

# Economic Systems



# Concept Review

Scarcity is the situation that exists when there are not enough resources to meet human wants.

An economic system is the way in which a society uses its scarce resources to satisfy its people's unlimited wants.

A society's economic system determines what to produce, how to produce, and for whom to produce.

An economic system in which families, clans, or tribes make economic decisions based on customs and beliefs that have been handed down from generation to generation.

The one goal of these societies is survival. Everyone's role supports this task. The good of the group always takes precedence over individual desires.

# Traditional Economies

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## **Advantages:**

Clearly answers the 3 economic questions. It produces what's best ensures the society's survival.

Little disagreement over economic goals and roles.

# Traditional Economies

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## **Disadvantages:**

Resistant to change and less productive because they won't adopt new approaches.

People are prevented from doing the job they want to do or are best suited for and therefore are less productive.

Much lower standard of living.

# Traditional Economies

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## Under Pressure to Change

Kavango people of Namibia.

Modern communication has led younger generations to want something more.

- There are no pure traditional economies in the world today.

# Traditional Economies

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**Primary Incentives: *Social approval and disapproval***

**Economic Goals**

Efficiency	<b>LOW</b>	Economic Growth	<b>VARYING</b>
Equity	<b>HIGH</b>	Economic Security	<b>HIGH</b>
Economic Freedom	<b>LOW</b>		

# Command Economies

The government decides what goods and services will be produced, how they will be produced, and how they will be distributed.

The wants of individual consumers are rarely considered.

Government owns the means of production.

Examples today: North Korea and Cuba



# Command Economies

Leaders set wages and therefore they decide who has the money to buy available products.

Also known as a centrally planned economy.

Heavily influenced by the work of Karl Marx.

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# Command Economy

According to Marx, all of history is a struggle between classes. Marx predicted that in time the workers would overthrow this system and transfer ownership of the means of production to the people.

The class struggle would be resolved and all citizens would share in the wealth.

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# Command Economy

Socialism is an economic system in which government owns some or all of the factors of the production.

Communism is a more extreme form of socialism in which there is no private ownership of property and little or no political freedom. This authoritarian socialism requires absolute obedience to authority.

# Command Economy

Democratic socialism is established by the democratic political process rather than a government overthrow. This is a mix of government ownership and private ownership of industry. Central planners control government-owned industries and other sectors of the economy, such as health care, to make sure everyone has access to those services.

# Command Economy

Karl Marx

Lived in the age of the Industrial Revolution which he believed created a system of wage slavery.

“Workers of the world unite; you have nothing to lose but your chains.”

Wrote *The Communist Manifesto* with Friedrich Engels (1848) and *Das Kapital* (1867-1894)

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# Command Economy

There are no pure command economies today.

North Korea is close. The government controls every economic decision. So much focus on military buildup came at the expense of basic necessities. Millions died of starvation.

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# Command Economies

## Impact of Command Economies

Effective in theory but not in practice. Central planners don't understand local conditions. Workers lack motivation due to no incentives (wages or private property). Prices tend to be lower than in a market economy which results in shortages. Causes loss of individual rights and great suffering.

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**Primary Incentives: *Government rewards and punishments***

**Economic Goals**

Efficiency

**VARYING**

Economic Growth

**LOW**

Equity

**MEDIUM**

Economic Security

**HIGH**

Economic Freedom

**LOW**



Based on **individual choice** but as people serve their own self-interest, they benefit others as well.

Adam Smith, in *The Wealth of Nations*, stated that we are “led by an invisible hand” to promote the interests of others.

# Market Economies

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Another feature of market economies is **private property**, the right of individuals and groups to own property.

Private property includes everything that an individual owns including intellectual property (ideas) and the labor individuals provide to earn money.

It is essential to protect private property rights in a market economy and that responsibility is the work of the government.

# Market Economies

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Another feature is the actual **market**, which is any place or situation in which people buy and sell resources and goods and services.

The market is where people can exchange their private property for someone else's.

# Market Economies

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**Capitalism** (an economic system based on private ownership of the factors of production) is the foundation of market economies.

The concept of **laissez faire** means the government should not interfere in the economy. In theory, the market should drive the production of goods and services that consumers want with no need for government involvement.

There are no pure market economies in the world today.

# Market Economies

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**Voluntary exchange** is a trade in which both traders believe that what they are getting is worth more than what they giving up.

Self-interest guides voluntary exchange.

In a market economy, most trade is based on the exchange of a product for money rather than another product.

# Market Economies

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Market economies are also characterized by **competition**, the effort of two or more people, acting independently, to get the business of others by offering the best deal.

**Consumer sovereignty** is the idea that consumers have the ultimate control over what is produced because they are free to buy what they want and to reject what they don't.

# Market Economies

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A market economy encourages efficient use of resources by allowing people and businesses to **specialize** in what they do best.

This allows people to trade what they can most efficiently produce for goods and services produced more efficiently by others.

This removes the need for households to be self-sufficient.

Leads to higher quality yet lower priced products.

# Market Economies

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## ***Impact of Market Economies***

### **Advantages:**

Economic and political freedom

Profit - serves as a reward for hard work and innovation and also ensures that resources are allocated efficiently (inefficiencies would lower profits)

Competition - Leads to high quality products and lower prices and create a more diverse product market.

# Market Economies

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## **Disadvantages:**

A pure market economy has no mechanism for providing public goods and services because it would not be profitable.

It does not provide security for those who cannot be economically productive.

It cannot prevent unequal distribution of wealth (example: the Industrial Revolution)

# Market Economies

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**Primary Incentives: *Private gains and losses from voluntary exchange***

**Economic Goals**

Efficiency

**HIGH**

Economic Growth

**HIGH**

Equity

**LOW**

Economic Security

**LOW**

Economic Freedom

**HIGH**

# Mixed Economies

An economic system that has elements of market and planned economies.

This is the most common type of economic system in the world.

The United States is essentially a market economy with some government regulation and planning.

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# Mixed Economies

Many European countries lean more towards democratic socialism.

In France, government has a controlling share of ownership in a number of industries and provides many social services.

The Swedish government own  $\frac{1}{3}$  of all Swedish companies. Swedish citizens receive “cradle to grave” social benefits. The Swedish people pay very high tax rates.

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# Mixed Economies

## *Three Roles of Government in a Mixed Economy*

- To establish the institutions that enable markets to operate.
  - To step in when the market operates in ways society finds unacceptable.
  - To provide certain goods and services that markets do not always provide or do not provide enough of.
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Economies are always changing in response to changes in natural, social, and political conditions.

EXAMPLE: Former Soviet Union countries that changed from command to more market-based economies in the 1990s.

# Trends in Modern Economies

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## ***Trend #1: Changes in Ownership***

Countries sometimes nationalize (take government ownership of) key industries during times of war.

Today we see more government-owned industries being privatized (changing back to private ownership) to encourage economic growth.

# Trends in Modern Economies

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## ***Trend #2: Increasing Global Ties***

One way to help privatize industry is to open it up to foreign investors.

The global economy is all the economic interactions that cross international borders.

Businesses and consumers now engage in more foreign trade than ever before.

# Trends in Modern Economies

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## ***Trend #2: Increasing Global Ties***

One reason is the opening up of the world's markets to trade (trade agreements between nations).

Another reason is the development of faster, safer, and cheaper transportation.

Globalization has also resulted in more cross-border business partnerships.

# Trends in Modern Economies

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