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LECTURE 03: ECONOMIC SYSTEMS II

I. Free-Market Capitalism
   a. Prices are set by the *market*, or the voluntary and mutual exchange between at least one buyer and at least one seller. Supply and demand meet, agreeing on a price.
      i. Voluntary exchange is crucial as that freedom of choice enables individuals to use their property (time, labor, capital) as they see fit.
      ii. This in turn implies there's competition. Not only does competition allow consumers choices (and thus each purchase is truly voluntary and not "buy or die"), but it is often the result of people choosing to enter any line of work they please.
   b. Involvement by the state (i.e. government) is small (but not zero).[1] Its main role is to establish and protect property rights through avenues such as police and courts.

II. Crony Capitalism
   a. On the surface, crony capitalism is identical to free-market capitalism: private hands own and run most firms.
   b. But such firms are also supported by the government in various ways including lax regulations, legal barriers to entry, tax breaks, subsidies, and other sources.
      i. Example. Many jobs in the United States require government permission in the form of licensing. It often requires years of schooling, capital investments, and a certain amount of experience. On the surface, it claims to ensure high quality but its ultimate goal is to constrain competition.
   c. Profits flow into private hands (and, indirectly, to the hands of bureaucrats and other significant political actors).

III. Relevance
   a. This is particularly important distinction that evades many. Policies that help businesses do not necessarily result in a better economy. Just because the stock market rises or falls doesn't mean the livelihood of the people are doing better or worse.

[1] Zero involvement would imply no government at all. This approach—anarcho-capitalism—suggests everything (police, courts, school system, roads) be handled by private hands.

b. When judging the quality of a policy, the question often hinges on if the policy would increase or decrease competition. Many pro-business but not pro-market policies make it harder to compete. This is good for incumbent firms but, clearly, not good for society as a whole.
c. What makes crony capitalism particularly difficult to detect is that these kinds of interventions are often framed as having a welfare-enhancing function.
    i. Example. Licensing requirements are often framed as protecting consumers from low quality service. Maybe they do. But those requirements also make it hard to start a new business, creating higher prices.
    ii. Example. Many regulations are actually desirable for large companies because such firms can absorb the cost of regulation easier than a smaller company.
    iii. Example. Preventing people from abroad selling to domestic consumers is often framed as helping locals get jobs. But it also protects domestic firms from competition and raises prices for everyone.
d. Why do politicians and other political actors tolerate, and even make, these rules? The short answer is that they have interests and incentives unconnected to the benefit of society as a whole. But we'll explore this idea in more detail when we cover public choice in Unit 3.