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ECON 201—Montgomery College

LECTURE 02: ECONOMIC SYSTEMS I

I. Capital
   a. *Capital* is a type of asset which is used to create goods or services. Buildings, computers, machinery, trucks, and land are examples.
   b. *Capital* is a type of *durable* good, or a good used for at least three years. It's a good you use over and over again. A car is a durable good; the gas for the car is not.
   c. Note that capital is both durable and used to make money (making goods and services).

II. Socialism
   a. *Capital (and non-capital) assets are publicly owned.*
      i. This is the key aspect of socialism. The state (central government) owns the means of production. Thus it has the authority to determine what is made, how much is made, where it's made, who makes it, and when it's made.
      ii. Economic decisions are determined by a central planning board which, in theory, allocates resources based on social priorities. The slogan "from each according to their ability and to each according to their need" captures this romantic goal. However, this system does not work.
   b. The Incentive Problem
      i. It is difficult to reward state planners for serving the people well.
   c. The Knowledge Problem
      i. It is difficult for state planners to know the best way to allocate resources.
   d. Socialism doesn't work because it can't overcome these problems; as evidence, all economically rich countries have low levels of socialism. While countries like Denmark and Sweden have generous welfare systems, they are fundamentally market economies.
   e. Note that socialism is different from communism.
      i. In socialism, the state controls all/most property.
      ii. In communism, *there is no property*. Everything is "owned" communally.

1. In theory people use the means of production to help others. They don't shirk their duties or favor one kind of person over another.
2. If you think this is silly keep in mind this is how the family unit works. No one "owns" the living room TV but its use is allocated without market transactions. Parents don't love one child more than another.[1]
3. But people don't think of strangers the same way as their friends or family. In practice a communist system would require the threat of force to ensure people don't try to live at the expense of others. The communist system would resemble socialism, which is one reason why economists typically treat these terms as interchangeable.

[1] I remember hearing about research that suggests most parents have a favorite child. But even if true the less-liked child will be treated much better than a stranger. Asymmetries of affection between offspring, to the extent they exist, are usually subtle.