

Guided Discussion Series

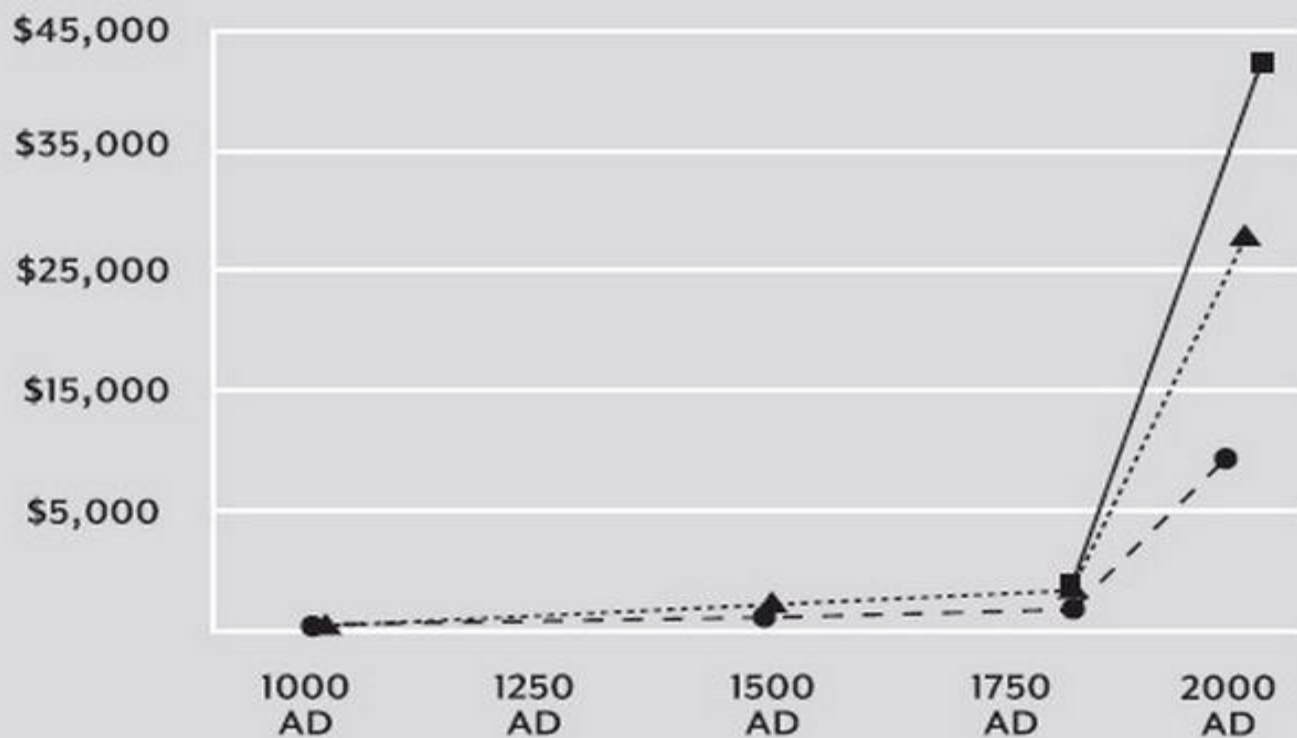
The Six Pillars **of a Free Market Economy**

Some important characteristics of a free market economy.

Guide: Roy Minet

GDP PER PERSON

● *The World* ▲ *Europe* ■ *The US*



*ALL FIGURES IN 2012 DOLLARS

Billions Lifted Out of Poverty

A 2017 study by the World Bank revealed that an increasing shift to (predominantly) free market economies has lifted billions of people out of grinding poverty. The percentage of the world population living on \$1.90 per day per person (in 2017 dollars) has improved as shown below:

1820 – 84%

1981 – 42%

2017 – 8%

Who Invented
The Free Market Economic System?

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Nobody invented the Free Market Economic System.

A free market economic system will automagically self-organize when people are

- Free
- Honest
- Peaceful

It is an entirely natural phenomenon.

What Took So Long?

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- Previously, no sizeable community of people was sufficiently free.
- In 1690, John Locke promoted the idea that people should have rights: life, liberty, property
- Other thinkers picked up and amplified the rights idea, leading to the “Age of Enlightenment.”
- People gained more freedom during the 1700s and that was especially so in the New World.

What Is an “Economic System”?

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An economic system provides the answers to the three economic questions:

1. What goods and services are to be produced?
2. For whom shall they be produced?
3. How shall they be produced?

How these three economic questions are answered determines the type of economic system.

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- **Free Market Economy** – People are left free to answer the three economic questions themselves. All resources are allocated/managed in a completely voluntary and decentralized way by cooperating individuals and groups.
- **Command Economy** – A central power or authority answers the three questions. Resource allocation is centrally planned and controlled.

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- **Command Economy** – There are no pure command economies – they would collapse in 10 minutes (from poor resource allocation).
- **Free Market Economy** – There are no pure free market economies – the government would meddle and screw it up in 10 minutes.
- **Mixed Economy** – All actual economies are mixed economies with some degree of freedom and some central control (meddling).

But How About Capitalism?

Capitalism = Free Market Economic System

The name “capitalism” was coined and used by Karl Marx in *Das Kapital*. Marx was a huge enemy of the free market and was able to stick it with an evil-sounding name.

Please do not use the term “Capitalism”

Always say “Free Market Economy”

“Crony Capitalism” does sound sort of evil. But “Crony Free Market Economy” sounds like the oxymoron it is. (The proper term is “crony statism.”)

Free Market Economy Characteristics

- Functioning is completely voluntary; no force is ever required.
- Therefore, it is the only economic system consistent with the NAP (non-aggression principle).
- Counterintuitively, it is the most powerful engine of economic growth possible, which results in ***the most rapid creation of wealth that is possible.***
- Peaceful, honest people left on their own will spontaneously self-organize into a free market economy.

The Role of Government

- Secure and guarantee people's rights – make sure they are:
 - Free
 - Honest
 - Peaceful
- Refrain from screwing up the free market economic system that automatically develops and flourishes.

The Six Pillars Of a Free Market Economy

- 1. Private Property** – A well-secured right to private property ownership is the first pillar. Without it, there can be only chaos.

The Six Pillars Of a Free Market Economy

- 1. Private Property**
- 2. Specialization** – People must be free to specialize in whatever they do best. This allows further honing of skills and the development of tools, thus greatly improving productivity.

The Six Pillars Of a Free Market Economy

1. **Private Property**
2. **Specialization**
3. **Voluntary Exchange** – People must be free to voluntarily exchange goods and services. Both parties to a voluntary exchange must benefit (otherwise the exchange would not take place). Thus, every such exchange actually increases total wealth. This is only guaranteed when the exchange is completely voluntary on both sides. It is some of the most powerful “magic” of a free market economy. (A barter economy so far.)

THE BIRTH
OF FREE
MARKET
ECONOMICS

I WISH I HAD
A ROCK.

I WISH I HAD
A STICK.



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The Six Pillars Of a Free Market Economy

1. Private Property
2. Specialization
3. Voluntary Exchange
4. Price System of Resource Allocation – Sound money is required. Prices must be free to adjust to the “market clearing price.” This is a point of equilibrium where the quantity produced equals the quantity consumed. It is the current “market value” of each commodity in the economy. Prices are critical signals which must not be corrupted as prices optimize resource allocation to produce the most wealth.

The Six Pillars Of a Free Market Economy

- 1. Private Property**
- 2. Specialization**
- 3. Voluntary Exchange**
- 4. Price System of Resource Allocation**
- 5. Market Competition** – Free and open competition among multiple buyers and multiple sellers in many transactions provides the “pressure” which causes prices to always seek the market-clearing price.

The Six Pillars Of a Free Market Economy

1. **Private Property**
2. **Specialization**
3. **Voluntary Exchange**
4. **Price System of Resource Allocation**
5. **Market Competition**
6. **Entrepreneurship** – People who are *willing to assume the risk* of investing to organize land, labor and capital (the three factors of production) to produce goods or services.

Some “Big Picture” Considerations

- Commodity Substitutes
- The nature of a business
- That Which Is Seen and That Which Is Not Seen
- Wealth Distribution
- The “Safety Net”

Commodity Substitutes Result In Colossal Complexity!

- Virtually every commodity has substitutes.
- This causes everything to interact with everything else.
- Changes in one sector of the economy cause changes in other sectors and vice versa.
- **Microeconomics** – Teaches the basic laws of economics about which everyone agrees.
- **Macroeconomics** – Attempts to understand entire complex economies, which is extremely difficult and error prone; lots of disagreement!

When the Price of Gasoline Increases

Less gasoline will be purchased because:

- More efficient planning of trips
- Eliminate least important trips
- Carpool
- Ethanol and propane
- Use plane, train, bus, taxi, or Uber
- Buy/ride a bicycle or walk
- Switch to hybrid or electric vehicles

The Nature of a Business

A business is an organization set up to marshal material, labor, and equipment to provide goods or services and to measure/track how effectively these resources are used. There are always three sets of people associated with a business:

- Customers (voluntarily exchange money for goods or services)
- Employees (voluntarily exchange work for pay)
- Owners or shareholders for a corporation (win or lose based on profits)

Profits Are Always Good For Everybody!

- The total operating costs of a business measure the amount of wealth it consumes.
- The total sales of a business measure the amount of wealth it creates or produces.
- Therefore, the profit (sales – costs) is the additional wealth the business has contributed to the economy.
- A business which is losing money consumes more wealth than it produces. That is why it is critically important that it either improve quickly or cease to exist. The remaining assets can then be reallocated to other uses which increase (rather than decrease) everyone's standard of living. Never subsidize!!

No Business Can Pay Taxes

Only people can pay taxes. Any taxes collected from a business must come from its:

- Customers (higher prices)
- Employees (lower wages or benefits)
- Owners (lower profits)
- Or (usually) some combination of all three

Taxing businesses is just a way to hide the taxes from the people who actually pay them.

Average US Business Profit

Does anyone have any idea what the average bottom line profit is that a US business earns (as a percentage of its sales)?

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Does anyone have any idea what the average bottom line profit is that a US business earns (as a percentage of its sales)?

It is 3.8%

If all businesses cut their prices to the point where they make zero profits, it would only be an average of 3.8% reduction of prices!

Source: Internal Revenue Service analyst for the year 2004. Total sales were \$20 trillion.

That Which Is Seen and That Which Is Not Seen

- Suppose the government levies a tax on “the wealthy” to feed “the poor.”
- The benefit to the poor is seen by the public as a good thing (the politicians make certain of that).
- Not seen is the delayed negative effects from confiscation of taxes that are diffused throughout the economy.
- The unseen bad effects more than offset the good, so total wealth is reduced.

French economist, Fredrich Bastiat, explained all this very lucidly in 1850 in two publications:

- A book titled *The Law* --

<https://fee.org/media/14951/thelaw.pdf>

- An essay titled *That which Is Seen, and That Which Is Not Seen*: --

<http://bastiat.org/en/twisatwins.html>

Both are simply written and very easy for anyone to understand.

Wealth Distribution

- The free market system is often criticized for fostering an unequal distribution of wealth.
- *Unequal wealth distribution is absolutely necessary and required!*
- If wealth were somehow to be distributed equally, the 6th pillar (entrepreneurship) would be destroyed because entrepreneurs would no longer have any incentive to take risks.
- BTW, there is no known economic system that can produce an equal distribution of wealth.

- A free market economy produces a “normal” (Gaussian) distribution of wealth:
 - A small number of very poor.
 - A large middle class which possesses most of the wealth.
 - A small number of very wealthy.
- A command economy produces a “two-spiked” wealth distribution:
 - A very large number of very poor.
 - Almost no middle class.
 - A small number of extremely wealthy (those who hold the power and make the decisions).

A Question to Be Asked

Would we prefer to have equal wealth distribution or would we prefer to reduce poverty?

It is impossible to have both!

Appreciate and Thank Rich People

- You cannot use force or fraud in a free market economy, so the only way to get rich is to do a very good job of enriching many others by satisfying their wants (offering them goods or services at a lower price than other suppliers).
- Being wealthy is the evidence that you have done a great job of helping a lot of others and that you deserve many thanks.
- Wealth accumulation enables private charity!

Free Market Characteristics Summary

- There are billions and billions of negative feedback loops that optimize resource allocation.
- Everything interacts with everything else to some degree. The complexity is *huge* and, as a whole, defies comprehensive understanding!
- Left alone, wealth production is maximized.
- Perturbing it with force will cause it to seek a new equilibrium, but wealth production will be lower. (Perturbation examples: subsidies, minimum wage laws, taxation, loan guarantees, “regulations,” etc.)
- A perturbation always has an effect that is seen *and* other effects that are unseen which are in the opposite direction and larger than the visible effect. (Bastiat)

The End

Note: These slides are available on royminet.org