



Common Sense Economics and Human Flourishing

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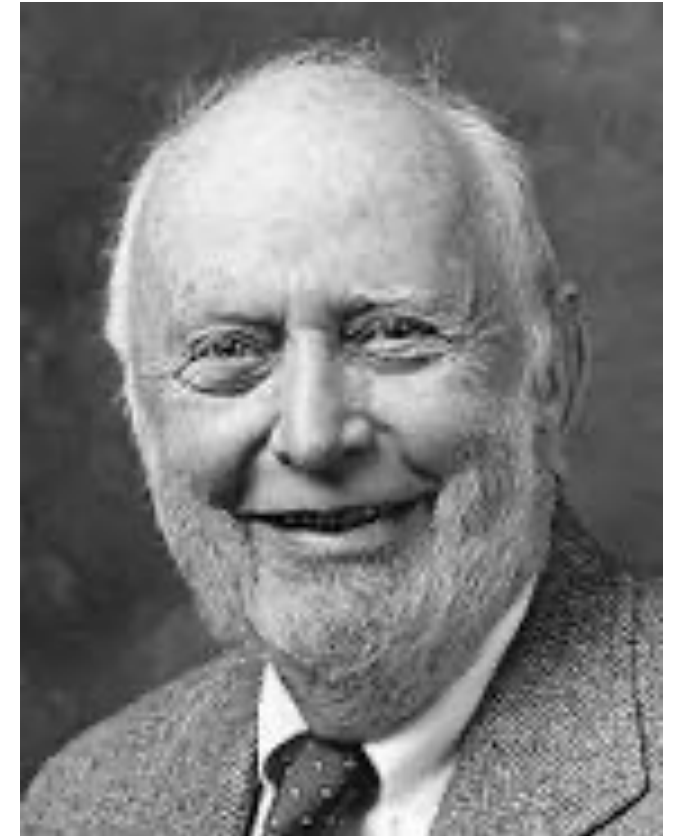
ECONOMICS - MARKETING

GUATEMALA

Institutions matter.

(Here identify your mentor.)

- ▶ *Institutions, Institutional Change and Economic Performance* (1990)
- ▶ Douglass North argues you get the institutions right, humans flourish, and countries grow.



Douglass C. North
1993 Nobel Laureate

The science of
decision-
making in a
world of
scarcity.

Incentives matter.

The decisions of
today have
consequence that
lie in the future.

Every decision has
a cost, an
opportunity cost.

Voluntary
exchange creates
wealth and
improves health.

People respond to
changes in
predictable ways.

Institutions matter.

Economics of the Constitution

- ▶ Limited government serves its people.
 - ▶ It defends the natural rights of people, their right to life, liberty, and pursuit of happiness; and prevents aggressions on the people.
 - ▶ In other words, it is the administration of justice.
- ▶ U.S. Constitution and our Founding Fathers based much of what is written in the Constitution on Lockean principles with the role of government clearly outlined.

Articles of Confederation

A perfect storm

Without any element of a central government under the Articles,

- ✓ States erected trade barriers.
- ✓ Free-riding occurred where some states paid taxes to cover war debt and administrative costs while others did not.
- ✓ Conflict between states over internal affairs and between the U.S. and foreign countries became increasingly difficult to resolve.
- ✓ Inflation ran rampant in a country buried in debt.

From the Articles to the Constitution

- By correcting the deficiencies of the Articles, the U.S. Constitution and Bill of Rights (Amendments 1-10) set the stage for economic growth and prosperity.
- The Constitution established the rules within which the people across the U.S. economy would break from the world's impoverished past and successfully lift themselves and their trading partners around the world to new standards of living.

U.S. Government

- The powers delegated to the federal government are explicitly listed and all others are left to the state or the people.
- Specifically, of interest are the economic incentives in the following clauses of Article I:
 - Spending Clause (Article I, Section 8, Clause 1)
 - Commerce Clause* (Article I, Section 8, Clause 3)
 - Coinage or Mint Clause* (Article I, Section 8, Clause 5)
 - Patent and Copyright Clause (Article I, Section 8, Clause 8)
 - Contract Clause (Article I, Section 10, Clause 1)
- The Bill of Rights protects the basic principles of human liberty and explicitly limits government interference in private lives.

Sherman Anti-trust Act of 1890

- ▶ Movement in the direction of using government to tamper industry.
- ▶ The boundaries of government expanded.
- ▶ This expansion endangered liberty.

Not-So-Roaring 20s and Great Depression

- ▶ Installment credit
- ▶ Margin trading in the stock market
- ▶ Smoot-Hawley Tariff bill
 - ▶ What history books don't tell you:
 - ▶ Smoot-Hawley Tariff went from majority Senate opposition to majority Senate support
 - ▶ 30 governments warned Congress that they would retaliate in Sept 1929
 - ▶ Stock market crashes in Oct 1929, moderately recovers, and drops again after it passes in Jun 1930
 - ▶ *The Midas Paradox* (2015), by Scott Sumner

Solutions of the Era

- ▶ Government policies, interventions, and regulations emerge to correct failures in markets
 - ▶ Tariffs
 - ▶ Taxes (high)
 - ▶ Subsidies
 - ▶ Other interventions
- ▶ Central bank intervenes
 - ▶ Restrictive monetary policy

Markets fail: This we know

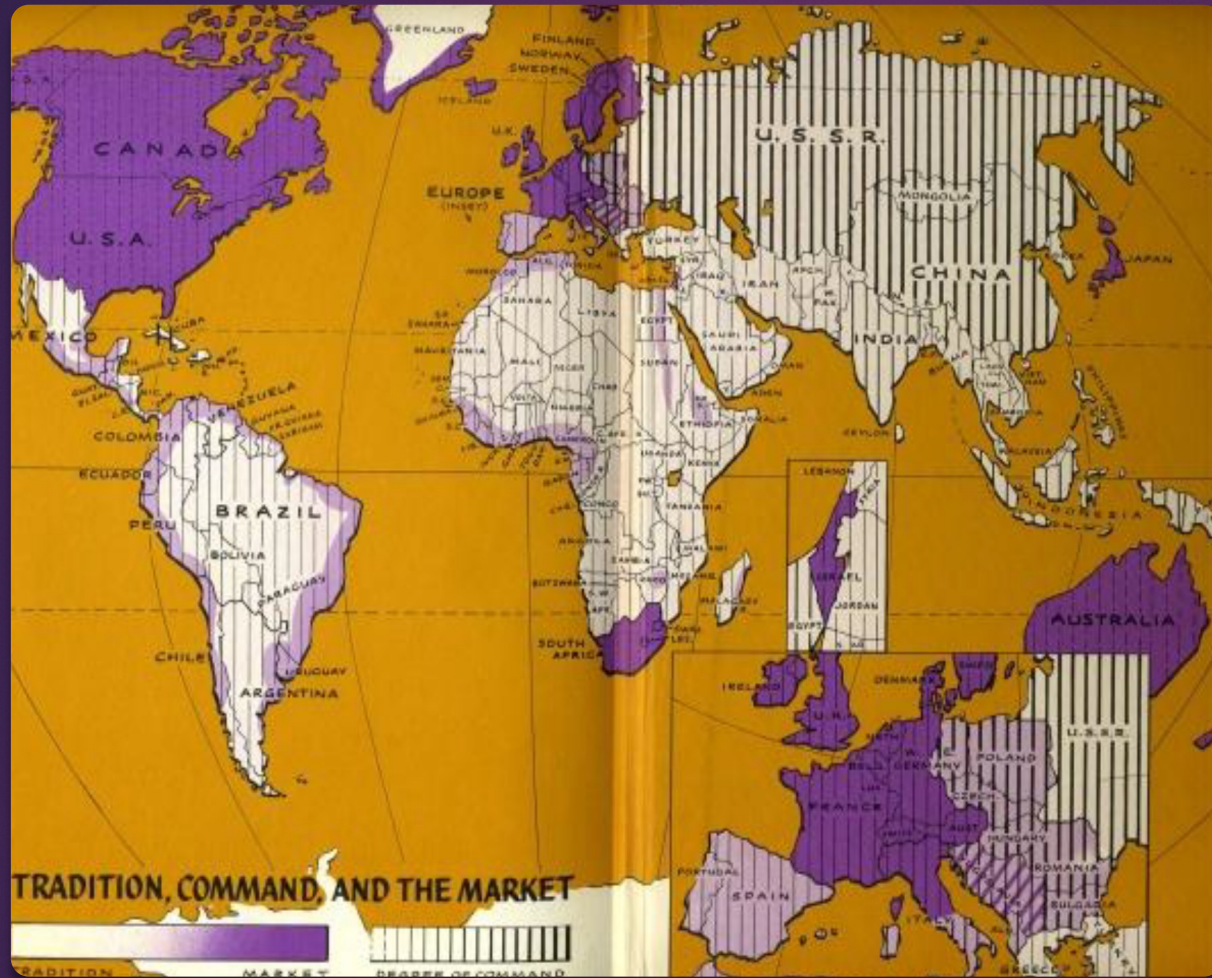
Market Failure is a concept in economic theory where in the allocation of goods and resources by a *free market* is not efficient.

- Public Goods
- Externalities
- Lack of Property Rights
- Asymmetric Information



GOVERNMENT FAILS!

But so does
government!



Resources:
Allocate them
strategically for
growth and
prosperity

Textbook confessions

- ▶ Levy, David M. and Peart, Sandra J., Soviet Growth & American Textbooks (December 3, 2009). Available at SSRN: <https://ssrn.com/abstract=1517983> or <http://dx.doi.org/10.2139/ssrn.1517983>

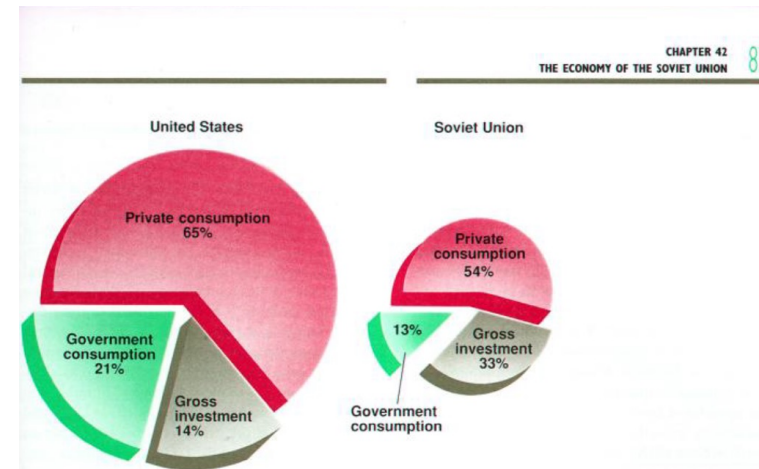
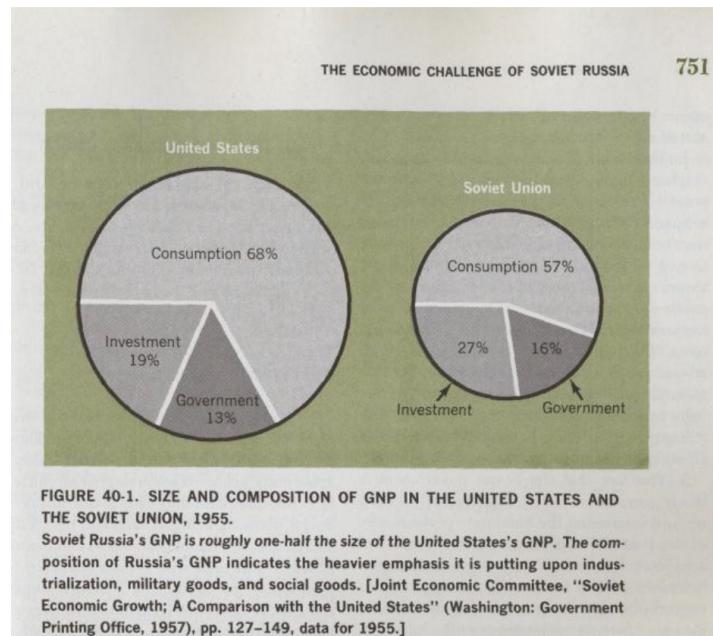


FIGURE 42-1

Size and composition of GNP in the United States and the Soviet Union

The Soviet Union's GNP is about 50 percent the size of the United States' GNP. As compared with the United States, the Soviet Union puts relatively greater emphasis on investment goods than on consumer goods. [Joint Economic Committee, *USSR: Measures of Economic Growth and Development, 1950-1980* (Washington, 1982), p. 67, and *Economic Report of the President*.]

USSR vs US

- ▶ USSR growth rates projected to be greater than US, leading to higher real GDP and income in the future.

TABLE VI · 1-1 *Relative Size and Growth Rates*

	U.S.S.R. GNP as Per Cent of U.S. GNP (1958)	Growth Rates (1950-1958)	
		U.S.	U.S.S.R.
Weights correspond to U.S. prices	65	2.9	6.0
Weights correspond to U.S.S.R. prices	33	2.9	7.5

Source: M. Bornstein, "A Comparison of Soviet and United States National Product" in Bornstein and Fusfield, *The Soviet Economy: A Book of Readings*, 1962.

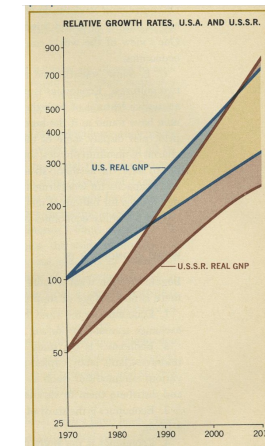


FIG. 1-1. The art of judgment, as well as scientific analysis, is involved in determining reasonable projections of growth rates free of either wishful or paranoid thinking. Not only are Americans and Russians concerned with the outcome of this economic sweepstakes, but so are Asians and Africans interested in choosing that form of economic organization which will move them most rapidly along the road of development. (Source: Fig. 42-1.)

Resources vs institutions

- ▶ Institutions are the rules and regulations that guide behaviors in a variety of settings.
- ▶ Investigate how different institutions lead to different outcomes.

Inspired by the Levy and Peart study






- ▶ Eyzaguirre, H., Ferrarini, T.H., O'Roark, J.B. (2019). "Textbook Confessions: Government Policies and Market Outcomes." Eds. Hall, Joshua and Lawson, Kerianne (Eds.) in Teaching Economics.
- ▶ Eyzaguirre, H., Ferrarini, T.H., O'Roark, J.B. (2016). "Textbook Confessions: Of Failures, Markets, and Government. Journal of Economics and Finance Education. 15(2): 60-71.
- ▶ Eyzaguirre, H., Ferrarini, T.H. and O'Roark, J.B. (2014). "Textbook Confessions: Government Failure." The Journal of Private Enterprise 29(3): 159-175.

POLITICAL VS MARKET
ALLOCATION
EXPERIMENT

INTO YOUR
LIVES

You now have \$75!








Spending \$\$ on item generates which emotion??				
-10 Upset	-5 Dissatisfied	0 Neutral	+5 Happy	+10 Ecstatic
				


Cart 1

	Cart 1	Price	Value
1.	Pantene Pro-V shampoo - 13 oz.	\$3	-10*-5*0*+5*+10
2.	Avatar on DVD	\$15	-10*-5*0*+5*+10
3.	Any laundry detergent - 24 oz.	\$5	-10*-5*0*+5*+10
4.	Johnson's baby formula - 26 oz.	\$8	-10*-5*0*+5*+10
5.	Fixodent denture cleanser	\$6	-10*-5*0*+5*+10
6.	Skittles candy - king size	\$1	-10*-5*0*+5*+10
7.	Tampax tampons - 1 box (24 ct)	\$7	-10*-5*0*+5*+10
8.	Electric beard trimmer	\$24	-10*-5*0*+5*+10
9.	Kellogg's Frosted Flakes cereal - 1 box	\$3	-10*-5*0*+5*+10
10.	Almonds (6 oz. can)	\$3	-10*-5*0*+5*+10
	TOTALS:	\$75	

Spending \$\$ on item generates which emotion??

-10 Upset	-5 Dissatisfied	0 Neutral	+5 Happy	+10 Ecstatic
				

Cart 2

	Cart 2	Price	Value
1.	Crest Toothpaste - 3 oz.	\$2	-10*-5*0*+5*+10
2.	<i>Titanic</i> on DVD	\$14	-10*-5*0*+5*+10
3.	Downy fabric softener - 20 oz.	\$3	-10*-5*0*+5*+10
4.	Huggies diapers - jumbo pack (31 ct.)	\$13	-10*-5*0*+5*+10
5.	Adjustable heating pad	\$26	-10*-5*0*+5*+10
6.	Snickers candy bar - king size	\$1	-10*-5*0*+5*+10
7.	Revlon lipstick - one tube	\$6	-10*-5*0*+5*+10
8.	Protein bars - 1 box (6 ct.)	\$6	-10*-5*0*+5*+10
9.	Kellogg's Strawberry Pop- Tarts - 1 box	\$3	-10*-5*0*+5*+10
10.	Gum 1 regular pack (15 ct.)	\$1	-10*-5*0*+5*+10
	TOTALS:	\$75	

How can
we choose
between
cart 1 and
cart 2?

Tradition

Contest

Drawing

Equal share

Command and control

Voting

Voting by a simple majority

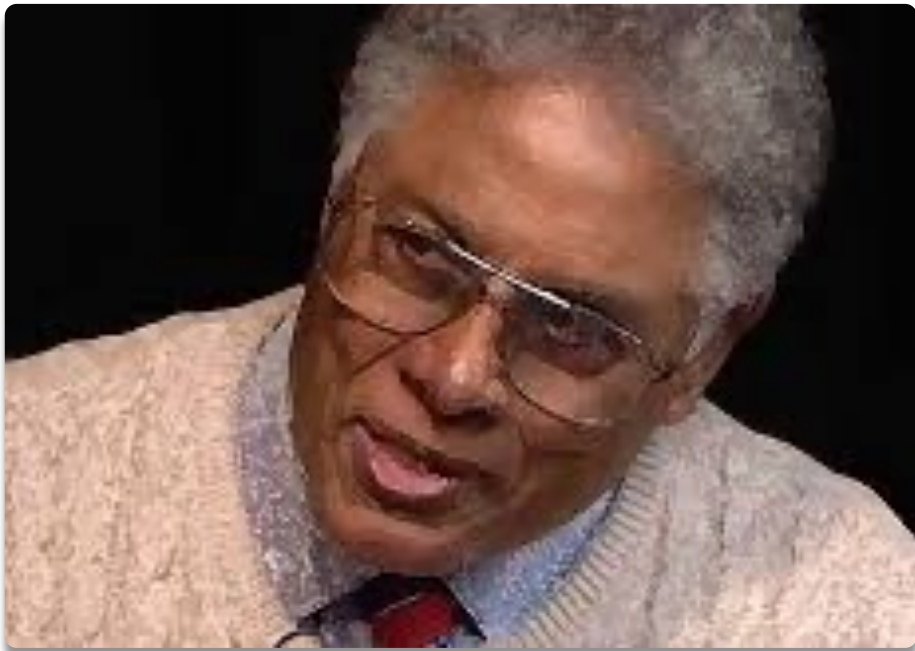
- ▶ Based on the highest positive value (+) or lowest negative value (-), let's have a show of hands for Cart 1.
- ▶ Now, Cart 2.
- ▶ The winner is ??????????
- ▶ CART 2!!!!

Anyone have two carts, both with negative values?

- ▶ Many active, registered voters cast their ballots for the lesser of two evils in 2016.



Thomas Sowell



- ▶ “The first lesson of economics is scarcity: there is never enough of anything to fully satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”

Responsible

and

accountable individual and decision- making

Personal value > price → purchase or pass
Personal value < price → pass



SPEND UP TO \$75 OF YOUR OWN WAGES AND SALARIES

Y/N?		Price (in \$)	Value (0, 5, 10)
	Pantene Pro-V shampoo – 13 oz.	\$3	
	<i>Avatar</i> on DVD	\$15	
	Any laundry detergent – 24 oz.	\$5	
	Johnson's baby formula – 26 oz.	\$8	
	Fixodent denture cleanser	\$6	
	Skittles candy – king size	\$1	
	<u>Tampax</u> tampons – 1 box (24 <u>ct</u>)	\$7	
	Electric beard trimmer	\$24	
	Kellogg's Frosted Flakes cereal – 1 box	\$3	
	Almonds – 6 oz. can	\$3	

Cart 2		Price (in \$)	Value (0, 5, 10)
Y/N?			
	Crest Toothpaste – 3 oz.	\$2	
	<i>Titanic</i> on DVD	\$14	
	Downy fabric softener – 20 oz.	\$3	
	Huggies diapers – jumbo pack (31 ct.)	\$13	
	Adjustable heating pad	\$26	
	Snickers candy bar – king size	\$1	
	Revlon lipstick – one tube	\$6	
	Protein bars – 1 box (6 ct.)	\$6	
	Kellogg's Strawberry Pop-Tarts – 1 box	\$3	
	Extra sugar free gum – 1 pack (15 ct.)	\$1	

Total invoice for all purchased goods: _____

Total value: _____

Total amount “saved”: _____

When individuals spend their earned income, they are:



MORE PURPOSEFUL IN SPENDING;



MORE LIKELY TO SAVE (AND
INVEST);



ACTIVELY PARTICIPANTS IN
GROWING THEIR ECONOMIES
AND HELPING OTHERS PROSPER.

Initially, limited *popular* attention is drawn to the soundness of government intervention but it grows in Public Choice economics

John Maynard Keynes

J. Buchanan, G. Tullock, M. Olson...

Others

Key issues

- ▶ Special interests
- ▶ Short-sightedness
- ▶ Rational ignorance or low information

Why this
topic
matters to
you and
your future

CSE 3.5 Guide to
American Federal

Debt: *From Debt limit-A
guide to American federal
debt made easy (2011).*

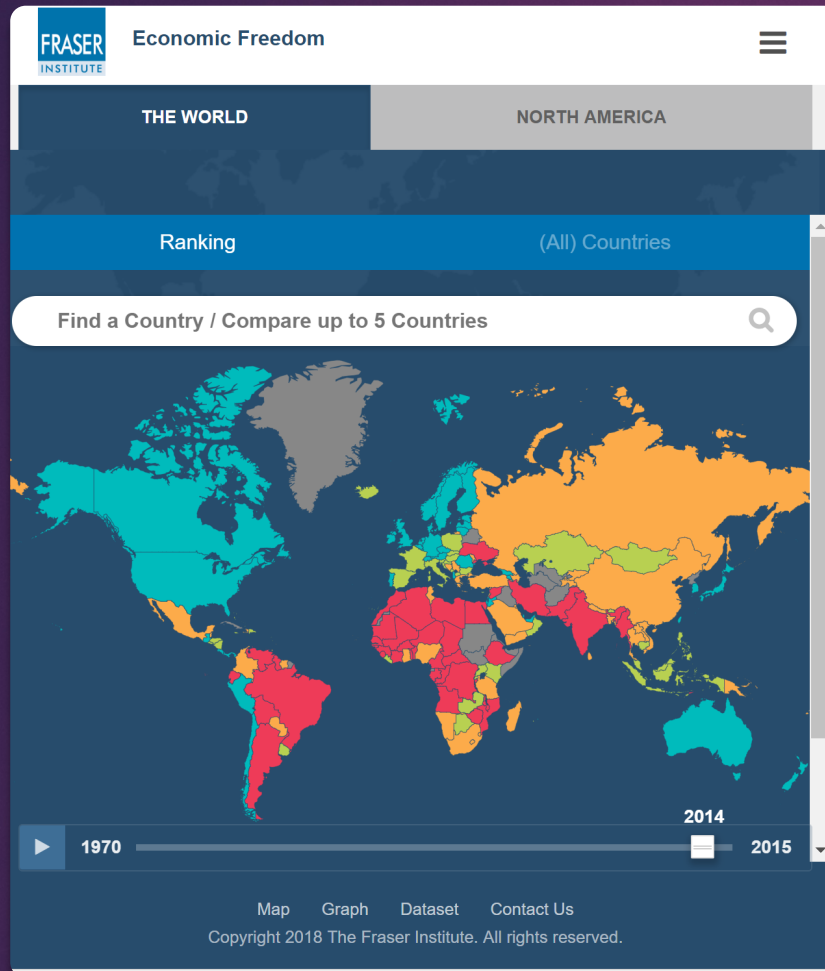
U.S. National
Debt Clock:
Real Time

Action items

- ▶ Earn a badge [Common Sense: The Economics of Government versus Markets](#) at Canvas.net. See the differences between the way in which the political process and markets made up of free and responsible individuals allocate resources and associate differences with different opportunities to live financially secure and rewarding lives.
- ▶ Share this with others.
- ▶ Make 2018-19 plans to advance your understanding of this topic.
- ▶ Identify ways to excite others with these ideas and better understand them, especially your legislators.
- ▶ Stay in touch! [Tawni.org](#)

Economic freedom

- ▶ Responsible and accountable personal choice
- ▶ Rule of law
- ▶ Easy access to markets
- ▶ Low taxation
- ▶ Limited government regulation and stable money



Fraser Institute Economic Freedom Map and Report, 2022

GDP per capita and Income per capita

- ▶ Real GDP reflects a nation's total product in a given period of time (usually one year). Real GDP is also discounted to a base year so that the numbers are comparable, removing the effects of annual inflation in order to better understand growth. Income per capita is derived from GDP because it divides GDP into the number of inhabitants in a nation and thus, provides a clear picture of how well people are doing in a given country or territory.
- ▶ Inflation is a key figure to take into account as it shows how purchasing power has eroded over time. A dollar today does not buy the same amount of goods as a dollar 50 years ago. Another important macro indicator is a nation's fiscal deficit as it reveals potential future problems with inflation as country's usually issues more currency which tends to result in higher prices as the illusion of more money in circulation drives prices up.

Economic Freedom and Income Per Person

- ▶ Economic freedom can be measured by looking at key indicators like income per capita, property ownership, access to capital and ease of doing business (as illustrated by Hernando de Soto's "The Mystery of Capital"). These indicators can reveal to us how easy it is for people to work, to create new businesses, to invest and exchange, and to have an overall measure of how well people are doing (at least materially and financially speaking).
- ▶ Provide two explanations that explain how differences in real GDP per capita and varying degrees of economic freedom translate in (1) lower potential to earn income per person and (2) higher potential to earn income per person.
 - ▶ If real GDP per capita decreases or stagnates in a country with low economic freedom, then the gaps between the have's and have-nots will widen and less people will have the opportunity for upward mobility, and most likely, the lower tier of the "have's" will begin to move downward. This happened in Argentina during Eva Peron's government, during which her populist policies caused Argentina to become a third world country after being a top agricultural power and a first world economy. Venezuela is another example of how a nation with immense oil reserves and economic drive and potential came crashing down once economic freedoms were stifled by Hugo Chavez's regime (and now Maduro's). Capital in Venezuela fled, black markets emerged, and the common people began to struggle to work and make a decent living.
 - ▶ On the other hand, a growing real GDP per capita usually translates into more economic freedom because as people earn more, their choices grow. They can have more freedom to spend, save and/or invest their resources, assuming that tax burdens do not rob them of their hard-earned money. Because there are more resources available for investment, people can aspire to higher paying jobs as capital investment allows for businesses to be more productive and profitable.

Market Failures

- ▶ When markets are unable to respond to discontinuities provoked by unforeseen crises like natural disasters, pandemics, irresponsible government policies. Markets need time to adjust, and those periods may cause some people to lose and companies to close, but other opportunities may arise.
- ▶ Through **creative destruction**, resources allocated in inefficient industries or companies that are unable to address strong market shifts and fail, can be reallocated into more profitable and sustainable ventures that can generate better job opportunities for people and thus, improve their income and potential to economically prosper.
- ▶ Governments can address these situations by cutting government spending, lower taxes, which in turn can allow people to better dispose of their resources according to their needs. Lowering taxes can also allow for investment opportunities in response to the crisis and create new jobs for people. Governments should stay away from distorting prices through adjusting interest rates, injecting money into the economy or providing incentives only to specific industries. These measures can create bubbles that, when they burst, can generate even worse economic effects than the current market failure.
- ▶ Provide two country- or industry-specific examples drawn from your country of choice.
 - ▶ Bank and mortgage industry bailouts during the 2008 financial crisis provided the perverse incentives to continue with irresponsible behavior within the financial industry as they were deemed as “too big to fail”.
 - ▶ In Guatemala, one of the most important measure taken in order to secure macroeconomic stability was by placing “locks” on the central bank by reducing their level of influence in the economy, limiting their ability to issue currency, intervene on the foreign exchange market and by eliminating legal tender, aside from also obligating government institutions to use the commercial banking system instead of the central bank.

Government Failures

- ▶ When government fails to fulfill their obligations:
 - ▶ Defend and protect life, liberty and private property
 - ▶ Allow for the enforcement of contracts and administrative justice
 - ▶ Sustain rule of law
 - ▶ Protect our national sovereignty
- ▶ Identify the three sources described in Common Sense Economics (2016: Part 3).
 - ▶ Avoid excessive spending and deficits
 - ▶ Avoid subsidies
 - ▶ Limit special interest influence
- ▶ Provide examples of each from your country or industry of choice. (see next page)

Examples of Government Failure

- ▶ Avoid excessive spending and deficits
 - ▶ The pandemic in Guatemala proved a classic textbook example of excessive spending and deficits. Loans were requested and the central bank was liberated to issue currency, which flooded the market with money, promoted government corruption to a level unseen before and at the end, resulted in inflation. Today we are seeing the effect with higher prices, higher interest rates and the subsequent credit crunch that will slow down growth and investment.
- ▶ Avoid subsidies
 - ▶ The government had been usually very prudent with the use of subsidies but the pandemic and the oil price crisis during the initial stages of the war on Ukraine proved an excellent opportunity to recur to this populist tactic. Propane gas and gasoline were heavily subsidized and this all causes a general price distortion in the market that, when liberated, hikes prices higher than before. Politically, it is very hard to let go of a subsidy and new opportunities for corruption arise.
- ▶ Limit special interest influence
 - ▶ Guatemala's local big beer company has been very active in stifling competition from foreign brands that could enrich the local beer market. Imported beers face a 40% import tariff, which makes them super expensive. An imported beer on the supermarket could go as high as US\$5.00 while local beers go for about \$1.50. Consumers pay the price and are limited in their choices.

Economic Freedom and Income Earned by the Poor

- ▶ Summarize the research on this topic and present two extreme rankings in economic freedom.
- ▶ Use Common Sense Economics (2016: Part 3) to identify the key differences in (1) property rights and (2) role of government in markets.

Economic Freedom Comparison

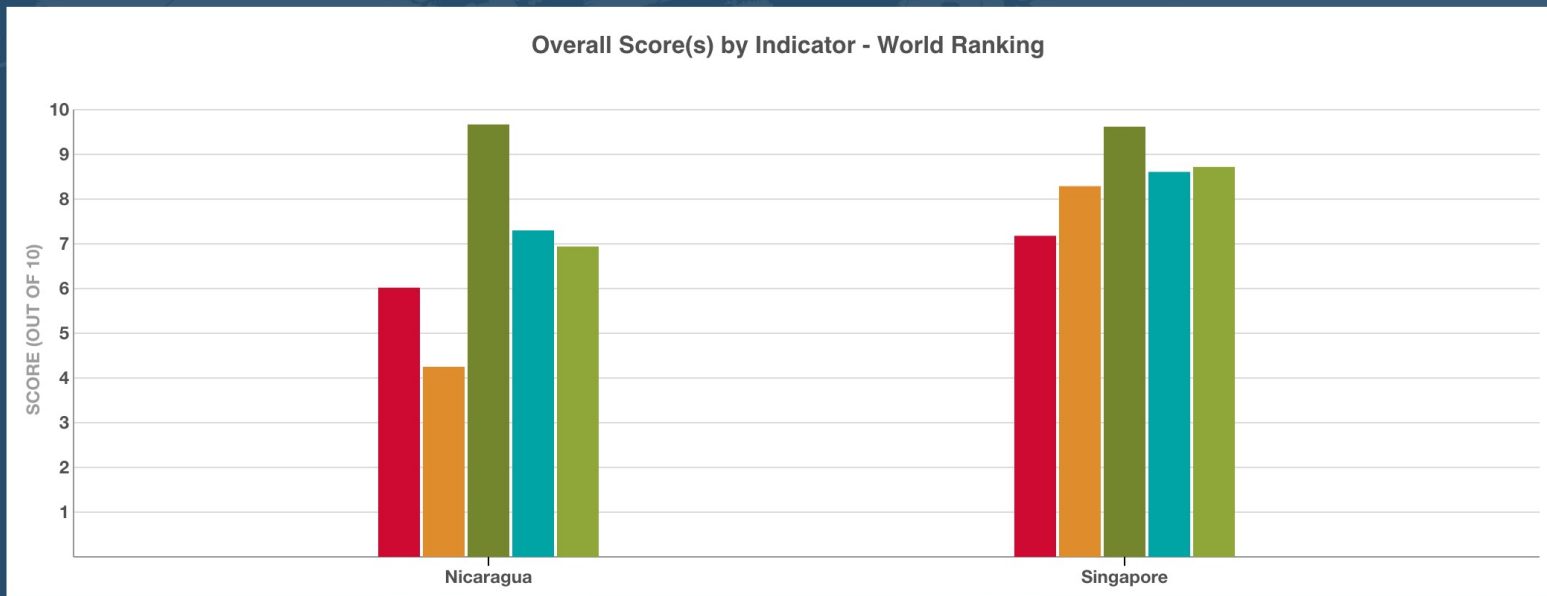


THE WORLD

NORTH AMERICA

Nicaragua x Singapore x

GRAPH OPTIONS



Post to: [Email] [Facebook] [Twitter]

Countries Selected:

- Nicaragua
- Singapore

Filter By Category:

- Size of government
- Legal systems & property rights
- Sound money
- Freedom to trade internationally
- Regulation

Deselect All



1970

2020

2020

Key Differences in Economic Freedom

Singapore

- A stronger legal system that allows for better protection of property rights
- Government does seem allow for a greater amount of personal freedom, which is reflected on international trade and greater property rights, less regulation and sounder money.

Nicaragua

- Because of the government's level of intervention, Nicaragua's legal system does no protect property rights, and as of late, has seen abusive intervention and closing of businesses and even NGO's such as the Red Cross.
- This is clearly reflected on how tough it is to trade internationally and how regulated life is in the country.

Economic Freedom and Income Earned by the Poor

Market Failure

- One of the biggest problems that we face in Guatemala is that, because of poor or unclear property rights, companies that deal in energy (hydroelectric plants) or African palm plantations, have been accused of diverting rivers and thus, harming small farmers that depend on these very important water sources. Another issue caused by lack of clear property rights is pollution and lack of accountability for its negative effects downstream, especially for poorer communities with no running water that depend on rivers for getting this resource.
- <https://rivers-ercproject.eu/a-dying-river-in-alta-verapaz-guatemala/>

Government Failure

- Malnutrition in Guatemala is one of our greatest social problems. 1 in every 2 children suffers chronic malnutrition.
- Many government programs and initiatives have been announced with very little and poor execution. Rampant corruption and the insistence from the part of the government to centralize aid and its distribution only exacerbates the problem.
- <https://www.unicef.org/lac/en/stories/guatemala-a-search-cases-child-malnutrition-are-hidden-pandemic#:~:text=In%20Guatemala%2C%201%20in%20every,count%2011%2C087%20cases%20%2D%20nearly%20half.>

Economic Freedom and Life Expectancy

- ▶ Greater economic freedom is highly correlated to higher income and greater choices and access to healthcare. This will lead to greater life expectancy as people have wider opportunity to choose from and resources to pay for health services.
- ▶ While Guatemala ranks higher in the economic freedom index than China (China imports coffee from Guatemala), Guatemala has a lower life expectancy (73.18 years) vs China (78.23 years), which can be explained by Guatemala's rampant corruption and government failure in addressing malnutrition and healthcare for people.

Economic Freedom and Civil Liberties

- ▶ Because economic freedom allows for choice, people are more empowered, responsible and accountable for their personal choices at almost every level of their lives. This allows for business opportunities to serve diverse needs and include more market segments into the economy that are usually left out when economic freedom is stifled and governments seek to take over in addressing the needs of poor people, for example. Greater economic freedom allows for business innovation, which in turn, opens opportunities for including and addressing more diverse and specific market segments.
- ▶ Íntegro in Guatemala, the company that I work for, is focused on taking retail shopping experiences that used to be only available in Guatemala City into developing rural areas such as Gran Carchá (San Pedro Carchá), SantaLú (Santa Lucía Cotzumalguapa) and our newest mall, Los Altos (Totonicapán).
- ▶ Venezuela has a very tight grip on the currency exchange market, and this has developed a black market for people to have access to dollars in order to travel or pay for imports. This tends to hurt consumer prices and the access people have to different products and services that are imported.

Communism, Socialism, and Capitalism

- ▶ Using credible sources, define each with respect to how scarce resources are allocated.
- ▶ Identify two strengths and two weaknesses.
- ▶ Using credible sources, identify which has a better record of helping humans flourish on various fronts, with attention drawn to social, environmental, and governance.

Capitalism

Definition: Capitalism is an economic system in which private individuals or businesses own capital goods. At the same time, business owners (capitalists) employ workers (labor) who only receive wages; labor does not own the means of production but only uses them on behalf of the owners of capital.

Strengths: Greater individual freedom and choice. Greater opportunity for upward mobility.

Weaknesses: Inequalities of results are more evident. Loss of values at the expense of materialism.

Historically it has been proven that under a free market system, people are more likely to rise out of poverty and with that, are able to take care of each other more (solidarity) and, through well defined and protected property rights, the environment is better cared for, as has happened with elephant populations in Africa in places where property rights are protected.

Socialism

Definition: any of various egalitarian economic and political theories or movements advocating collective or governmental ownership and administration of the means of production and distribution of goods

Strengths: More access for more people of **the same** things. Reduced perception of inequality or poverty.

Weaknesses: Reduced freedom. Reduced opportunities for upward mobility.

By removing the incentives that private property and free trade bring to people, socialism discourages work (free rider issue) and creates poverty. Lack of property rights also harms the environment as incentives to protect what is yours are removed, as illustrated by the regulation of property rights where protected species live.

Communism

Definition: Communism is a political and economic ideology that positions itself in opposition to liberal democracy and capitalism, advocating instead for a classless system in which the means of production are owned communally and private property is nonexistent or severely curtailed.

Strengths: Proposed elimination of inequalities. Utopian vision of common progress for all.

Weaknesses: Political oppression to force equality. No upward mobility. Stifled innovation.

Communism has been a terrible destructive force in nations where it has been imposed. The loss of life and levels of political oppression have proven its ineffectiveness as shown in the former USSR, China, Cuba and Venezuela. The effects on the environment under communism have been terrible, as natural resources are only viewed as means and cogs in the machine (as well as human beings).

Thomas
Sowell

“Socialism in general has a record of failure so blatant that only an intellectual could ignore or evade it.”

F.A. Hayek

“The tragedy of collectivist thought is that, while it starts, out to make reason supreme, it ends by destroying reason because it misconceives the process on which the growth of reason depends.” ~ p180