GreatHearts®

Economics 10: Economic Systems

April 20 - April 24

Time Allotment: 20 minutes per day

Student Name: ___________________________________

Teacher Name: ___________________________________

Economics 10: Economic Systems
April 20 – April 24

Packet Overview

Date	Objective(s)	Page Number
Monday, April 20	Identify correlations between the type of economics nations have adopted and how those countries have done in terms of wealth, happiness, health and freedom.	2
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Friday, April 24	***Scheduled Day Off***	

Additional Notes:

Reminder about "Office Hours" via Zoom ***on Tuesday and Thursday from 1-1:50, you can connect with me via Zoom*** to ask questions, discuss concepts etc... However, you can email any time! Please continue to ask questions! E-mail: Patrick.Franzese@greatheartsnorthernoaks.org.

Again, each day's lesson is designed to take no more than 20 minutes. If you have spent more than 20 minutes on a lesson and/or you do not have access to a computer or the internet, then have your parent sign the page next to the "student expectation" section under each lesson and you will receive full credit for the assignment.

Academic Honesty

I certify that I completed this assignment independently in accordance with the GHNO Academy Honor Code.

Student signature:

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I certify that my student completed this assignment independently in accordance with the GHNO Academy Honor Code.

Parent signature:

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Monday, April 20: The Impact of Economic Freedom

Objective: Be able to do this by the end of this lesson.
Identify correlations between the type of economics nations have adopted and how those countries have done in terms of wealth, happiness, health and freedom.

Student Expectations: Conduct some research using the links provided (or others that you find) and answer the questions in each section.

Introduction to Lesson

As we learned last week, every country essentially has a mixed economy that operates somewhere on the spectrum between a market economy and a command economy. This begs the question, of what are the general results from countries who are located towards one end compared to the other. In this lesson, we will first look at where countries generally are on that spectrum. Then, we will look at how countries are ranked in terms of wealth, happiness, health and freedom, and see how that correlates to economic freedom.

Economic Freedom

Each year various organizations put out reports ranking each country in terms of economic freedom. While they each use slightly different criteria, these rankings are relatively consistent. Below are three organizations that put out annual rankings. Take some time to explore these rankings—you are free to search for other organizations as well who publish annual rankings as well—and answer the questions that follow:

- https://www.heritage.org/index/ranking
- https://www.cato.org/economic-freedom-world
- https://www.fraserinstitute.org/studies/economic-freedom

1) Which countries were generally at the top of each ranking? What attributes did each of the countries have?

2) Which countries were generally at the bottom of each ranking? What attributes did each of the countries have?

3) Where was the United States? Why did it earn this ranking?

4) Which country at the top of rankings surprised you? Why?

5) Which country at the top of rankings surprised you? Why?

Economic Freedom and Wealth

Similarly, various organizations put out reports ranking each country in terms of wealth. While they each use slightly different criteria (i.e., total wealth, wealth per capita etc…) these rankings are relatively consistent. Take some time to explore these rankings below—you are free to search for other organizations as well—and answer the questions that follow:

- **https://en.wikipedia.org/wiki/List_of_countries_by_financial_assets_per_capita**
- **https://www.investopedia.com/articles/managing-wealth/112916/richest-and-poorest-countries-capita-2016.asp**
- **https://www.statista.com/statistics/203941/countries-with-the-highest-wealth-per-adult/**

1) What is the relationship between the freest economies and the wealthiest nations? Similarly, what is the relationship between the least free economies and the poorest nations?

2) Where was the United States? What explains the difference between how it is ranked in terms of wealth and how it is ranked in terms of economic freedom?

3) Do the wealthiest nations generally have characteristic of a market economy or a command economy?____

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GreatHearts®

Economic Freedom and Personal Happiness, Health and Freedom
As Great Hearts imparts, there is more to life than material items. Thus, although increased wealth is the result of economic freedom, it is important to look at other aspects of life to see the impact of, or correlation with, economic freedom. Looking at factors such as happiness, health and freedom can provide good insight. Links below explore these areas and how countries are ranked. Granted, each ranking will use somewhat different and subjective criteria in coming to its conclusions. However, there are nonetheless trends you can see. You are free to search out other websites. Moreover, I encourage you to think of other categories that you believe are important to living a good life and see how economic freedom is related its pursuit/achievement.

Happiness: - https://happiness-report.s3.amazonaws.com/2020/WHR20.pdf

Health: - https://worldpopulationreview.com/countries/healthiest-countries/
- https://www.weforum.org/agenda/2019/02/these-are-the-world-s-healthiest-nations/

Freedom: - https://www.cato.org/human-freedom-index-new
- https://freedomhouse.org/countries/freedom-world/scores

1) What is the relationship between the freest economies and the happiest, healthiest and freest? Similarly, what is the relationship between the least free economies and the lest happy, healthy and free nations?

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2) Where was the United States? What explains the difference between how it is ranked in terms of wealth and how it is ranked in terms of economic freedom?

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3) Do the happiest, healthiest and freest nations generally have characteristic of a market economy or a command economy?

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4) (Optional) If you looked at a different category, what did you look at and what did you find?

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Tuesday, April 21 – Lesson: The Impact of Command Economies

Objective: Be able to do this by the end of this lesson.
Explain the results of countries who have adopted heavily command economies

Student Expectations: Annotate the readings and answer the questions.

Introduction to Lesson
Hopefully yesterday's lesson provided good insight that successful nations who have a system more aligned with a market economy have generally achieved greater wealth, happiness, healthy and freedom than those countries who have a system more aligned with a command economy. Today's lesson expands on this idea by focusing on those countries who tend towards, or have tended towards, a command economy. The excerpt below comes from a report titled "The Opportunity Costs of Socialism" that was issued in October 2018 by The Council of Economic Advisors, which is an agency within the Executive Office of the President that is charged advising the President on the formulation of both domestic and international **economic** policy. The entire report can be found here: https://www.whitehouse.gov/wp-content/uploads/2018/10/The-Opportunity-Costs-of-Socialism.pdf

The Dismal Track Record of Highly Socialist Countries

Socialism is a continuum. No country has zero state ownership, zero regulation, and zero taxes. Even the most highly socialist countries have retained elements of private property, with consumers sometimes spending their own money on themselves (Pryor 1992). This report therefore begins with the historically common highly socialist regimes, by which we mean countries that implemented the most state control of production and incomes for at least a decade.[21] Of more than a dozen countries meeting these criteria, this section emphasizes Maoist China, Cuba, and the USSR, which are the subject of much scholarship, and Venezuela, which has been unusual as an industrialized economy with elements of democracy that nonetheless pursued highly socialist policies.[22]

Many of the highly socialist economies were agricultural, with state and collective farming systems implemented by socialist governments to achieve purported economies of scale and, pursuant to socialist ideology, to punish private landowners. Agricultural output dropped sharply when socialism was implemented, causing food shortages. Tens of millions of people

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[20] This effect is the monopsony mirror image of monopoly pricing. Sellers with market power typically exercise it by constraining the quantity or quality of what they produce and thereby squeeze the buyers in the market (Williamson 1968; Farrell and Shapiro 1990; Whinston 2006). Buyers with market power typically exercise it by constraining the quantity or quality of what they purchase.

[21] The highly socialist countries are sometimes called "communist," although, as previously noted, communism has a different meaning in the theory of socialism. We presume that, in contrast to the Nordic countries, central government spending far exceeds private spending in highly socialist countries—although, with pervasive state ownership and centralized control, it is difficult to construct accurate measures of the components of spending that would be comparable between highly socialist countries and the rest of the world.

[22] Also recall, from the second section above, the parallels between modern socialist rhetoric and the statements attributed to Mao, Castro, and Lenin.

starved. It took quite some time for sympathetic scholars outside socialist countries to acknowledge that large state farms were less productive than small private ones.

The economic failures of highly socialist policies have been described at length by both survivors and scholars who have reviewed the evidence in state archives. Not only did highly socialist countries discourage the supply of effort and capital with poor incentives, but they also allocated these resources perversely because central planning made production decisions react to output and input prices in the opposite direction from those of a market economy.

Although agriculture is not a large part of the U.S. economy, present-day socialists echo the historical socialists by arguing that healthcare, education, and other sectors are unfair and unproductive, and they promise that large state organizations will deliver fairness and economies of scale. It is therefore worth acknowledging that socialist takeovers of agriculture have delivered the opposite of what was promised.

Present-day socialists do not want the dictatorship or state brutality that often coincided with the most extreme cases of socialism. However, peaceful democratic implementation of socialist policies does not eliminate the fundamental incentive and information problems created by high tax rates, large state organizations, and the centralized control of resources. As we report at the end of this section, Venezuela is a modern industrialized country that elected Hugo Chávez as its leader to implement socialist policies, and the result was less output in oil and other industries that were nationalized.[23]

When evaluating the misalignment between the promises of highly socialist regimes to eliminate the misery and exploitation of the poor and the actual effects of their policies, it is instructive to look at a major guide economists use to determine value: the revealed preference of the population—in other words, voting with their feet. Implementation of highly socialist policies, such as in Venezuela, have been associated with high emigration. Perhaps more telling is that historically socialist regimes—such as the USSR, China, North Korea and Cuba—have forcibly prevented people from leaving.

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[23] See also the fifth section, on socialism in the Nordic countries, and the sixth section, on single-payer healthcare. Further evidence about the effects of socialism on nonagricultural industries are reported by Conquest (2005), Gregory (2004), Horowitz and Suchlicki (2003), and Kornai (1992). Johnson and Brooks (1983, 9) describe how the "Soviet rural road system can only be described as a disgrace, the result of decades of socialist neglect."

State and Collective Farming

State and collective farming (hereafter, "state farming") is a historically common practice in highly socialist countries.[24] The state acquires private farmland, and often much livestock, by force. The land is organized in large parcels, typically about one per village as compared with the multitude of parcels in a typical village before collectivization. Villagers were required to work on the land, with the output belonging to the state. Decisions were made by government employees and party apparatchiks, who may have had little or no experience or specialized knowledge in comparison with the original landowners (Pryor 1992). These decisions included devising and implementing complex systems of production targets and quality requirements (Nolan 1988).

The socialist narrative emphasizes exploitation, which in an agricultural economy refers to the power dynamic that determines the division of agricultural income between landlords and farm workers. State farms purport to end the exploitation by eliminating the landlords, known as kulaks in the USSR.[25] Another advantage of state farms, from the socialist perspective, was economies of scale (Pryor 1992). In principle, the knowledge and techniques of the best farmer could be applied to all the land rather than the comparatively small plot that the best farmer owned.[26] Capital may be easier to obtain for a larger organization. Writing about the USSR in 1929, Joseph Stalin stressed transforming "agriculture from small, backward, individual farming to large-scale, advanced, collective agriculture, to joint cultivation of the land." Writing about China in 1958, the British economist Joan Robinson asserted that "the minute fragmentation of the land" that prevailed before collective farming was a major source of inefficiency. The family itself was sometimes criticized as operating on too small a scale; in

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[24] State or collective farms were formed, e.g., in the USSR; elsewhere in the Soviet Bloc; and in Vietnam, North Korea, China, Cuba, South Yemen, Congo, Ethiopia, Cambodia, and Laos (Pryor 1992, chap. 4). In principle, participation in collective farms was voluntary, and operations were collectively managed by villagers, whereas state farms were owned and managed by government with the farm workers as government employees. In practice, even the collective farms may come "under the control of the Communist Party and the government," as they did in the USSR (Dolot 2011, chap. 2). See also Johnson and Brooks (1983, 4–5), Conquest (1986, 171), and Pryor (1992, 12–14).

[25] With landlords resisting the seizure of their property, the state often imprisoned or murdered landlords (Conquest 1986; Rummel 2011).

[26] The CEA is not aware of socialist explanations of why the best farmer owned comparatively little land or did not contribute his or her talents to a larger but purely voluntary collective. A neoclassical explanation might involve credit constraints and the like, or simply that it would not be efficient for the best farmer to control more land than he or she chose to purchase in the marketplace (i.e., the market reflects genuine limitations on scale economies; see also Conquest (1986).

China, household utensils were confiscated and villagers were assigned to communal kitchens for eating and food preparation (Jisheng 2012).[27]

Eyewitnesses tell a different story concerning the operation of state farms, and central planning more generally. In Cuba and the USSR, for example, the managers of state farms were chosen from the ranks of the Communist Party, rather than because of management skill or agricultural knowledge (Dolot 2011).[28] "The state monopoly stifled incentives for increasing production," describes a Chinese eyewitness (Jisheng 2012, 174–77). Production units sometimes had an incentive to produce less and to hoard inputs, in order to obtain more favorable allocations the next year (Gregory 1990).

The Opposite of What Was Promised

State farms reduced agricultural productivity rather than increasing it. The unwarranted faith in state farms had a doubly negative effect on agricultural output: Not only was less produced per worker, but workers were removed from agriculture, on the mistaken understanding that farming was becoming more productive (Conquest 1986). Both the lack of food and reliance on central planning rather than market mechanisms resulted in tens of millions of deaths by starvation.

Statistics from highly socialist regimes are informative, but necessarily imprecise. Gregory (1990), Kornai (1992), and others explain how officials in these regimes deceive their superiors and the public. Refugees from the regimes may be free to talk after their escape, but they may not constitute a random sample of the populations they left and may have imperfect memories. Readers are advised that the estimates in this section are necessarily inexact.

In Cuba, the disincentives inherent in the socialist system sharply reduced agricultural production. As O'Connor (1968, 206–7), explains, "Because wage rates bore little or no relationship to labor productivity and [state farm] income, there were few incentives for workers to engage wholeheartedly in a collective effort." Table 1 shows the change in agricultural production in Cuba spanning the agrarian reform period of 1959–63, when about 70 percent of farmland was nationalized (Zimbalist and Eckstein 1987). Production of livestock fell between 14 percent (fish) and 84 percent (pork). Among the major crops, production fell

[27] See also Lenin (1951).

[28] See also O'Connor's (1968, 205) description of Cuban state farms with "[inefficiencies] arising from overcentralized decisionmaking, together with a shortage of qualified personnel which was aggravated by a tendency to place politically reliable people in top administrative posts even when they lacked technical skills."

between 5 percent (rice) and 75 percent (malanga). The biggest crop, sugar, fell 35 percent. There was not a major Cuban famine, however, because of Soviet assistance and emigration.[29]

Table 1. Agricultural Production in Cuba Before and After the Nationalization of Farms

Livestock	Change from 1957–58 to 1963–64	Crop	Change from 1957–58 to 1963–64
Beef	-45%	Sugar	-35%
Pork	-84%	Corn	-39%
Poultry	-36%	Rice	-5%
Fish	-14%	Malanga	-75%
Eggs	-40%	Yucca	-56%
Milk	-39%	Potatoes	-50%

Source: Salazar-Carrillo and Nodarse-Leon (2015).

The CEA also notes that, while Cuba had similar gross national income to Puerto Rico before the Cuban Revolution in the late 1950s, by 2000 Cuban gross national income had fallen almost two-thirds relative to Puerto Rico.[30]

In the USSR, the collectivization of agriculture occurred with the First Five-Year Plan, 1928–32. Horses were important for doing the farm work, but their numbers fell by 47 percent, in part because nobody had much incentive to care for them when they became collective property (Conquest 1986). In the Central Asian parts of the USSR, the number of cattle fell more than 75 percent, and the number of sheep more than 90 percent (Conquest 1986). Looking at official Soviet data for about 1970, Johnson and Brooks (1983) concluded that the entire suite of socialist policies—"excessive centralization of the planning, control, and management of agriculture, inappropriate price policies, and defective incentive systems for farm managers and workers and for enterprises that supply inputs to agriculture"—was reducing Soviet agricultural productivity about 50 percent.[31]

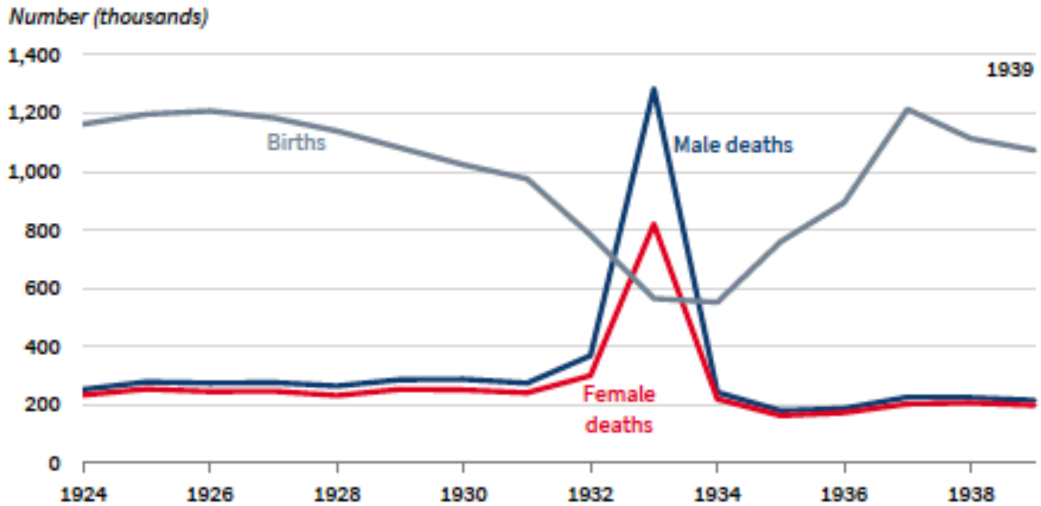
A famine ensued in 1932 and 1933, and about 6 million people died from starvation (Courtois et al. 1999).[32] The death rates were high in Ukraine, a normally fertile region from which the

[29] See Walters (1966) on Soviet economic aid to Cuba.
[30] Collins, Bosworth, and Soto-Class (2006) and the Barro-Lee data set, using GDP for Cuba in 1950. The result is more extreme if the comparison is based on GDP because people and businesses outside Puerto Rico have substantial claims on the production occurring there.
[31] This is likely an underestimate because, as Johnson and Brooks acknowledge, their research project was made possible through cooperation with the Soviet government.
[32] Conquest (1986, 301) cites 7 million.

Soviet planners had been exporting food.[33] Figure 2 shows the time series for Ukrainian deaths by sex, along with births. This time series also appears to show that millions more people were not born because of the famine.

Mao's government implemented the so-called Great Leap Forward for China from 1958 to 1962, including a policy of mass collectivization of agriculture that provided "no wages or cash rewards for effort" on farms.[34] The per capita output of grain fell 21 percent from 1957 to 1962; for aquatic products, the drop was 31 percent; and for cotton, edible oil, and meat, it was about 55 percent (Lin 1992; Nolan 1988).[35] During the Great Chinese Famine from 1959 to 1961, an estimated 45 million people died (Dikötter 2010). Figure 3 shows the time series for deaths and births, which form a pattern similar to Ukraine's, except that the absolute number of deaths was an order of magnitude greater.

Figure 2. Annual Sex-Specific Trends in Numbers of Births and Deaths in Ukraine, 1924–39



Source: Meslé and Vallin (2012).

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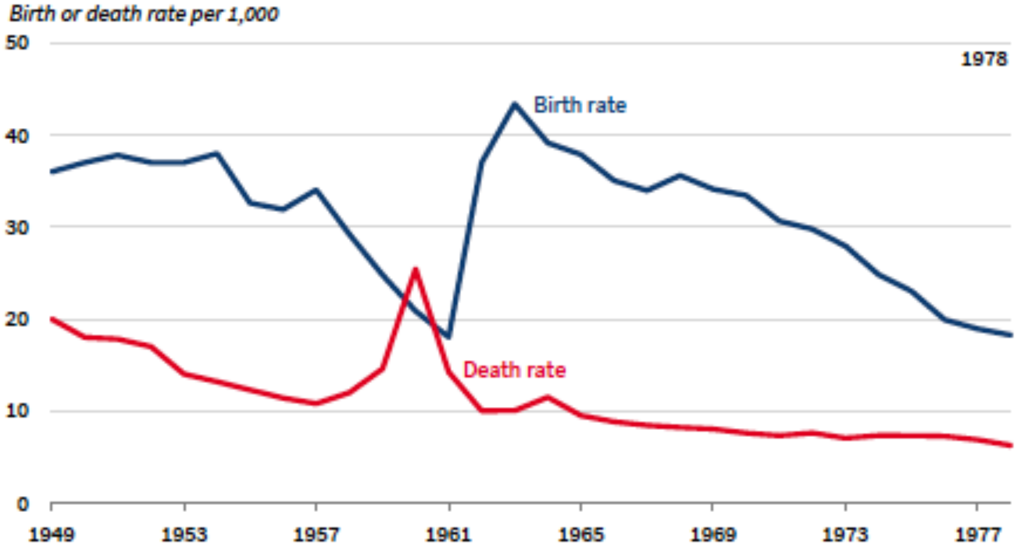
[33] In fact, the USSR as a whole was exporting grain at that time (Dalrymple 1964, 271; Courtois et al. 1999, 167). Note that there were also starvation deaths elsewhere in the USSR (Conquest 1986). In contrast to the famines associated with highly socialist regimes, Ó Gráda (2000) and Goodspeed (2016, 2017) find that one important margin of adjustment during the Irish Famine of 1845–51 was substantially increased net imports of relatively cheap corn and other grains, and similarly dramatically increased exports of higher-value agricultural output such as eggs, dairy products, and cattle.

[34] Meng, Qian, and Yared (2015, 1572), summarizing Walker (1965).

[35] See Cheremukhin et al. (2015) for aggregate productivity time series.

Figure 3. Birth and Death Rates in China per 1,000, 1949–78



Source: China National Bureau of Statistics.

Failed agricultural policies are not the only way that civilians died at the hands of their highly socialist state. Rummel (1994), Courtois and others (1999), Pipes (2003), and Holmes (2009) document noncombat deaths in the Soviet Bloc, Yugoslavia, Cuba, China, Cambodia, Vietnam, Laos, North Korea, and Ethiopia. These deaths exclude deaths in military combat, but include deaths in purges, massacres, concentration camps, forced migration, and both escape attempts and famines. The death rate in famines was particularly high in North Korea, where about 600,000 people died from starvation in the late 1990s out of a population of about 22 million (Goodkind, West, and Johnson 2011).[36] Cambodia's Communist period was especially violent.

The total noncombat civilian deaths in the highly socialist countries were a combination of the effects of government takeovers of important industries and brutal political systems. Modern American socialists are against state brutality. But it is a mistake to ignore the highly socialist tragedies altogether, because it was high taxes, large state organizations, and centralized control that delivered the opposite of what was promised and forced consumers to endure intolerably small supplies of food and other consumer goods. In other words, the low output of state farms and centralized planning was a result of economic failures that cannot be rectified with more peaceful implementation. Venezuela, discussed below, is a case in point.

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[36] The CEA did not find comparable data on deaths for highly socialist regimes in Afghanistan, Angola, Benin, Congo, Mozambique, Somalia, and South Yemen. Such data may be lacking because their implementations may have been comparably peaceful from a civilian perspective.

Though the nationalization of agriculture depressed output, the privatization of the same land brought it surging back. Johan Norberg explains how, when Chinese villagers began to (secretly) privatize their land, the "farmers did not start the workday when the village whistle blew any longer—they went out much earlier and worked much harder. . . . Grain output in 1979 was six times higher than the year before."[37]

Although socialist policies are ostensibly implemented to reduce poverty and inequality, it was the end of highly socialist policies in China that brought these results on a worldwide scale. China's major reforms began in 1978, which is about the time that the poverty rate in China, and therefore world poverty rates and world inequality, began a remarkable decline (Sala-i-Martin 2006).[38] Policy changes in India also coincided with reduced poverty in that country, although it is debated whether the early Indian policies were socialist (Basu 2008). The end of socialism in the USSR increased inequality in that region, but this was not enough to offset, by worldwide measures, the progress elsewhere in the world (Pinkovskiy and Sala-i-Martin 2009).

Lessons Reluctantly Learned

Before the First Five-Year Plan, the USSR's economists had observed the productivity losses that came with attempts to collectivize farming. Conquest (1986, 108) describes how they "still defended small scale agriculture in 1929—but soon had to repudiate that position." The political leadership then prohibited the types of economic analysis that might show the opportunity costs of state farms (Conquest 1986).

Although the eyewitnesses saw in real time the economic problems with large state organizations, some distinguished economists outside the socialist countries dismissed any evidence that might suggest socialism to be a failure in the USSR or China. For instance, Paul Samuelson, the first American to win the Nobel Prize in economics, expressed surprise that the Soviet collective farms were not more productive than private land allotments (Samuelson 1976). As recently as 1989, he and William Nordhaus were still writing that "the Soviet economy is proof that, contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive" (Samuelson and Nordhaus 1989, 837). John Gurley (1969), one of the 11 managing editors of the *American Economic Review*, wrote that "the basic overriding economic fact about China is that for twenty years it has fed, clothed, and housed

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[37] Norberg (2016, chap. 1), citing Zhou (1996).
[38] See also the official rural poverty measure (State Council of the People's Republic of China 2016), which fell from 98 percent in 1978 to 6 percent in 2015.

everyone, has kept them healthy and has educated most. Millions have not starved."[39] As recently as 1984, John Kenneth Galbraith asserted that "the Russian system succeeds because, in contrast with the Western industrial economies, it makes full use of its manpower."[40]

The infamous journalist Walter Duranty privately estimated that 7 million people died from the Soviet famine, but instead he published Soviet propaganda in the *New York Times* during those years.[41] Meanwhile, the highly socialist governments themselves eventually acknowledged the value of private enterprises. As a means of increasing national output, Cuba, China, the USSR, and other highly socialist countries eventually permitted private enterprises both in and outside the agriculture sector to coexist with state-owned enterprises.[42]

Venezuela: An Industrialized Country with Highly Socialist Policies

Venezuela is not an agricultural economy, but it nationalized important parts of its economy, implemented effectively high marginal tax rates, and centrally controlled prices of consumer and other goods. As with the other highly socialist countries, its state-owned enterprises have proven to be unproductive. Millions of people have already fled the country.

The economies of the highly socialist countries described above are agricultural and labor intensive. An oil-rich country such as Venezuela that managed its oil assets well and paid cash royalties to its citizens independent of how much they earn could in principle be providing income for its citizens with zero marginal tax rates.[43] The economy could also be unregulated and without state-owned enterprises (with oil assets rented to private businesses to operate), and therefore not be socialist in any aspect of the definition introduced in the first section above. However, this is not the path taken by Venezuela over the past 20 years, when it

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[39] Gurley republished these ideas later (e.g., Gurley 1976, 13). Today, it must be acknowledged that the Great Chinese Famine was in the middle of Gurley's "twenty years" period, when everyone in China was supposedly fed.

[40] According to Schumpeter (1943, chap. XIII), these attitudes are to be expected. He says that intellectuals benefit from criticizing the social system in which they live, and that it is the abundance of the market system that allows intellectuals to be a large share of the population.

[41] He won a 1932 Pulitzer Prize for some of his publications about the USSR (Conquest 1986, 320). Though he personally visited the famine regions in 1933, his *New York Times* publications that year denied that there was a famine, and mocked a journalist who reported otherwise (Conquest 1986, 319; Applebaum 2017). Conquest explains how Duranty was further honored in New York City for telling "people what they wished to hear." The *New York Times* "publicly acknowledg[ed] his failures" in the 1980s (https://www.nytco.com/new-york-times-statement-about-1932-pulitzer-prize-awarded-to-walter-duranty/).

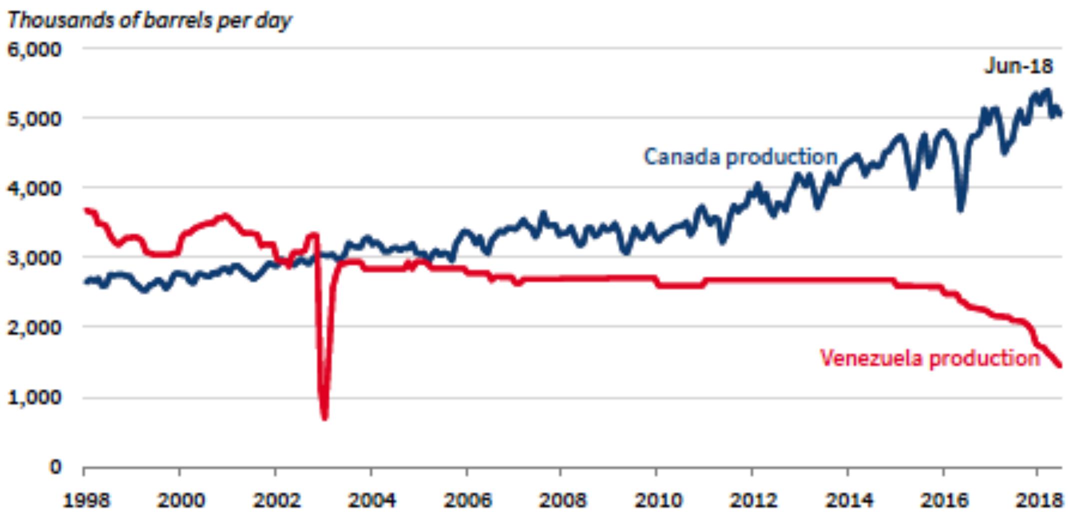
[42] See Johnson and Brooks (1983, 5–6), Zimbalist and Eckstein (1987, 13), Pipes (2003, 871), and Dikötter (2010, xxii).

[43] For example, the oil-rich state of Alaska has no sales or state income tax. Oil-rich Norway, conversely, has marginal tax rates that are similar to other Nordic countries (recall the fourth section above).

nationalized most oil assets and many other businesses, implemented effectively high marginal tax rates, and centrally controlled prices of consumer and other goods.

In 1999, "Hugo Chávez convinced the people of Venezuela they were being robbed by the greedy oil companies, dramatically raised taxes and royalties on new and existing projects. . . . The state-owned oil entity no longer possessed the know-how to develop its resources and production began declining" (*Oil Sands Magazine* 2016). Oil revenues were spent on generous social programs rather than investing in the country's oil production capacity or cutting taxes (*Economist* 2017; Monaldi 2018).[44] As shown in figure 4, Venezuela's oil production has been declining while production in Canada, which has petroleum resources similar to Venezuela's, has been increasing.[45]

Figure 4. Total Petroleum and Other Liquids Production, 1998–2018



Source: U.S. Energy Information Administration.

Venezuela nationalized several other businesses, ranging from cell phones to medicines. According to Transparency International (2017, 52), "From 2001 to 2017, the Venezuelan state went from owning 74 public enterprises to 526, four times more than Brazil (130) and ten times more than Argentina," and by 2016 state enterprise employment reached 6 percent of the entire workforce.

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[44] Under Hugo Chávez, the Venezuelan government "constructed a free healthcare program for people living in poor and marginalized areas," largely by importing about 31,000 medical personnel from Cuba (Brading 2013, chap. 4; Westhoff et al. 2010; see also Wilson 2015).

[45] The success of Canada's oil industry over the same time frame is one reason why the CEA believes that the economic disaster in Venezuela cannot be blamed on world oil markets.

Earning and spending are heavily taxed in Venezuela. The top rate on personal income is 34 percent, plus 11 percent for payroll. The value-added tax rate is 16 percent. Inflation is a tax implicitly paid while a worker or consumer holds currency; even during normal times, inflation was 2 percent per month. Import restrictions are relevant because, in a well-functioning economy based on natural resources, many consumer goods would be imported. Currency transactions, and international financial transactions generally, are tightly controlled, which means that an importer would in effect pay a tax when obtaining the foreign currency required to purchase foreign goods. As of 2012, the import tariff rate was 12.1 percent on nonagricultural goods. Imports are also at risk of theft by border patrol. If we take the foreign exchange and import theft rates to each be 10 percent, this puts the overall tax rate on earning for the purpose of obtaining consumption goods at over 60 percent.[46]

The Venezuelan economy does not benefit from price signals the way that less-regulated economies do. High inflation, which is expected to reach 1 million percent per year in 2018, makes it difficult to discern relative prices (Fischer, Hall, and Taylor 1981). Even without inflation, many prices are not determined by the market. In Venezuela, the 2011 Law of Fair Costs and Prices gives the Superintendent of Fair Costs and Prices (known as SUNDECOP) "broad authority to regulate the prices of almost all goods and services sold to the public," deciding "whether prices are 'fair' and to identify businesses that make 'excessive profits through speculation'" (USTR 2013). "Basic goods like flour and aspirin had fixed prices and were so cheap that companies had no incentive to make them" (Kurmanaev 2018).

Emigration has proven to be an important way that Venezuelan policies have reduced the supply of goods and services. Talented workers have emigrated from the oil industry and from medical practice (Dube 2017). Overall, about 2 million people have emigrated from the country in recent years (Alhadeff 2018).

Questions

1) What are characteristics of countries who have adopted highly socialist policies?

2) What occurred with state and collective farming? Why?

3) Would this occur to other industries such as mining and manufacturing? Why or why not?

4) Reflecting of what we discussed about human nature, why do you believe these countries failed?

5) Could countries who adopt highly socialist policies succeed? Why or why not?

Wednesday, April 22 - Lesson: The Use of Knowledge

Objective: Be able to do this by the end of this lesson.
Explain the importance and role of prices in conveying knowledge throughout society

Student Expectations: Watch the video, annotate the reading and answer the questions

Introduction to Lesson(s)
Over the next couple of lessons, we explore concepts the highlight why command economies have largely while market economies have largely succeeded. In this today's lesson, we look at the important role prices play in disseminating knowledge throughout an economy. Market economies largely allow the price system to work and thus facilitate this knowledge and as well as productive activity. Conversely, command economies largely distort the price system and thus impede both important knowledge from being transmitted and productive activity.

Economics 10: Economic Systems
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Hayek – Use of Knowledge
Read/annotate in your reader pg 157-164 (read only the top line of pg 164…"knowledge and skill."). Note, Additionally, I highly recommend you watch the following video which provides a wonderful overview of today's reading:
https://mru.org/courses/great-economists-classical-economics-and-its-forerunners/hayek-use-of-knowledge-in-society-summary

When done, answer the following questions:

1) What is the economic problem of society?

2) What does the price system do/allow/facilitate? How or why?

3) How do command economies (i.e., centralized planning) prevent the use of knowledge?

4) Why is the price system not appreciated more?

Thursday, Apri1 23 - Lesson: Law of Unintended Consequences

Objective: Be able to do this by the end of this lesson.
Explain how laws have impacts that are not seen and often negative

Lesson Student Expectations: ****Take Quiz on page 23 either after completing this lesson!**** Watch my video on Google Classroom and complete the reading/questions below.

Introduction to Lesson
A common response to any economic issue that arises is "do something." Many people expect the government to take action and thus many government officials have incentive to act. However, many times well-intentioned laws often create situations that are the exact opposite of what the law intended. When laws change the incentives, people will change their behaviors.

Unintended Consequences
(https://www.econlib.org/library/Enc/UnintendedConsequences.html?to_print=true)
By Rob Norton

The law of unintended consequences, often cited but rarely defined, is that actions of people—and especially of government—always have effects that are unanticipated or unintended. Economists and other social scientists have heeded its power for centuries; for just as long, politicians and popular opinion have largely ignored it.

The concept of unintended consequences is one of the building blocks of economics. Adam Smith's "invisible hand," the most famous metaphor in social science, is an example of a positive unintended consequence. Smith maintained that each individual, seeking only his own gain, "is led by an invisible hand to promote an end which was no part of his intention," that end being the public interest. "It is not from the benevolence of the butcher, or the baker, that we expect our dinner," Smith wrote, "but from regard to their own self-interest."

Most often, however, the law of unintended consequences illuminates the perverse unanticipated effects of legislation and regulation. In 1692 the English philosopher John Locke, a forerunner of modern economists, urged the defeat of a parliamentary bill designed to cut the maximum permissible rate of interest from 6 percent to 4 percent. Locke argued that instead of benefiting borrowers, as intended, it would hurt them. People would find ways to circumvent the law, with the costs of circumvention borne by borrowers. To the extent the law was obeyed, Locke concluded, the chief results would be less available credit and a redistribution of income away from "widows, orphans and all those who have their estates in money."

In the first half of the nineteenth century, the famous French economic journalist Frédéric Bastiat often distinguished in his writing between the "seen" and the "unseen." The seen were the obvious visible consequences of an action or policy. The unseen were the less obvious, and often unintended, consequences. In his famous essay "What Is Seen and What Is Not Seen," Bastiat wrote:

> There is only one difference between a bad economist and a good one: the bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen.

Bastiat applied his analysis to a wide range of issues, including trade barriers, taxes, and government spending.

The first and most complete analysis of the concept of unintended consequences was done in 1936 by the American sociologist Robert K. Merton. In an influential article titled "The Unanticipated Consequences of Purposive Social Action," Merton identified five sources of unanticipated consequences. The first two—and the most pervasive—were "ignorance" and "error."

Merton labeled the third source the "imperious immediacy of interest." By that he was referring to instances in which someone wants the intended consequence of an action so much that he purposefully chooses to ignore any unintended effects. (That type of willful ignorance is very different from true ignorance.) The Food and Drug Administration, for example, creates enormously destructive unintended consequences with its regulation of pharmaceutical drugs. By requiring that drugs be not only safe but efficacious for a particular use, as it has done since 1962, the FDA has slowed down by years the introduction of each drug. An unintended consequence is that many people die or suffer who would have been able to live or thrive. This consequence, however, has been so well documented that the regulators and legislators now foresee it but accept it.

"Basic values" was Merton's fourth source of unintended consequences. The Protestant ethic of hard work and asceticism, he wrote, "paradoxically leads to its own decline through the accumulation of wealth and possessions." His final case was the "self-defeating prediction." Here he was referring to the instances when the public prediction of a social development proves false precisely because the prediction changes the course of history. For example, the warnings earlier in this century that population growth would lead to mass starvation helped spur scientific breakthroughs in agricultural productivity that have since made it unlikely that the gloomy prophecy will come true. Merton later developed the flip side of this idea, coining the phrase "the self-fulfilling prophecy." In a footnote to the 1936 article, he vowed to write a book devoted to the history and analysis of unanticipated consequences. Although Merton worked on the book over the next sixty years, it remained uncompleted when he died in 2003 at age ninety-two.

The law of unintended consequences provides the basis for many criticisms of government programs. As the critics see it, unintended consequences can add so much to the costs of some programs that they make the programs unwise even if they achieve their stated goals. For instance, the U.S. government has imposed quotas on imports of steel in order to protect steel companies and steelworkers from lower-priced competition. The quotas do help steel companies. But they also make less of the cheap steel available to U.S. automakers. As a result, the automakers have to pay more for steel than their foreign competitors do. So a policy that protects one industry from foreign competition makes it harder for another industry to compete with imports.

Similarly, Social Security has helped alleviate poverty among senior citizens. Many economists argue, however, that it has carried a cost that goes beyond the payroll taxes levied on workers and employers. Martin Feldstein and others maintain that today's workers save less for their old age because they know they will receive Social Security checks when they retire. If Feldstein and the others are correct, it means that less savings are available, less investment takes place, and the economy and wages grow more slowly than they would without Social Security.

The law of unintended consequences is at work always and everywhere. People outraged about high prices of plywood in areas devastated by hurricanes, for example, may advocate price controls to keep the prices closer to usual levels. An unintended consequence is that suppliers of plywood from outside the region, who would have been willing to supply plywood quickly at the higher market price, are less willing to do so at the government-controlled price. Thus results a shortage of a good where it is badly needed. Government licensing of electricians, to take another example, keeps the supply of electricians below what it would otherwise be, and thus keeps the price of electricians' services higher than otherwise. One unintended consequence is that people sometimes do their own electrical work, and, occasionally, one of these amateurs is electrocuted.

One final sobering example is the case of the Exxon Valdez oil spill in 1989. Afterward, many coastal states enacted laws placing unlimited liability on tanker operators. As a result, the Royal Dutch/Shell group, one of the world's biggest oil companies, began hiring independent ships to deliver oil to the United States instead of using its own forty-six-tanker fleet. Oil specialists fretted that other reputable shippers would flee as well rather than face such unquantifiable risk, leaving the field to fly-by-night tanker operators with leaky ships and iffy insurance. Thus, the probability of spills probably increased and the likelihood of collecting damages probably decreased as a consequence of the new laws.

The Cobra Effect: Lessons in Unintended Consequences
(https://fee.org/articles/the-cobra-effect-lessons-in-unintended-consequences/)
By Anthony Davis and James Harrigan

Every human decision brings with it unintended consequences. Often, they are inconsequential, even funny. When Airbus, for example, wanted to make its planes quieter to improve the flying experience for travelers, it made its A380 so quiet that passengers could hear, with far too much clarity, what was happening in the plane's bathrooms. Other times unintended consequences have far-reaching, dramatic effects. The US health care system is a case in point. It emerged in its present form in no small part because of two governmental decisions.

First, wage and price controls during World War II caused employers to add health insurance as an employee benefit. Why? The law prohibited employers from raising wages, so to attract workers, they offered to provide health insurance. Then, in 1951, Congress declared that employer-provided health insurance benefits would not count as taxable income. This made it cheaper for employees to take raises in the form of increased tax-free insurance benefits rather than in the form of increased taxable wages.

Unintended consequences happen so often that economists call them "Cobra Problems," after one of the most interesting examples.

Consequently, not only do workers now receive health insurance through their employers (unlike, for example, their car and home insurance), but those insurance plans also tend to be more luxurious than what they would have been had Congress never given them special tax treatment. These two political decisions helped to create the health care system we now have, a system that nearly everyone agrees is broken.

No one set out to create a broken system, no more than anyone ever set out to make bathroom noises more conspicuous on airplanes. These were unintended consequences. And you can see them everywhere when you know to look.

Unintended consequences happen so often that economists call them "Cobra Problems," after one of the most interesting examples.

In colonial India, Delhi suffered a proliferation of cobras, which was a problem very clearly in need of a solution given the sorts of things that cobras bring, like death. To cut the number of cobras slithering through the city, the local government placed a bounty on them. This seemed like a perfectly reasonable solution. The bounty was generous enough that many people took up cobra hunting, which led exactly to the desired outcome: The cobra population decreased. And that's where things get interesting.

As the cobra population fell and it became harder to find cobras in the wild, people became rather entrepreneurial. They started raising cobras in their homes, which they would then kill to collect the bounty as before. This led to a new problem: Local authorities realized that there were very few cobras evident in the city, but they nonetheless were still paying the bounty to the same degree as before. In the end, Delhi had a bigger cobra problem after the bounty ended than it had before it began. City officials did a reasonable thing: They canceled the bounty. In response, the people raising cobras in their homes also did a reasonable thing: They released all of their now-valueless cobras back into the streets. Who wants a house full of cobras?

In the end, Delhi had a bigger cobra problem after the bounty ended than it had before it began. The unintended consequence of the cobra eradication plan was an increase in the number of cobras in the streets. This case has become the exemplar of when an attempt to solve a problem ends up exacerbating the very problem that rule-makers intended to fix.

There is, of course, nothing special about cobras. The same sort of thing happened in the late 1980s in Mexico City, which was at the time suffering from extreme air pollution caused by cars driven by its 18 million residents. The city government responded with Hoy No Circula, a law designed to reduce car pollution by removing 20 percent of the cars (determined by the last digits of license plates) from the roads every day during the winter when air pollution was at its worst. Oddly, though, removing those cars from the roads did not improve air quality in Mexico City. In fact, it made it worse.

Come to find out, people's needs do not change as a result of a simple government decree. The residents of Mexico City might well have wanted better air for their city, but they also needed to get to work and school. They reacted to the ban in ways the rule-makers neither intended nor foresaw.

The people released their cobras into the streets, except this time the cobras were cars.

Some people carpooled or took public transportation, which was the actual intent of the law. Others, however, took taxis, and the average taxi at the time gave off more pollution than the average car. Another group of people ended up undermining the law's intent more significantly. That group bought second cars, which of course came with different license plate numbers, and drove those cars on the one day a week they were prohibited from driving their regular cars. What kind of cars did they buy? The cheapest running vehicles they could find, vehicles that belched pollution into the city at a rate far higher than the cars they were not permitted to drive. The people released their cobras into the streets, except this time the cobras were cars.

These examples of unintended consequences aren't aberrations. Unintended consequences arise every time an authority imposes its will on people. Seat belt and airbag laws make it less safe to be a pedestrian or cyclist by making it safer for drivers to be less cautious. Payday lending laws, intended to protect low-income borrowers from high lending rates, make it more expensive for low-income borrowers to borrow by forcing them into even more expensive alternatives.

Requirements that corporations publicize how much they pay their CEOs in order to encourage stockholders to reduce CEO pay resulted in lesser-paid CEOs demanding more pay. Three-strikes laws, intended to reduce crime, increase police fatalities by giving two-time criminals a greater incentive to evade or even fight the police. The Americans With Disabilities Act gives employers an incentive to discriminate against the disabled by not hiring them in the first place so as to avoid potential ADA claims. Electrician licensing requirements can increase the incidence of injury due to faulty electrical work by reducing the supply of electricians, thereby encouraging homeowners to do their own electrical work.

But perhaps nothing illustrates the scope of the potential problems arising from unintended consequences better than Venezuela's terrible game of whack-a-mole that began with the 1976 nationalization of its oil industry. The government's intent was to keep oil profits in the country. And that's how it went—for a while.

But when the government takes over a once-private industry, the profit incentive to maintain physical capital is lost, and physical capital deteriorates. The deterioration plays out over a decade or so, and that's what made it appear—at least for a while—that unlike everywhere else socialism had been tried, Venezuela's socialism was working. But as the oil industry's physical capital broke down, oil production fell. Coincidentally, it was around this time that oil prices fell also—a fact socialism's supporters point to as the real culprit. The ultimate unintended consequence of Venezuela's nationalizing its oil industry was slavery. That is without question incorrect given that no other oil-producing nation suffered what Venezuela was to suffer.

As oil revenues and production plummeted, Venezuela's government acted the way governments inevitably do when revenues disappear. It borrowed and taxed as much as it could, and then it started printing money. The printing led to the unintended consequence of inflation, then prices rose so high that people could no longer afford food. To respond to this unintended consequence, the government imposed price controls on food. But this created a new unintended consequence wherein farmers could no longer afford to grow food. And so the farmers stopped growing food. Finally, the government forced people to work on farms in order to assure food production.

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None of this means there is no place for legislation. What it does mean is that lawmakers should be keenly aware that every human action has both intended and unintended consequences. Human beings react to every rule, regulation, and order governments impose, and their reactions result in outcomes that can be quite different than the outcomes lawmakers intended. So while there is a place for legislation, that place should be one defined by both great caution and tremendous humility. Sadly, these are character traits not often found in those who become legislators, which is why examples of the cobra problem are so easy to find.

Summary Questions

1. What is the law of unintended consequences?

2. How does the law of unintended consequences apply to economics?

Quiz – Week of April 20
(Complete without looking at your notes or packet!)

1. What has been the result of those countries that implemented an economy whose characteristics were more aligned with a market economy?

2. What has been the result of those countries that implemented an economy whose characteristics were more aligned with a command economy (i.e., were highly socialistic)?

3. Which statement *best* summarizes Hayek's *main* argument in *The Use of Knowledge in Society:*

(a) The economic problem of society is how planners can best use the knowledge given to them
(b) People appreciate the price system because it is not the product of human design and the people guided by it usually do not know why they are made to do what they do
(c) In a competitive industry the task of keeping cost from rising requires constant struggle, absorbing a great part of the energy of the manager
(d) Prices coordinate the separate actions of people in a system in which knowledge of the relevant facts needed to make decisions is dispersed among many people

4. Give an example of the "Law of Unintended Consequences." Explain both the goal of the action and the results.