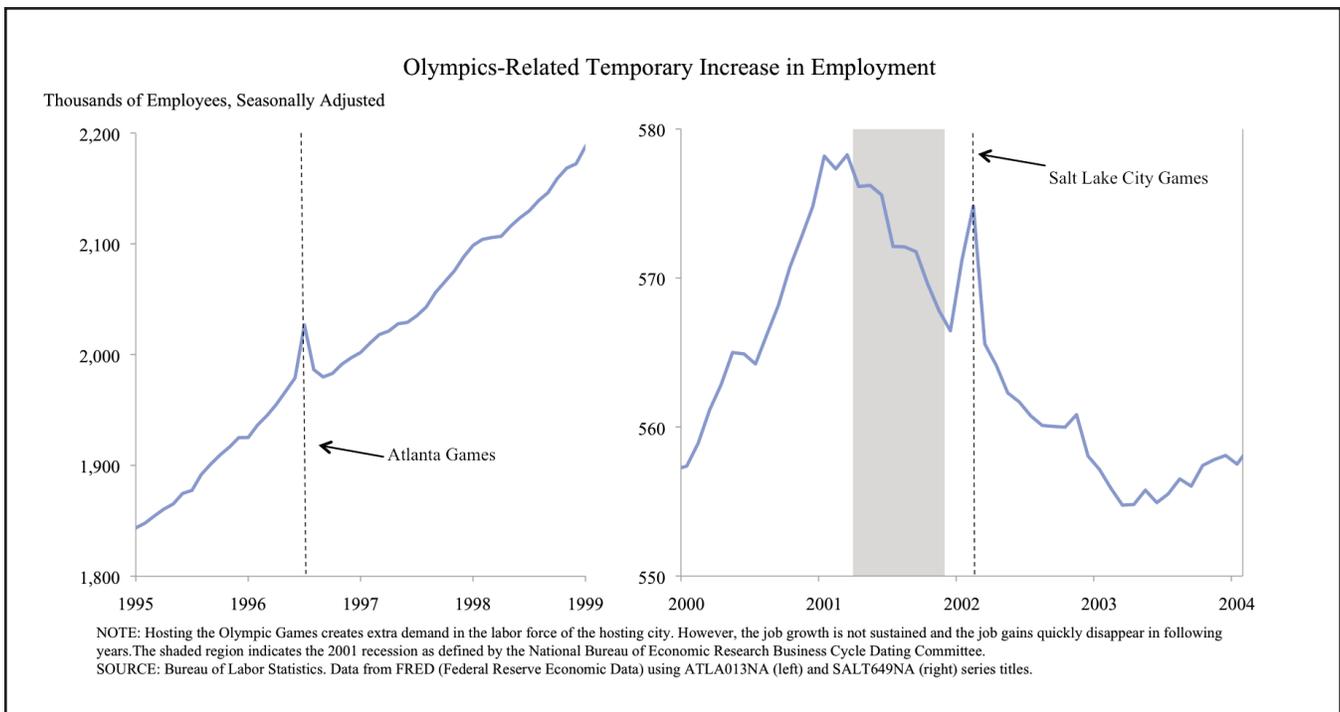
Host cities stand to gain appreciably from *legacy effects*, or economic benefits that accrue over time. The Olympics require well-developed infrastructure, which is more challenging for host cities in developing countries. These extensive infrastructure projects could take longer or possibly never come to pass without some sort of urgent impetus—in this case, the Olympic Games. For years following the games the infrastructure improvements (if used by businesses and the community) could provide productivity gains for the local economy, as well as improve the quality of life.

The construction of the sports facilities requires careful forward planning to avoid creating costly facilities that will later sit vacant or have limited use. Without establishing demand for their future use, the hefty explicit costs associated with maintaining these structures will fall to the public. For example, in Sydney, Australia, it now costs \$30 million per year to operate the 90,000-seat stadium constructed for the 2000 Summer Olympics. Athens, Greece, serves as a shocking example of failed legacy planning; the majority of facilities used in the 2004 Games are in a state of ruin.

In contrast to the post-Olympic experience in Sydney and Athens, several institutions of higher learning in Atlanta have acquired Olympic facilities, including parts of the 1996 Olympic Village now used for student dormitories, and the Olympic aquatics facility. Additionally, the main Olympic Stadium has been repurposed as a baseball park for the Atlanta Braves. The Olympic facilities can also revitalize urban blight by increasing real estate activity in their immediate area. This is precisely the intention behind the location of the Olympic complex of the 2012 Games in the run-down industrial district in East London.

Hosting the Olympics sends a signal to the world that raises the stature of both the host city and nation on the global stage. The implicit benefit of positive publicity received from the games is expected to increase tourism and attract businesses. Andrew Rose and Mark Spiegel of the Federal Reserve Bank of San Francisco suggest that hosting the Olympic Games sends a signal of trade liberalization to the world and results in greater trade activity in the long run. Within the city itself, hosting the games requires the combined efforts of countless local volunteers, which engenders a sense of civic pride among the populace. These implicit benefits are difficult to measure but are important factors in the decision to host the games.

Hosting the Olympic Games is no easy task. It requires substantial investment on the part of the host city and nation. To determine whether it is a wise investment, policymakers must carefully (and honestly) measure the economic costs that they will incur as well as the economic benefits expected. Since the host city must share revenue gained from the games, it should not expect large immediate explicit benefits. A net economic profit is contingent on whether the host city can maximize the economic benefits it receives from legacy effects through adept forward planning. In doing so, it will reap rewards long after the closing ceremony. ■



NOTES

¹ The cost-benefit analysis that follows is not exclusive to hosting the Olympic Games and is also applicable to other mega-events such as the Super Bowl or World Cup.

² Candidate cities often match the promised amenities of the other bidders while understating their costs to make their bid more attractive to IOC members. This practice can lead to the phenomenon known as the *winner's curse*, whereby the host city will make itself worse off by submitting a winning bid that exceeds the value of hosting the Olympics.

³ The original projected cost of \$124 million was \$2.68 billion short! This burden fell entirely on the taxpayers and it was not until 2005 that the sum was paid off through a tax on tobacco. After this incident, no country wanted to bid for the Summer Olympics because of the perceived risk of financial ruin. Los Angeles was the only city to bid for the 1984 Summer Games and it did so with the condition that it would not incur any financial obligation.

⁴ For example, the Spanish government was short \$6.1 billion from the 1992 Barcelona Summer Olympics, while Atlanta (1996) and Sydney (2000) reported breaking even. Beijing spent around \$42 billion for their 2008 Summer Olympics, and it is unlikely that there will be a net profit.

⁵ Crowding out occurs when increases in government spending lead to decreases in private spending.

⁶ A supply and demand chart is the best way to visualize crowding out. The Olympic construction projects will cause an outward shift of the demand curve, but the supply curve (representing the capacity of the local construction industry) will remain stationary. Thus, prices for construction services will increase and some other projects will be put on hold in response.

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GLOSSARY

Crowding out: The situation in which increases in government spending lead to reductions in private spending.

Explicit cost: A cost that involves actually laying out money.

Implicit cost: A cost that does not require an outlay of money; it is measured by the value, in dollar terms, of foregone benefits.

Legacy benefits: Benefits that accrue over time.

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Federal Reserve Bank of St. Louis *Page One Economics Newsletter*:
“The Legacy of the Olympics: Economic Burden or Boon?”

After reading the article, answer the following questions.

1. Provide examples from the essay for each of the following:

Explicit costs	
Implicit costs	
Explicit benefits	
Implicit benefits	

2. How did the funding strategy for the Olympics change in 1984? Was the new strategy a fiscal success?

3. Describe legacy effects and explain how cities that host the Olympic Games gain from them.

4. Provide examples of former host cities that have planned poorly for facilities and that have planned well.

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Teacher's Guide

Federal Reserve Bank of St. Louis *Page One Economics Newsletter*: "The Legacy of the Olympics: Economic Burden or Boon?"

After reading the article, answer the following questions.

1. Provide examples from the essay for each of the following:

Explicit costs	Direct spending on the construction of Olympic facilities: sports venues, the Olympic Village, and infrastructure improvements.
Implicit costs	This is the benefit that would have been received from the best alternative use of the funds. For example, instead of hosting the Olympics, a nation could fund public works projects, launch new or improve existing social programs, or save the funds.
Explicit benefits	Direct revenue that is gained from ticket sales, advertising rights, and tourism.
Implicit benefits	Increased civic pride in the host city and higher international esteem. Positive publicity may increase tourism, attract business, lead to greater trade activity, and engender civic pride among the populace.

2. How did the funding strategy for the Olympics change in 1984? Was the new strategy a fiscal success?

The Los Angeles organizing committee sought to repurpose existing facilities and attract corporate sponsorship, shifting some of the financial burden of hosting the Olympics to private sources. The new strategy was successful; the 1984 Los Angeles Games yielded benefits of \$335 million.

3. Describe legacy effects and explain how cities that host the Olympic Games gain from them.

Legacy effects are economic benefits that accrue over time. The extensive infrastructure improvements associated with hosting the Olympics may provide productivity gains for the local economy and improve the quality of life for years to come.

4. Provide examples of former host cities that have planned poorly for facilities and that have planned well:

- Sydney, Australia, pays \$30 million per year to operate the Olympic Stadium produced for the 2000 Summer Olympics.
- In Athens, the majority of facilities used in the 2004 Games are now in a state of ruin.
- In Atlanta, several institutions of higher learning acquired Olympic facilities; for example, part of the 1996 Olympic Village is now used as student dormitories, and the main Olympic Stadium has been repurposed as a baseball park for the Atlanta Braves.

For Further Discussion

Read the following to your students and use the activity that follows to lead a classroom discussion on opportunity cost.

One of the common pitfalls of economic reasoning is the tendency to ignore opportunity costs. Remember that an opportunity cost is the value of the next-best alternative when a decision is made; it's what is given up. For example, you might choose to spend the evening watching television without giving it much thought; in fact, you might consider it "free." An economist would remind you that there is still a cost to your "free" activity—the opportunity cost. In this case, the cost of watching television is giving up your next-best alternative, perhaps taking your dog for a walk. So, while watching television might not entail a monetary cost, it is not free—choosing television means giving up the opportunity to do other things. One way to avoid the mistake of ignoring opportunity costs is to pose questions in terms of choices. So, instead of asking yourself, "Should I watch television this evening?" ask, "Should I watch television or walk my dog this evening?"

Consider the following:

- 1. Your grandfather has given you a \$50 gift card for an online retailer. You have picked out some new music and a book by your favorite author. The only other thing you would consider buying is a new calculator that you will need for your math class next semester, which also has a price of \$50. The music and book you have picked out were a gift. You might think of them as "free." Explain why they are not free.**

Choosing the music and book means giving up the opportunity to buy the calculator—it is the opportunity cost. So, the opportunity cost of the book and music is the calculator.
- 2. Explain why using credit card reward miles to purchase an airline ticket does not make the ticket free.**

The opportunity cost of using reward miles to purchase the airline ticket is purchasing some other good or service, or redeeming the cash value of the reward miles. The airline ticket is not free because it requires giving up the next-best alternative.
- 3. Sam says the only cost of going to college is tuition, fees, and textbooks.**

Besides paying for tuition, fees, and textbooks, Sam should consider the opportunity cost. If Sam were not attending college, he would likely be working full-time. If Sam could earn \$25,000 per year working, in the four years he spends working instead of going to college, he could earn \$100,000. Luckily for Sam, if he earns a degree he will likely earn a higher income for the rest of his career and will likely be better off.
- 4. Rachel has been invited to see a movie with friends on Friday night. The price of the movie ticket is \$9. She has also been asked to babysit some young children in her neighborhood on Friday night for \$25. Explain the cost of attending the movie in terms of the explicit and implicit (opportunity) costs.**

If Rachel goes to the movie with friends, she will pay an explicit cost of \$9. In addition, she will forgo the opportunity to babysit and have an implicit or opportunity cost of \$25. So, the total cost of seeing the movie with friends is \$34 (\$25 implicit + \$9 explicit).

Common Core Standards

Grades 6-12 Literacy in History/Social Studies and Technical Subjects

- **Key Ideas and Details**

RH.11-12.1. Cite specific textual evidence to support analysis of primary and secondary sources, connecting insights gained from specific details to an understanding of the text as a whole.

RH.11-12.2. Determine the central ideas or information of a primary or secondary source; provide an accurate summary that makes clear the relationships among the key details and ideas.

- **Craft and Structure**

RH.11-12.4. Determine the meaning of words and phrases as they are used in a text, including analyzing how an author uses and refines the meaning of a key term over the course of a text (e.g., how Madison defines *faction* in *Federalist* No. 10).