



Economic Systems and Macroeconomics: Crash Course Economics #3

Crash Course: Economics

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Adriene: Hi I'm Adriene Hill. Mr. Clifford: And I'm Mr. Clifford and welcome to Crash Course Economics. Adriene: Today we're going to focus on macroeconomics and talk about economic systems and the nations that really like them. Wink, wink. Mr. Clifford: "Economic systems and the nations that really like them. Wink, wink." What does that even mean? Adriene: I'm trying to come up with a spicy title for today's show. OK, try this one on. How about "economic systems and the nations that are 'attracted' to them?" Mr. Clifford: No. No. Adriene: Or when economic systems and nations "hook up." Mr. Clifford: I don't even know what to say. Stan, roll the intro. [Intro] Adriene: So to pick up where we left off, we all have wants. Food, cell phones, a good education, a \$10,000 gold Apple watch, but like the Rolling Stones tell us, you can't always get what you want. We don't have an infinite amount of resources like raw materials, workers, and time, so we have to make choices. Speaking of, eugh, who likes this? I'm gonna go change shirts. I'm gonna make another choice. So this shirt, it's way better, right? Anyway, we as a social order have to figure out three things. Number one: what to produce, number two: how to produce it, and number three: who gets it. Answer these three questions and you've got an economic system! There's a ton of backstory here about the history and evolution of economic thought; we'll get to that in a future video. In today's video, we're gonna chat about the world today. Let's take a look at two different economic systems: market economies and planned economies. Mr. Clifford: It all comes down to who owns and controls the factors of production. These are the major inputs required to produce stuff and Karl Marx classified them as land, labor, and capital. He even wrote a book about it, *Das Kapital*. In a planned economy, the government controls the factors of production, and it's easy to assume that's the same thing as communism or socialism but that's not quite right. According to Karl Marx, "The theory of communism may be summed up in the single sentence: abolition of private property." So true Communism is a classless society. When I say classless, I'm talking about a social order where everyone owns the factors of production, and output is distributed equally. Kind of like China, and Cuba and the former Soviet Union, except not at all. In practice, no country has ever been truly communist. There's a lot of countries that are socialist. Often, socialism has both private property and some public ownership and control of industry. The goal is to meet specific collective objectives and to provide free and easy access to things like education and healthcare. In both communism and socialism, there is economic planning, and the government, usually in the form of some bureaucratic agency, helps decide what to produce, how to produce it, and who gets it. Now if an economy is completely controlled by the government, down to the number of shoes that should be produced, that's called a command economy. Adriene: On the other side of the spectrum, we have free market economies. In free market or capitalist economies, individuals own the factors of production, and the government keeps its nose out of the stuff and adopts a *laissez faire* or hands-off approach to production, commerce, and trade. In free market economies, businesses make things like cars, not to do good for mankind but because they want to make a profit. Since consumers, that's me and you, get to choose which car we want, car producers need to make a car with the right features at the right price. Economists call this the invisible hand. Oooooohhhh. If consumers prefer one company's car, that business will make more profit and have an incentive to produce more cars. Car companies that don't offer the cars people want will disappear. Maybe you've heard of the DeLorean? It was a cool looking car, but not a car that many people wanted to buy. Apparently it was expensive, underpowered, and poorly-made. And it didn't actually travel through time. Anyway, this concept applies to all other markets, like cell phones or shoes. Scarce resources will go to the most desired use, and they'll be used efficiently, more or less. After all, if a business is wasteful and inefficient or makes something that no one wants to buy, then some other business will make a similar product that's either better or cheaper or both. If there's no

consumer demand for a product, resources won't be wasted producing it. We often take markets for granted, but look at the alternative. Assume instead that a government agency was in charge of deciding exactly which types of cars and cell phones and shoes to make. Do you think they could quickly respond to changes in tastes and preferences? If there was only one government monopoly producing cars, do you think they'd be produced efficiently? Mr. Clifford: So the invisible hand of the free market is the idea that individuals and businesses meet society's needs when they seek their own self-interest. Competitive markets with profit-seeking businesses will have an incentive to produce high-quality products as efficiently as possible. In the words of Adam Smith, "It's not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." Now, it looks like the free market's perfect and we don't even need a government, but that's not quite right. There's a bunch of things the government must do, because free markets won't. First, is maintain the rule of law. We need laws and police and contracts and courts to keep everything orderly. Second, we need public goods and services, like roads and bridges and education and defense, because goods can't get to consumers if bridges are falling down, and consumers can't make good choices if they're not educated, and no one really cares about buying the new iPhone if there's a bomb dropping on your head. Third, the government sometimes needs to step in when markets get things wrong, but what does that even mean? Adriene: Well, let's go back to producing cars. The free market produces what we consumers want to buy, and when we buy, we're thinking about what a car looks like. If it's the color we want, maybe if it's safe, what it costs. Most of us aren't worried about air pollution. We don't think much about who made our car, what they were paid, what the conditions at the factory were like; that's when government steps in to regulate production. In a free market economy like the United States, you might think that the government doesn't tell car producers what types of cars to produce and how to produce them, except that it does. Cars need to meet strict emissions and safety standards, and there are laws dictating how much manufacturers can pollute and how workers should be treated, and here's the big takeaway: modern economies are neither completely free market nor planned. There's a spectrum of government involvement. For example, on one end we have North Korea. They have a command economy where production is entirely controlled by the government. On the other end, we have countries like New Zealand; they have private property, few taxes, and few regulations. In the middle, we have the rest of the world. So most modern economies are actually mixed economies with both free markets and government intervention. Mr. Clifford: And a great way to explain a mixed economy is by looking at something called "the circular flow model." Let's go to the Thought Bubble. A modern economy is made up of households, which are individuals like you and me, and businesses. Businesses sell goods and services to households in the product market -- that's anywhere goods and services are bought and sold. The households need to pay for those goods and services, but where do they get the money? The households earn the money by selling the resources, like labor, to businesses. Now, this is done in the resource market. The businesses use the money they earn from selling products in the product market to pay for resources in the resource market, and households use the money they earn in the resource market to buy products in the product market. But there's another key player in the economy: the government. The government also buys products and resources. For example, they'll buy cars from businesses and hire government employees like policemen to drive them. The government pays for public goods like roads and bridges and public services like firefighters and teachers. They also provide transfer payments to individuals in poverty and subsidies to businesses to produce things like fuel efficient cars. But where does the government get the money? Well, they get some of it from taxing households and businesses and they get some of it from borrowing, but we'll talk about that later. So



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basically, that's it. That's the circular flow of products, resources, and money, and the interactions between businesses, individuals, and the government. Now, it gets more complex when you add in international trade and the financial sector, but now, the simplified circular flow shows how the modern economy works. Adriene: Thanks, Thought Bubble. We've established that economies differ based on the amount of government involvement, but it's important to keep in mind that economies can change. Over time, Denmark and Canada have adopted more elements of a planned economy, like universal healthcare. China, on the other hand, has added more free market elements to its economy and now has less government ownership and control of production, so communist China actually has a socialist market economy. But which type of economy is better and how much should the government get involved? It's hard to find support for command economies outside North Korea, and may some nostalgic Cubans and Russians. Those who support socialism would point out Denmark's high standards of living and low income inequality, but free market enthusiasts might point out China's massive economic growth and growing middle class after backing away from central planning. Ultimately, the optimal amount of government involvement depends on your personal values. For example, what, if anything, do you think the government should do to help people in poverty? Do you think it's up to each individual to provide for themselves, come what may, or do you think the government should step in as a safety net and help pay for food and healthcare? What if the person made choices that got them in financial trouble, like gambling or made them sick, like smoking? Should society help then? Well, economists aren't really good at answering these types of questions. Sorry. It's not that they're heartless. It's just they don't operate in the realm of feelings. In the words of economist Thomas Sowell, "There are no solutions, only trade-offs." Sure, it would be great if we could end poverty or provide healthcare for everyone, but we're gonna have to give something up in order to do it. Forcing car producers to meet emissions and safety regulations will increase production costs and likely increase the price of cars, but it also reduces pollution and fossil fuel consumption, which will hopefully improve public health and save money in the long run. There is always an opportunity cost, and deciding if it's worth it--well, that's up to you and your elected officials and a bunch of lobbyists. Deng Xiaoping transformed China from a country with debilitating poverty and famine to the economic powerhouse it is today. Regarding this debate, he said, "It doesn't matter whether a cat is black or white, if it catches mice, it's a good cat." Which makes me think about that green shirt, that was a good shirt. I'll be right back. Mr. Clifford: So let's wrap this thing up. In practice, almost all countries are somewhere between the extremes of a command economy and a completely free market economy. That's because mixed economies seem best at handling the circular flow of goods, money, and resources. But the debate over free markets and government control will never end. Adriene: Well, actually, it will end, when humanity ends, because microscopic organisms don't divide themselves into factions based on economic theory, but anyway, that's why it's vital for you to be informed about the merits and the limits of economic systems and be willing to support solutions that get the job done, as opposed to getting stuck in one ideology. Economic theories and models can seem really great in the abstract, but when they're kicked out into the real world and actually have to govern the affairs of billions of people, it turns out that some flexibility is a very important thing. Mr. Clifford: Thanks for watching; we'll see you next week. Adriene: Crash Course is made with the help of all these nice people who definitely appreciate a spicy title, wink, wink. And if you wanna help keep Crash Course free for everyone forever, please consider subscribing over at Patreon. Patreon is a voluntary subscription service that allows you to pay whatever you want monthly and make Crash Course exist. Thanks for watching and don't forget to be irrationally exuberant.