Every economic system must answer three questions. The first question is, what will be produced? That is, what combination of goods and services is our economy going to make with its limited resources? What combination of cars and houses, medical care, and vacations are we going to produce. The second question is, how will these goods be produced? What production methods will be used? What way will labor and capital and resources be combined to produce the goods and services that satisfy our wants and needs? And the third question is, who gets the goods? That is, how is the output divided among the people in the economy, each of whom probably wants more? These are three questions that every economic system must answer.

Well, let’s consider the way that one extreme kind of economic system might answer these questions. My extreme example is going to be a system of pure laissez faire. Laissez faire is a French word that means, “let do,” or “leave it alone.” In a laissez faire system individuals are allowed to make decisions completely for themselves. I decide how I want to use my time, energy, and talent. Maybe I want to be a carpenter and go and hammer nails for money. Maybe I want to build houses and charge people for my services. Or perhaps I sit and think about what I’m good at and decide that I should be a teacher, and I go and I deliver lectures and write books, and earn my money that way.

In a laissez faire system every man and woman in the economy makes his or her own choices about how to use their talents, and typically, in a laissez faire system, prices that arise in market interactions become the guide to people about what they should do. I see that teachers earn a lot of money and carpenters earn less. I’m a relatively good teacher; I’m not so great a carpenter, so I divert my energy into teaching. I train myself to become a better teacher. I’m responding to the incentives in the market prices. This is a laissez faire system. It’s a system in which people are directed, coordinated, and motivated by impersonal prices in the market, and these prices coordinate action among millions of people until they begin to hum along like a bee hive, everyone specialized, doing his or her own thing. And the outcome is the wealth that is created. Some people make cars, other people are teachers, other people build houses, and other people raise vegetables. That’s an extreme laissez fair system. And what you’ll get is the law of the jungle.

Now, the good thing about laissez faire is it allows for maximum individual freedom. Another good thing about laissez faire is that everyone in the economy can respond to information as he or she sees it. Information is distributed throughout the economy. You know things that I don’t know, you see opportunities that I can’t see, you can discern your own talents probably a lot better than I can, and whenever you respond to the information that only you have, you’re going to create wealth that I couldn’t create if I were trying to tell you what to do.

So laissez faire allows the freedom and the good use of all available information. On the other hand, laissez faire often creates messes whenever individuals are doing their own thing and pursuing their own advantage opportunistically. Consider one case. When you’re at a football game everybody’s sitting there enjoying the game, sitting in their seats, watching the fun out on the field, and sure enough, inevitably some bozo stands up. Now, when this bozo stands up, the person behind him or her also has to stand up just to see around, and before too long everybody, just to be able to see at all, is on their feet. Now, no one can see any better than they could see originally, and everyone’s legs are getting tired, and you’re more likely to have beer spilled on you. This is a problem, and it’s a problem that’s a breakdown of the system because people are acting selfishly. This is what happens when we have pollution and litter. It’s what happens when people decide not to get a flu shot, it’s what happens when individuals impose costs on other people or make choices that don’t consider others because there are no prices or other signals in the system to guide them. After all, if I had to pay every time I threw down trash, then that price would connect me to other people. But because I can do it thoughtlessly, we wind up with a lot more litter than we would otherwise get.

Also, sometimes in laissez faire systems, someone will amass a large amount of power because they own a lot of stuff and they can start telling people what to do. You wind up with monopolies and concentrations of power that we’d like to break up and restore competition and other incentives to create wealth, as opposed to hoard it and turn it into power that’s actually inefficient.

So there are all kinds of things that can go wrong with this view of the world in laissez faire, so that inclines us to consider another extreme, and that is planned economy. Let’s have a wise, central planner, who looks over all of the resource that we have and considers everything that people want, and puts together some master plan that’s the creation of a beautiful garden. You go and plant these flowers, you go and be a carpenter, you go and be a teacher, and we’ll all trade and have a lot of wealth. Well, this view of the world is great, because we’d like to believe there is
someone who has our best interests at heart, who sees the world clearly enough, who sees from 30,000 feet and can
direct us in the creation of something better than whenever we're all doing our own thing.

The problem with this view; however, is where does this central planner actually get the information that he or she
needs to craft this perfect view of the world? How does he or she know what people really want and who's good at
what? Not only that, but how does he or she actually get each individual to play their part in the system? How does
the central planner get you to be a teacher and you to be a carpenter? What incentives and motivations are offered?
Or does this become coercive. See? Central planning seems to deny the possibility of a great amount of individual
freedom. Either that, or the central planner starts giving out monetary incentives that look a lot like what we've got
over in the laissez faire market, so why not go back there?

The central planner doesn't get as much information as the individuals have over here in the jungle view of the world.
If the central planner can get that information, can craft the perfect view of the world, then even then you've got the
problem of motivating people to play their part in this picture. Now, all that aside, you've still got the problem that once
somebody's got enough power to tell people what to do, how do we keep them from abusing that? Aren't people
inclined to behave selfishly and opportunistically once they've got their finger on the switch? The problem with central
planning is that people at the top can't always be trusted to act in the best interest of everyone in the economy, and
people in the economy are all going to be diverting their energies into influencing the central planner to do things their
way, which creates a great deal of lobbying and waste.

So here we have two extreme views of the world—laissez faire, which can break down and turn into a mess, and
central planning, which can turn into an abuse. So which outcome is better? Well, your answer to that question is
probably going to depend on your politics and your philosophy. But in the real world what we see is that there are all
kinds of mixed systems. Every economy has some degree of laissez faire and some degree of planning. In the
United States, for instance, which prides itself on being a freewheeling, democratic, dog-eat-dog sort of free market,
we have all kinds of little islands of central planning. They're called corporations. I mean, what's the difference
between a centrally planned corporation and what the Soviet Union aspired to in the 1970's? You've got a group of
people here, responsible to shareholders, that are making decisions about what this manager will do and what this
division's responsibilities are, and who's going to turn out what products on what timetable. So, these corporations
exist, but they exist within a sea of freewheeling competition and laissez faire. So there's a mixed system, a system in
which individuals can be entrepreneurs and start businesses, that in which there are many organizations, which are
centrally planned that are part of the landscape.

On the other hand, you look at the situation in China, for instance, in which the government maintains a lot of authority
over the way the economy works, and yet what the government is choosing right now to do is to allow more laissez
faire in order to increase incentives for more productivity and wealth creation. So here's another mixed system, one
where the government isn't afraid to direct traffic, and in fact, it's not even afraid to drive some of the bigger cars, but it
also allows individuals to be competitive, to make decisions according to their assessment of their gifts and talents
and market opportunities.

Every economy involves some mixture of these two extremes - laissez faire and central planning. The role of the
government then in any economic system is to regulate the mix of these two. In some countries the government
decides to deregulate and stay out of commercial decision-making. At the same time; however, trying to prevent
everyone from standing up at the football game, trying to prevent the accumulation of monopoly power, trying to keep
people from pollution and encourage people to get flu shots.

Other governments decide to take a more active role in the actual allocation of resources. They direct bank lending;
they allow licenses for certain people to enter certain kinds of work. You get more government involvement in these
cases. But every country and every economic system can be placed on a spectrum somewhere between the jungle
and the garden, somewhere between the free-wheeling, freedom-loving, free market, laissez faire view of the world,
and between the view of the world in which some wise planner oversees and directs people so as to create the best
possible outcome. The truth is that whenever you're trying to use information well in a system, and whenever you're
trying to allocate resources to provide the most satisfaction, that every situation is different and every situation calls for
some different mix between planning and free markets.