

Economics: A Christian Worldview – Why Would Anyone DO That?

(TEACHER INSTRUCTIONS/KEY)

Purpose

In this interesting activity created by the Foundation for Teaching Economics (fte.org), students see how incentives play an important role in human actions, and they see how perverse incentives played out in several scenarios in the Soviet Union's communist economy.

Time

35-40 minutes

Prep

1. Go to this link at the Foundation for Teaching Economics web site for a general review of the game:
<https://fte.org/teachers/teacher-resources/lesson-plans/edsuleasons/lesson-3-incentives-matter/>
2. Here is a video (7:39) that explains how to run the game on this page:
<https://www.youtube.com/watch?v=1Vsdko3q19o>
3. The below material in this document is a simplified version that eliminates two of the five scenarios in the original. (The original set of instructions is on the above page link.) If you want to use this simplified version, print Pages 1-3 for yourself and Pages 4-5 (front to back!) for each student.

Instructions

STEP 1: Introduction (Read/explain to students).

People respond predictably to positive and negative incentives.

- Rewards: positive incentives that make people better off
- Penalties: negative incentives that make people worse off
- + and – incentives affect people's choices and behavior
- People's views of rewards and penalties differ (different values)
- Responses to incentives are predictable (SELF-INTEREST!)
- Changes in incentives → changed behaviors
- Incentives can be MONETARY or NON-MONETARY
- Acting as consumers, producers, workers, savers, investors, and citizens, PEOPLE RESPOND TO INCENTIVES to ALLOCATE THEIR SCARCE RESOURCES → highest possible returns

Entrepreneurs are people who take the risks of organizing productive resources to make goods and services. Profit is a key incentive that leads entrepreneurs to accept the risks of business failure.

Entrepreneurs do this:

- Take risks to develop new products, start new businesses
- Recognize opportunities, accept challenges
- Often innovative; try to solve problems
- Accept risks in organizing resources to produce, hope to profit
- Actions influenced by government tax and regulatory policies

Lesson Theme:

- The legendary (and sometimes comical) inefficiency of productive efforts and the seemingly perverse behavior of firms in the former Soviet Union can be explained by examining the incentives faced by the managers of those enterprises, and by recognizing how those incentives differed from incentives faced by workers and planners.
- Non-market Soviet firms' behavior was perverse: **INCENTIVES!**
- Competitive markets reward firms for good performance with **profits**.
- Soviet ministry penalized managers for any disruptions, rewarded them for **meeting targets**.

STEP 2: Scenario 1 (as a class)

- Show PowerPoint slide 1 and read it to the class. (The Russian caption on the bottom of the cartoon says, basically, this: MAN 1: "Who would ever need a nail that size?" MAN 2: "That's a minor detail! What's important is that we met our quota!")
- Show PowerPoint slide 2 and read it to the class. Pull up the two questions and ask for student feedback on the answers. (Answer: Quotas were based on **WEIGHT**.)

STEP 3: Scenario 2 (Instructions on PowerPoint slide 3)

- Put students in groups of 3-5.
- Groups elect a discussion leader, recorder, and question asker.
- Hand out Scenarios 2 & 3 (printed front to back). Tell students to do Scenario 2 in their groups (take about 10 minutes) **and NOT to look on the back at Scenario 3 yet!**
- **Discuss Scenario 2 as a class.** Use your teacher notes on Page 3.

STEP 4: Scenario 3.

- Tell students to flip their handouts over and discuss Scenario 3 in groups (give groups 10 minutes).
- Discuss Scenario 3 as a class. Use your teacher notes on Page 3.

STEP 5: PowerPoint Wrap-Up

- Review the last four PowerPoint bullets on Page 4.
- Give students time to answer the last question individually, then go around the class and ask for students' answers.

Teacher Notes – Scenario 2 (Drilling)

1. The output targets were **based on meters drilled**. Since drilling slowed down as the hole became deeper, it was much faster to drill lots of shallow holes than one or two deep holes. When oil lies far below the surface, the likelihood of finding much oil is small.
2. Remind students that they cannot just change to market pricing; they must come up with an output target. Many groups will immediately change the output target to **barrels of oil**; encourage them to think how they would behave.
3. Some possibilities: **Firms would be reluctant to drill unless they were certain of hitting oil, so less drilling would occur**. When **oil was found, numerous wells would be drilled in a small area to maximize the number of barrels that could be extracted in a short time**. One effect might be a very **erratic supply of oil**—large amounts until a drilling area was depleted, then very little—**because no one wanted to take the risks** of drilling a dry well.

Teacher Notes – Scenario 3 (Light Bulbs)

1. Workers take the burned-out light bulbs to work, hidden in their pockets. When they go to the bathroom, or find themselves alone in a hallway or supply closet, they replace the working bulbs there with the burned-out bulbs from their pockets. They take the new bulbs home. The factory reports another burned out bulb and receives more when they become available.
 - Light bulb vendors are motivated by profit to accept the risks of a quasi-legal enterprise.
 - Workers accept the costs and risks of petty thievery from their employers because the transaction costs of getting light bulb legally are so high.
 - The government looks the other way because the costs of acknowledging and dealing with the problem of shortages are so high.
2. American citizens pay for light bulbs by trading their income (earned by working) for bulbs. Soviet citizens pay for light bulbs with their time as well as with their money.
3. The non-monetary costs to the Soviet citizens include such things as time spent finding light bulbs and time spent waiting in line. (Economists refer to these as *transaction costs*.)

“Why Would Anyone Do That?”

The Foundation for Teaching Economics (www.fte.org)

Don't turn this page over until instructed!

Scenario 2:

Keep two things in mind:

1. Who is the decision maker in this scenario?
2. What incentives does the decision maker face?

In their book *Meltdown—Inside the Soviet Economy*, authors Paul Craig Roberts and Karen LaFollette report on the seemingly mysterious propensity of Soviet geologists for drilling many shallow holes rather than a smaller number of deep holes. Since most of the oil deposits lie at relatively deep levels, it is not too surprising that “...Soviet geological expeditions in the Republic of Kazakhstan have not discovered a valuable oil deposit for many years....The surprising fact is that they were “...considered successful....The geologists and ministers are paid handsomely for their efforts, everyone goes out and gets drunk, and no one cares that the whole exercise has been an extraordinary waste of time and money” (p.10).

Further investigation reveals that Soviet geologists are very well-educated and clearly no less intelligent than geologists in the rest of the world. How then, can we explain their actions?

Clues

- In the process of oil-well drilling, the deeper the hole, the slower the drilling progress.
- The Soviet geologists were paid on a quota and premium system; that is, they were paid if they reached their quota and received bonuses if they exceeded it.

Given this information:

1. Start with the quota system. What do you suppose the quotas were based upon? Brainstorm a list of possibilities.
2. For each item on your brainstorm list, identify the incentives for the geologists and predict the behavior they would be most likely to engage in. Which item on your list best explains the behavior the authors reported?
3. If you were the minister in charge of oil production, how would you change the system to create incentives that would encourage the production of oil rather than oil wells (NOT the same ones in a market economy, but a different one)?
4. What perverse outcomes might occur because of your new target?

“Why Would Anyone Do That?” – Scenario 3:

Keep two things in mind:

1. Who is the decision maker in this scenario?
2. What incentives does the decision maker face?

(The following anecdote circulated in the U. S. in the late 1980s and seems to have come from the experiences of Americans traveling in the Soviet Union.) In the streets and informal markets of the city, there were vendors of light bulbs, and they often had significant numbers of buyers. At first glance, this wasn't surprising, as any visitor who had entered a Soviet building could easily see that light bulbs were apparently in short supply. Entryways and stairwells were often quite dark, and when light fixtures were in evidence, they almost never had bulbs. So, it didn't seem strange to see people buying light bulbs—until, that is, the observer discovered that the people were buying light bulbs that didn't work. The bulbs often looked normal enough, but usually the filament was broken, and the bulb had burned out. Even more amazing is that the customers seemed to know and accept that the bulbs wouldn't work. When asked why he was purchasing broken light bulbs, one Soviet citizen seemed puzzled that the American observer would ask, and responded, “Well, to take them to work, of course.”

Clues

- Light bulbs were in perennially short supply in the Soviet Union.
- Government offices, factories, etc. received shipments of light bulbs first. Only then were remaining bulbs offered for sale in state stores.
- Despite this fact, hallways, closets, and bathrooms in government offices and factories were almost always dark.
- There seemed to be no serious government effort to stop the sale of broken bulbs.

Given this information:

1. Explain the phenomenon of the burned-out-light-bulb vendors in terms of incentives and their effect on human behavior. Include the behavior of light-bulb vendors, workers/consumers, and government officials.
2. Compare and contrast the ways in which American citizens and Soviet citizens “pay” for light bulbs.
3. Soviet citizens paid for light bulbs with money, but they also paid in other ways. What non-monetary “payments” did they make?
4. Do you think the non-monetary costs or the money cost was a greater burden? Explain your thinking.