The title of this lecture series is a little misleading. We are first going to explore what is known as Pure Capitalism, and compare and contrast that to the economic system of the United States. You should quickly realize that “our economic system” as practiced currently in the United States is not Pure Capitalism, but that of a Mixed Economic system that leans towards capitalism. Our economy has a great deal of government involvement, much more than what Pure Capitalism requires. From this knowledge, you should better understand the ongoing discussions between political groups about the size of government in the economy. Generally, those wanting smaller government are wanting the economy to move more towards the doctrines of pure capitalism. Generally, those wanting larger government are wanting the economy to move more towards an economic organizational structure known as Socialism.

Picture in your mind a pendulum swinging back and forth along an economic continuum between Pure Capitalism on the left and Socialism on the right. Over the economic history of our country, that pendulum has swung back and forth a few times. During the 60’s and 70’s (Kennedy, Johnson, Nixon, Ford, Carter administrations), most economists would agree that the pendulum was swinging in the direction of Socialism. During the 80’s and 90’s (Reagan, Bush, Clinton administrations), most economists would agree that the pendulum was swinging back in the direction of Pure Capitalism.
Limited government involvement DOES NOT mean zero government involvement. It means that government has a very narrow role in the pure capitalistic economy.

Individual ownership of the factors of production means that individuals like you and I own land, capital, our labor and entrepreneurial talents; not the government. And, we have specific “property rights” associated with these resources.

Individuals pursue their own self interest with few constraints means that we can use the factors of production in a way that we as individuals choose to use them in order to make a living subject to few legal barriers. This would be in contrast to the extensive system of federal and state laws, rules, and regulations that we currently confront in our economy with respect to the factors of production that we own.
In this country we practice a democratic form of government known as a representative democracy. Our confederation of states is referred to as a republic.

republic (rî-pûb´lik) noun
1. a. A political order whose head of state is not a monarch and in modern times is usually a president. b. A nation that has such a political order.
2. a. A political order in which the supreme power lies in a body of citizens who are entitled to vote for officers and representatives responsible to them. b. A nation that has such a political order.

Religious beliefs fall into this category as well. Religious beliefs are part of a society’s cultural make-up and can influence the economy and the governance of people. Just as criminal and administrative laws are mechanisms that serve to instruct people how to behave and are used to modify or even control behavior, religious documents and doctrine also serve to instruct and modify or even control people’s behavior. Our form of government, our religious beliefs, and cultural practices are examples of institutions that interact with each other to determine the type of economy that will develop and how it will change over time.
What is an economic system?

There are six basic criteria associated with a pure capitalistic system:

- The institution of private property
- Free enterprise and free choice
- Self interest
- Competition and unrestricted markets
- The market system
- The limited role of government
How much land does the state and federal governments own in this country? Who owns the principle passenger rail system in this country? How many people are employed by government in this country. It is true that most property in this country is in private hands, but the government owns productive resources as well. We are considering the degree of government ownership or government ownership of productive resources relative to private ownership of those resources. Does the government own and/or control too many resources, or too few resources? Well, that is up to you. How? Through the political parties and candidates you support and vote for, you can affect the institutional structure of the nation and ultimately the type of economy we employ. Informed voting is one of the duties of citizenship.
Law and Order. One of the functions of government in a capitalist society. But, government must also define private property rights (what are our property rights?), and then be ready to enforce those defined private property rights in order to maintain a capitalistic society. Without the definition and enforcement of property rights, capitalism does not stand much of a chance as a successful economic system. This has been a major problem for the former Soviet Union’s transition from a form of command economy (communism) to a more market oriented economic system (capitalism). There were very little if any private property rights in the former Soviet Union. What we are witnessing is a difficult struggle as the former Soviet Union wrestles to define private property rights and develop an institution to recognize and enforce those property rights. Until the former Soviet Union can accomplish this, the transition to a more market oriented (capitalistic) economy is going to be a tough, bumpy road.
Hmm. Can I go out this afternoon, buy some land, and begin constructing a confined swine facility in this state? Well, the answer is basically no. Our state has recently been under a construction moratorium that has not allowed the construction of new swine facilities. Even without this moratorium, I would have to go to government and get the necessary permits to build these facilities on land that I own. I have to basically get permission from the state. Does that sound like what is represented in the slide above?

Well, basically no, but look carefully. “… so long as they do not infringe on the legal property rights of others” Some citizens in North Carolina allege that the swine industry has infringed on the legal property rights of others. Some citizens allege that the odor is offensive and has decreased the value of their real estate holdings. Some citizens allege that their wells and surface waters have been contaminated by excess nitrogen associated with swine effluent lagoons. We are talking about an alleged negative externality. Now we can see the avenue of government involvement in this issue.

Is this too much government involvement here? Not enough? Just right? I am sure we could get some real fireworks going here. But, the bottom line is whether the allegations are true or false. Will we wait for unbiased science to make that determination? Will scientific analysis be unbiased?
Free Enterprise and Free Choice (An Extension of Property Rights)

- Exists when private individuals are allowed to obtain resources, to organize those resources, and to sell the resulting product in any way the individual chooses.
- As long as their actions do not infringe on the property rights of others
Hmm. How does this one stack up when comparing it to what you observe in our economy today? Again, can I purchase some land and other resources, organize those resources as I see fit, and then sell the product of those resources as I see fit? I don’t think so. Any government “red tape” that I have to deal with? Any hoops that I have to jump for government before I get their blessing to go forward?

Where have all these rules and regulations that can stifle free-enterprise come from. Well, again we have to take a closer look. Again, we read, … “as long as their actions do not infringe on the property rights of others.” When a negative externality develops, often government steps in with rules and regulations to mitigate the externality. Those rules and regulations put restrictions on private property rights and can lead to stifling free enterprise and free choice. Society must decide how much erosion of private property rights it can tolerate (cost) relative to reconciling the negative externality (benefit).
Let me give you another personal example. Zoning is an artificial restriction imposed by government that constrains the use of land. Zoning defines ones property rights with a tract of land. Zoning controls what can be done and what cannot be done with a tract of land. When my wife and I purchased our home, the land the home was on was zoned R-40 (residential use, minimum lot size 40,000 square feet). Next door to us was a private, K through 12 school. The zoning for the school was O&I (office and institutional). In a few years, the private school went under financially and was sold to an investor. The investor leased the school facilities to an entrepreneur who attempted to open a recreational facility. Basketball, baseball, soccer, weight room, tanning beds, etc. The entrepreneur planned to put up outdoor lights on the field and operate seven days a week and during the night. In order for the entrepreneur to develop the recreational facility the way he/she wanted, the land and buildings would have to be re-zoned HC or heavy commercial. Heavy commercial zoning means that just about anything and everything could go in there if this entrepreneur’s venture failed. From a car dealership to a junk yard and beyond. If the school property were to be re-zoned to heavy commercial, what could easily happen to the value of my home and land? Who would want to live next to a whatever? Do you see that changing the zoning (property rights) associated with the school property could impose a serious negative externality on the property my wife and I owned. Do you think we fought the re-zoning? Yes we did, and fortunately we won. But, we stifled free-enterprise in the process. We acted in our self interest to protect the value of what was ours.
“Workers are free to enter any line of work for which they are qualified.” Sounds fantastic, but we all know that our history is jaded with the exclusion and under-utilization of certain demographic groups of our work force. Pure capitalism does not care if an individual is female, male, white, black, green, red, yellow, blue, Italian, African, Mexican, Brazilian, Iranian, Christian, Jewish, Muslim, Hindu, etc. Pure capitalism implies that an employer hire the best person for the job. The person that will maximize profitability for the enterprise. We should now start to understand why government agencies like the Equal Employment Opportunity Commission were created. Why Affirmative Action and anti-discrimination policies were developed. Right to work laws and the Americans with Disabilities Act (ADA). These are government attempts to modify citizen behavior to adopt this tenet of pure capitalism.

“Consumers can buy the desired basket of goods and services that they feel is best for them.” In our society today, can you do that? For the most part, probably yes. But there are some of you already thinking of some things that you cannot legally buy that you think are best for you. There are some that think our government only allows us to chose from those items that the government deems to be safe and proper for us to consume. Should the government allow any and all products to come to market? Should our pool of commodities not be restricted at all? Drugs (legal and illegal), alcohol, and firearms come to mind here. What is a black market? Is it pure capitalism’s way of circumventing government constraints on consumer choice?
In pure capitalism, the consumer is king or queen. The consumer ultimately determines which commodities will survive in the market place. Only those commodities that consumers are willing to pay a price above the full cost of producing and distributing will continue to be produced. But along with this comes the caveat of “buyer beware” and “buy at your own risk”. Government has chosen to limit the production and distribution of some commodities because of the cost, or potential cost, that society may incur from a commodity before society has enough time to evaluate the product and determine to ultimately accept the product or reject the product; may be substantial. Would you want drug companies to quickly release new drugs to the market without careful and prudent testing? Drug companies may have incentive to release a drug “too quick” in anticipation of large profits. The Federal Drug Administration (FDA) is charged with “protecting” consumers by assuring proper drug testing before a drug reaches market. This is of course is no guarantee. The allergy medication Seldane was approved and released, and I used it myself. But after being on the market for a while, a dangerous drug interaction was discovered. Seldane plus a common antibiotic, erythromycin, proved to be a deadly combination. Sure, if a drug company were to behave irresponsibly you can sue, but what cost have you incurred in the event that someone dies. Will the law suit bring back a family member? There are “market imperfections” associated with pure capitalism that government tries to mitigate through regulation.
A classic example of consumer sovereignty is illustrated by what happened when Coca Cola brought out the product “New Coke” and dropped the traditional Coca Cola beverage from the market. Folks tried the New Coke, but not many kept buying it. The consumer balked. As a result of losing money and market share to Pepsi, Coca Cola brought back the “Old Coke” in the form of “Coca Cola Classic” that you drink today.

We hear people complaining all the time about the sex and violence on TV and in the movie theaters. Some have called for government to intervene. There are rating systems now for television programming. Why is television and Hollywood putting all this violence and sex on the screen? Well, are we paying good money to watch it? I would conclude that television and movies contain what they do because we are consuming it at a very profitable level for the producers. We are telling them through our consumption that this is what we want to see. If we did not want to see this type of programming, then we would not be buying it, and the industries would quickly figure out that what they were producing was not profitable. Programming would then change.

Should government assume that we do not know what the best basket of commodities for us to consume is, then step in to “take care of us?” Should government intervene and censor what television and Hollywood should produce?
Self interest is a powerful force in capitalism. Adam Smith in his 1776 book, *Wealth of Nations*, referred to self interest as the “invisible hand” that is the guiding force in the market place. Smith alleges that the “invisible hand” guides individuals in pursuit of their own self interest to use resources efficiently. Let us take a look at self interest from a variety of perspectives.

Consumers, in their self interest, strive to maximize the amount of satisfaction possible from spending a given amount of money income. *as little as possible!*

Consumers, in their self interest, strive to maximize the amount of satisfaction possible from spending a given amount of money income. They want to get the “biggest bang for their buck.” Do you blame them? What do you do? I often here retailers or salespersons grumble about how people today just want something for nothing, this world has gone bonkers. Has it? Or are consumers just acting in their own self interest trying to get the lowest price possible for the commodities they consume?
Now, let us look at self interest from the producer’s or seller’s point of view. Producers strive to maximize the amount of profit possible from selling commodities at the highest possible price the market will bear. Producers try to “squeeeeeze as much profit out of that consumer as they possibly can.” Do you blame them? They are trying to earn as much for their family as anyone else would. What would you do in their shoes? Now, I hear a lot of consumers complaining about how a producer or salesperson is trying to gouge them, or rip them off, or consumers scream that prices are just too high and the world has gone bonkers. Has it? Or, are producers just behaving in their own self interest trying to earn as much as they can from the production of the goods and services they provide consumers.

Do you see some conflict between the self interest of consumers and producers? Maybe conflict is too harsh of a word. What about competition? Does competition more adequately describe what is going on between the consumer and the producer? Do consumers compete with each other to get the goods and services they desire? Well, just go to the grocery store or Home Depot right after the weather person has announced that twenty inches of snow is coming or Hurricane Humphrey is on the way. Do producers compete with each other for consumers to buy their goods and services?
The competition between consumers and producers, let me give you another personal and I hope, practical example. On June 7, 2000, the heating and air conditioning person came to my home to do routine maintenance on our HVAC system. I have a contract with the company to do this twice per year. Well, my wife called me at the office with some bad news. It seems that when Hurricane Floyd hit in September of 1999 and our crawl space flooded a little, the condensate pump burned out. The condensate pump removes the moisture that accumulates on the evaporation coil of your home air conditioning system. You have surely noticed the water dripping from your car or truck after you have been running its’ air conditioner during the summer. Well, that is condensation from your auto’s evaporator. You would not want this water running under you house, so a pump carries the moisture from the air conditioner to the outside of your home. So I asked, “How much”, and she responded “$279.00.” I asked her to put the HVAC person on the phone. Knowing a little bit about this stuff from previous experiences and reading, I told the HVAC person thank you, but I will take care of it. That afternoon, after work, I drove down to Hodges street where the “old” farmers market used to reside. In that area are several HVAC wholesale supply firms. I went in and picked up a condensate pump for $38.06 including tax. It took me maybe 10 minutes to hook that pump up after supper that evening. $279.00 - $38.06 = $240.94 savings.

What was going on here? Well, to have good competition there must be many buyers and sellers acting independently AND good information available and utilized by the buyer and seller. Without the education and knowledge that I possess, ignorance could have cost me a sizeable chunk of change. Ignorance gets “ripped off” or taken advantage of, repeatedly.
O.K., here are some other perspectives of self interest. Most all of you have been employees at some point in your lives. What is your objective, or what is in your self interest? Strive to obtain the highest level of income possible for the least amount of work? Come on now, be honest! How many of you tell that employer that you are willing to work 60 hours a week for a $1.00 per hour and give 120% every hour? I have heard employers complain that they can’t find anybody that wants to work anymore. All of ‘em want to get paid big bucks and sit around talking all day. You all ever heard that?

Well, what about the employer? What is the employer’s objective, or what is in their self interest? Strive to obtain the most amount of work from employees for the least cost? Basically, work them to death and pay them peanuts. I have heard employees grumble that their employer expects too much and pays them far too little for those expectations.

Hey, do we have another conflict arising here? Or again, maybe I should ask if there is a competitive environment that develops between employers and employees. While we are on a role, let us substitute the word student for employee, and teacher for employer and rewrite things a little.

*Students strive to obtain the highest grade possible for the least amount of work.*

*Teachers strive to get the most amount of work from students for the least cost.*

Any truth to those statements above? Do you understand self interest?
Picture an agricultural producer negotiating with a land owner to rent the land owner’s land for production. What is each party trying to do and why? Does self interest drive the negotiations? At some point, land owner and tenant will come to an agreement on the rental rate. Both will probably walk away thinking the other got the better deal, but that’s just human nature. The tenant will gripe that the rent is too high, and the landowner will probably gripe that the dang farmer wanted something for nothing. And so it goes, but a transaction occurred and a price was determined that both agreed on, thus reconciling the competition created by self interest.

There is a dark side of self interest as well, and unchecked self interest can be destructive. Whenever a large group such as the Irish or Chinese migrated to this country, there was a time period of intense discrimination. These groups threatened currently employed persons by willing to work hard for less pay. Rather than be put out of a job, segments of society held prejudice against these groups and tried to exclude them. The same societal phenomena occurred between lesser educated white people and newly freed African slaves. Females were discriminated against by men as they began to poor into the work force in the 60’s and 70’s. Our government tried to basically exterminate Native Americans in the 1800’s as citizens scrambled to claim land and other natural resources as the country grew from the Atlantic to the Pacific oceans. What can temper this dark side of self interest and keep it from destroying a society. Well laws can help, but they don’t change peoples attitudes or the feeling of being threatened. I think it is clear that a society’s strength in morals, ethics, integrity, and general character is the prescribed treatment for self interest’s “Greed Gremlin.” From where do those things derive?
At this point, we should realize that self interest creates competition between parties. The capitalistic tenet of competition and unrestricted markets develops from self interest.
And “good” competition requires adequate information to be available to all parties of a transaction as previously discussed.

We want a large number of buyers and sellers to prevent what is called collusion. We may have a problem with collusion if there were only three auto manufacturers in the world. The three CEO’s could get together on a golf course some where and agree to restrict production and drive prices and profits through the roof while at the same time divide the market up so that each shares equally and will be willing to participate in this act of collusion. This may be bad news for consumers. The previous description is basically what is done within the OPEC Oil Cartel. What if there were only one manufacturer or seller of automobiles? Well, we would then have a monopoly and this individual or corporation would control production and prices. Huge economic profits would accrue to this producer. What if there were only one buyer for a producer’s hogs, chickens, turkeys, tobacco, corn, wheat, or soybeans? That buyer could pretty much offer you a price and tell you to take it or leave it. In this situation, the buyer is referred to as a monopsonist and the market structure is referred to as a monopsony.

Unrestricted markets refer to the freedom of sellers and buyers to get into and out of the market without artificial restrictions such as laws or other businesses trying to block entry or exit. Are there any restricted markets in our country? Sure. Tobacco and peanut production are restricted markets. You must obtain a quota in order to produce. I cannot legally plant tobacco or sell peanuts at market without first buying or renting quota. The swine industry in North Carolina is currently (1999/2000) a restricted market due to a government moratorium in place that forbids the construction of new swine facilities.
In pure capitalism, there are few market restrictions. In fact, one of the roles of government in pure capitalism is to prevent monopolies and monopsonies and do all that is possible to provide an economic environment that is conducive to good, strong, healthy competition in the market place. In pure capitalism, competition is the regulating force in the economy. When we have many sellers for consumers to choose from, if one seller raises his/her price, consumers go to one of the other many sellers. Picture a four way intersection in your mind with gas stations on each corner. If one gas station raises its price five cents a gallon and the others do not, what is going to happen? If one gas station lowers its price by five cents a gallon and the others do not, what is going to happen?

Economists basically recognize two types of profits. Normal profits and economic profits. Normal profits occur when a firm earns an amount of money that basically covers all of their costs an accountant would figure up and provides a return to the factors of production that the firm owns that is equal to what those factors of production would earn if used in a production process elsewhere. In other words, total revenue minus accounting costs minus opportunity costs. Economic profits occur when a firm earns an amount of money that is in excess of accounting costs and opportunity costs. Think of economic profits as being super duper mega profits.
What would you do if you were an agricultural producer and your neighbor was producing cotton and making money hand over fist? You have never planted cotton. Your neighbor is building a new house, has a new Ford crew cab and a Ford Expedition parked in front of the old house. Your neighbor just bought a new pontoon party barge to go along with that 18 foot Skeeter bass boat. The neighbor’s kids are racing around the farm with three new Honda four wheelers with the new push button gear changer. And, to top it all off, your neighbor’s whole family is going on one of those cruise ships to all of those islands in the Caribbean for December holidays! Now, what are you thinking? You want some or all of that don’t you? How are you going to get it? Well, you freely enter the cotton market (unrestricted market) and start planting cotton. Are you the only producer that has noticed the economic profits earned by your neighbor. Probably not, so now there are more and more producers planting cotton wanting that December cruise. What is going to happen? As more and more producers enter the market and start growing cotton, the production of cotton is going to increase. Assuming that the consumption of cotton remains unchanged, inventories are going to increase significantly. Decreasing production in the short run is not going to happen because everybody has “cruise on the brain” so the only other thing that can give in the market is the price of cotton. Which direction is the price of cotton going to go? What starts to happen to the profitability of cotton as the cotton price falls? Hey, we have been at this dance before. What do you think starts to happen to the price of inputs used in cotton production when all these new producers scramble to get seed, fertilizer, chemicals, etc. Those input prices are going to go up due to competition among cotton producers! What will happen to the cost of producing cotton? It is going to rise! So what eventually happens to the economic profit that cotton was earning? It disappears. Economic profits do not prevail long with competition and unrestricted markets.
The Market System

◆ An institution that develops from the
  – Private Property Rights
  – Free Choice and Free Enterprise
  – Self-Interest
  – Competition and Unrestricted Markets

◆ Also referred to as the “Price System”
The Market System

- Capitalism is a market economy. That is, buyers and sellers relate their opinions by expressing how much they are willing to pay for, or how much they demand of goods and services.
The Market System

- Prices are used to signal the value of individual resources and commodities. Therefore, prices provide valuable information to consumers and producers.

- Prices are the "guiding light" to which resource owners, businesses, and consumers follow when economic choices must be made.
The Market System

- Therefore, we can say that the market system (price system) IS the organizing force in capitalist systems.

  - Organization is the coordination of individuals in the furtherance of a common goal.
The Market System

- Resources tend to flow where they yield the highest rate of return or highest profit.
On the next few slides, we are going to look at resource movements between curriculums within the two year associate degree program at North Carolina State University known as the Agricultural Institute.
The grain embargo imposed on the USSR on January 4, 1980 by the Carter administration as a reprisal for the Soviet invasion of Afghanistan led to a period of low grain prices and net farm income across the U.S. It was not until the late eighties that the agricultural sector started to come out of one of the worst financial crises in modern times.
The chart on the top is North Carolina Real Net Farm Income. The chart on the bottom is Agricultural Institute Enrollment for the fall semester. Do you see any relationship between the two charts? Do they have a similar pattern? Do you notice that enrollment is “lagging” real net farm income? In other words, as net farm income increases, Ag. Inst. enrollment increases in response, but a few years after the increase in real net farm income. When real net farm income decreases, Ag. Inst. enrollment decreases in response, but a few years after the decrease in real net farm income. Pretty neat huh?

As agriculture becomes more profitable, more students tend to enroll in the agricultural curriculums of the Ag. Institute. As agriculture becomes less profitable, less students tend to enroll in the agricultural curriculums of the Ag. Institute. Are we seeing human resources responding to rates of return?
Percentage of Students Enrolled In Livestock Mgmt. & Tech
Percentage of Students Enrolled
In Field Crops Technology
Percent of Students Enrolled in General Agriculture
Percentage of Students Enrolled in Ornamentals & Landscape
Percentage of Students Enrolled in Turfgrass Management
This chart contains all students enrolled in Field Crops Technology, Livestock Management and Technology, and General Agriculture.
This chart contains all the students enrolled in Ornamental and Landscape Technology and Turfgrass Management.
The chart on top is the traditional agricultural production students, and the chart on the bottom is the ornamental and turf students. Do you notice human resource movements within the curricula of the Ag. Institute over time? What could these human resources be responding too? Remember, we have discussed that resources tend to flow where they can earn the highest rate of return. A student committed to an agricultural career has a number of curriculum to choose from within that general career path. What do you think students may be looking at when choosing an agricultural curriculum to enter?

If you answered, “Give me the money!”, you are probably correct. The next few slides will give you an idea about starting salaries for Ag. Institute graduates on average, and average starting salaries for Ag. Institute by major. The surveys that the data originate from are given on graduation day in the spring. The students that are missed by the survey are the ones that do not show for graduation.

- Gen. Ag.
- Turfgrass
- Orn. & Land.
- Livst. Mgmt.
- Field Crops
- Ag. Pest
- Ag. Bus.
- All Majors

1999
1997
1996
That someone or entity is government. Under pure capitalism, government is supposed to protect and enforce property rights. Built into our federal and state Constitutions is the right of government to use eminent domain. Eminent domain is the right of government to take private property for public use. In North Carolina, the owner of the property is to be compensated at fair market value. Some of your families may have run into this in conjunction with the building of a road.
Under pure capitalism, another role of government is to provide a system to reconcile negative externalities. Our government has two systems, the legislative branch and the judicial branch. Legislators pass laws and the courts enforce those laws. The courts also hear civil disputes that very often deal directly with negative externalities. At the conclusion of a civil process, compensation is often awarded to the prevailing party in the action. Folks, we are talking about law suits here. The act of suing each other for some wrongful act.
The Limited Role of Government

- Eliminate monopolies that would restrain trade,
- Issue money,
- Prescribe a standard of weights measures,
In pure capitalism, government has a plenty to do and is essential to the existence of the economy.

What is a public good? The example used above was national defense. Basically, the provision of a public good is a government response to “market failure.” A market failure occurs when capitalism (1) produces the wrong amounts of certain commodities, or (2) fails to allocate any resources whatsoever to the production of certain commodities whose output is economically justified. The first type of failure results from spillover costs and spillover benefits (externalities). Spillover costs (negative externalities) can be remedied by government through legislation or specific taxes. Spillover benefits (positive externalities) can be remedied by government through specific subsidies to consumers or producers, or through the production of quasi-public goods. The second type of failure strictly involves government production of public goods. (McConnel and Brue, Economics: Principles, Problems and Policies, 14th edition, Irwin McGraw-Hill, Inc., 1999, ISBN 0-07-047094-4)
In order to have a pure public good, two characteristics must be present. Public goods are collectively consumed, and no one can be excluded from consuming the good once it is produced.

When a commodity is collectively consumed, it means that many people can consume the same units of the good or service simultaneously, and consumption of the good or service by one person does not diminish the amount available for anyone else. Huh? Look, there could be 5,000 people reading what is written here scattered all over the world. If a person has a computer with internet access, they can get what you are looking at right now. When you are reading this, or they are reading this, you all are collectively consuming what is here. When you go to a movie, everyone in the movie theater with you is collectively consuming the movie. As you quietly watch the movie, you do not diminish the value of the movie to anyone else. When you are driving around the Raleigh beltline, you are collectively consuming the road with the thousands of other motorists. Do you have a handle on collective consumption now? Remember, just because a commodity can be collectively consumed does not make it a public good. Public goods must have two characteristics.

The second characteristic of a public good is the inability to exclude people from consuming the commodity once it is produced.
It is believed that the private sector will underproduce, or not produce at all, a commodity in which it cannot exclude people from consuming without paying a price for the commodity that covers production costs and allows the firm a reasonable profit. What is the incentive for a firm to produce a commodity if it cannot make any money? The non-exclusion principle means that there is no technology available to prevent people who do not pay for the good or service from consuming it, or the costs of exclusion are too high relative to the commodities benefit. (Mabry and Ulbrich, Intro. To Economic Principles, McGraw-Hill, Inc., 1989, ISBN 0-07-044797-7).

A movie is collectively consumed, but we can exclude people from watching the movie by requiring that they pay for a ticket. So a movie is not a public good, it is a private good. North Carolina has a provision in it’s state constitution forbidding toll roads. The beltline is collectively consumed, and our North Carolina constitution forbids a means to exclude people from using the road by using toll booths to collect fees for road use. Therefore, in North Carolina, our road system is by definition a public good. What about national defense? Would it be produced by the private sector in quantities that would be effective? How would a business firm exclude people from consuming national defense? How could the business firm legally make people pay for national defense? If you don’t pay, does the private business firm have the right to kick you out of the country? Put you in prison?
All right, let us trying something here. Picture that we are sitting in a classroom full of students. I announce that the government is going to privatize the production of national defense for the country. Who will bid on this contract to produce national defense? Well, lets assume that I do, and I get the bid. Now, how am I going to pay the production costs? This national defense thing ain’t cheap you know. Just one of those Tomahawk Cruise Missiles runs a couple million, and some of those fighter jets are in the $16 million range. How can I make you all pay for this? You will all collectively consume the benefits of national defense. I can’t make you pay for it.

O.K., since I can’t make you pay for it because I don’t have any authority to take any action against you if you don’t pay to enjoy the benefits of my hard work at providing national defense, I guess I am going to have to get a hat out and start passing it around the room asking for donations. How much money do you think I would collect after passing the hat around the room? Do you think everyone contributed something to the cause? Or, do you think a few folks thought to themselves, “Why should I pay a dime, I enjoy the benefits regardless of whether I pay or not. So why pay?” You bet there were a few thinking that way, and economists refer to them as “Free Riders” The next time I pass the hat around the room, I will probably collect less because more of you will have learned to be free riders: people getting the benefits from a commodity without contributing one nickel to the commodities cost.
Fire and police protection could be provided on a private sector basis. If you want the fire department to respond to a fire call at your home or business, you pay an annual fee for that protection. If you want the police to respond to a burglary call in the middle of the night, you pay an annual fee for that protection. If you do not pay the annual fee, when you call, they just tell you that they are sorry, you are not a subscriber to their services. Well, I hope you can easily see the potential problems that may arise from such a system.

Education, fire and police protection, roadway network, minimal health care standards and disease control; all of these have huge spillover benefits or positive externalities associated with their production. The producer of these goods and services cannot reap all of the benefits from the sale of these items, so they will tend to be under-produced by a capitalistic market system. Some refer to this phenomena as a “market failure.” Government steps in to produce these goods and services to ensure adequate production and accessibility.

We can conclude that the market system (capitalism) fails to allocate resources for the production of public goods, and will under allocate resources to the production of quasi-public goods. Therefore, the government purchases public and quasi-public goods and services based on group or collective choice. What is a group or collective choice? That is us! We vote, we support certain candidates, so we determine democratically what goods and services government will purchase and provide. How are public and quasi-public goods and services paid for? We pay taxes! Taxes are simply a means of diverting or releasing resources from the private sector to the public sector (government) and can significantly alter the make up of the economy’s total output.
Public Production vs. Public Provision

- Public Production:
  - government actually produces public goods using government employees and other government owned resources
  - For example: DOT production of streets, roads, highways, and associated services
Quasi-public goods and services can be produced using public production or public provision. Since quasi-public goods can be excluded, government can choose to fund these goods and services outright with tax dollars or through “user fees”, or a combination of the two. Using tax dollars and “user fees” allows for the recognition of spillover benefits and the market forces of supply and demand.

Take the National Park system for example. If you were to go to Yellowstone National Park in north western Wyoming, you would be charged $20 per vehicle driven to enter the park in the year 2000. The charge to use the park is a “user fee” that helps offset the public cost (tax dollar cost) of providing and maintaining the park for citizens. Those that use the park the most, pay the most to use it.
Privatization

- **Privatization**: the shifting of actual government production of quasi-public goods to the private sector.
  - Volunteer fire departments in North Carolina often negotiate contracts with municipalities to provide fire protection.
  - Garbage collection has been contracted out
  - Prison management has been contracted
THE MIXED ECONOMIC SYSTEM

Pure Capitalism is only one extreme type of social organization for the production and distribution of commodities.

– The other extreme is a political system whereby the government, or a central decision making body, controls all productive resources.

Alias: COMMUNISM
MIXED ECONOMIC SYSTEM

- In reality, most economic systems are a combination of market and political systems.
MIXED ECONOMIC SYSTEM

- In the US, we have a hybrid economic system.
  - Some decisions are made by the government directly.
    » Movement of resources has been strongly influenced by government through our tax system
  - Most decisions, however, are made in the market by businesses (producers) and consumers.
Economic Systems

Market Economies  Mixed Economies  Command Economies

Pure Capitalism  Socialism  Pure Marxist

Communism

Hong Kong
Singapore
United States
Canada
Japan
W. Germany
Economic Systems

Market Economies   Mixed Economies   Command Economies

Pure Capitalism   Socialism   Pure Marxist Communism

Great Britain   Cuba   North Korea

France   Sweden

← China

← Former USSR
MIXED ECONOMIC SYSTEM

Therefore, our system is a mixed economic system that leans heavily towards pure capitalism.
MIXED ECONOMIC SYSTEM

- After World War II, the role of the US government in our economic system expanded.

  - Government stepped in to help out (subsidize) certain industries and individuals.
MIXED ECONOMIC SYSTEM

- loan guarantees to Lockheed and Chrysler,

- protective tariffs on textiles, automobiles, beef, and peanut imports,

- price support programs for many agricultural commodities,
MIXED ECONOMIC SYSTEM

- expanded social welfare programs. Tax dollars are redistributed to those whom the government deems to be needy,

- Social Security and Medicare Programs
- Medicaid Program
MIXED ECONOMIC SYSTEM

- and tax other industries and individuals.
  - windfall profit tax on the oil companies, (Carter Administration 1976-1980)
  - luxury taxes on expensive boats and automobiles, (10% tax under Bush Administration, Democratic Congress)
  - repeal of capital gains exclusion in the tax code (Reagan Administration, Democratic Congress).
MIXED ECONOMIC SYSTEM

- Restrictions on the agricultural sector by means of quotas or allotments.
  - e.g. peanuts, tobacco, milk, and certain fruits

- Restrictions on production and procurement of resources due to environmental concerns.
Government Intervention

◆ Whether this government intervention is good or bad is a decision you must make.
◆ Once you decide, you must voice your opinion at the voting booth.
◆ To make objective decisions, you must have information.
◆ This course is designed to provide information for the decision making you will have to undertake in the course of your career.
CONCLUSIONS

◆ **CAPITALISM:**

An economic system in which individuals privately own productive resources and possess the right to use these resources in whatever manner they choose subject to certain (minimal) legal restrictions.
CONCLUSIONS

◆ A pure capitalist system works within the institution of private property that is controlled and enforced through the legal framework of laws, courts, and police.
CONCLUSIONS

- It is a system of free enterprise, where producers freely choose the resources they use in the production process.

- Consumers have freedom of choice also, as do workers and owners of resources in general.
CONCLUSIONS

- Individuals and producers express their desires through the market system where

- prices are signals about the relative scarcities of different goods, services, and resources.
CONCLUSIONS

- The role of government is limited to the
  - protection of private property rights,
  - provide an environment favorable to competition, and
  - provide public goods.
CONCLUSIONS

- Reconcile Negative Externalities through Legislative Action or Civil Process
- Provide for national defense,
- eliminate monopolies that would restrain trade,
- issue money,
- prescribe standards of weights measures,
- raise funds by taxation and other means (BORROW) for public goods, and settling disputes judicially
THE CIRCULAR FLOW REVISITED

$ COSTS

RESOURCES

BUSINESSES

GOVERNMENT

HOUSEHOLDS

GOODS & SERVICES

$ REVENUE

PRODUCT MARKET

$ CONSUMPTION

GOODS & SERVICES
FLOW TO HOUSEHOLDS
FROM GOVERNMENT
THE CIRCULAR FLOW REVISITED

RESOURCES FLOW TO GOVERNMENT

BUSINESSES

GOVERNMENT

HOUSEHOLDS

RESOURCES

GOODS & SERVICES

PRODUCT MARKET

$ COSTS

$ INCOMES

$ REVENUE

$ CONSUMPTION

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