

LECTURE 03: ECONOMIC SYSTEMS II

I. Capitalism

- a. *Capital (and non-capital) assets are privately owned.*
- b. Private ownership—of both capital and non-capital—is the definitive quality of capitalism. (We emphasize capital assets because that’s what the debate often gravitates towards, but capitalism desires other things to also be privately owned.)
- c. Under private ownership, decisions about production is decentralized. Each producer makes decisions about how much to produce, when to produce it, the quality to produce it at, whom to hire, etc. With all this discretion, how does a capitalist system coordinate?
- d. *Market prices.* Market prices solve both problems socialism struggles with. The price for a good or service is *information*—it informs us how scarce something is—and it’s an *incentive*—when prices change, then behavior changes.
 - i. Imagine the price of cheese increases and imagine that people don’t know why it’s increasing. *Even in their ignorance* as to the cause of higher cheese prices, they will know the most relevant fact: how much scarcer cheese is becoming.
 - ii. People who eat cheese will eat less cheese for the obvious reason that cheese is more expensive. This is desirable: if cheese is scarcer, we want people who value the cheese the least to not consume what’s there. The people who value cheese the least are the most likely to see those higher prices and decide it’s not worth it. And the greater the price change, the greater the adjustment in consumption.
 - iii. People who make cheese will have an incentive to make more cheese for the obvious reason that it’s more profitable to sell. This is desirable; if cheese is getting scarcer, we want resources, like milk and effort, reallocated to making cheese. Their other uses, like yogurt and ice cream, are now less valuable uses for milk. And, again, the greater the price change, the greater the adjustment in production.
 - iv. And so the great economic miracle. Resources are allocated efficiently (though not necessarily “fairly”) without a central

planner. We live in a world of unprecedented abundance and no one is in charge!