



Economic Systems

The Three Basic Economic Questions:

- ▶ What should we produce?
- ▶ How should we produce?
- ▶ For whom should we produce?



The Three Basic Economic Questions:

- ▶ ***What should we produce?***

- ▶ Should we make TVs and computers, cars and trucks, or military tanks and airplanes
 - ▶ How many of each thing should we make?



The Three Basic Economic Questions:

▶ ***How should we produce it?***

- ▶ Should we invest in the latest tools and machines to make our products?
- ▶ Should we allow one large company to make all the TVs?
- ▶ Or, should we encourage many smaller companies to compete in making TVs?



The Three Basic Economic Questions:

- ▶ ***For whom should we produce it?***

- ▶ Should we make mostly expensive products that only wealthy people can afford,
- ▶ Or, should we focus on everyday items that most ordinary people can afford?



Command Economies

- ▶ An economy in which the government makes all basic decisions.
 - ▶ In ancient societies, most people did not have the power to answer the basic economic questions.
 - ▶ 20th Century – A different kind of Command Economy evolved – Communist nations of Russia and China
 - ▶ Governments made all the economic decisions.



Command Economies

- Equal distribution of wealth
- Make sure that the basic needs of all citizens were met.
- Government committees in these huge countries tried to predict all the things that people would need
- They controlled all the resources
- Decided what should be produced; how to produce it; how to distribute goods and services



Command Economies

- ▶ Due to size and complexity of modern nations, command economies were doomed to fail
- ▶ One decision-making group could not compile enough information to figure out
 - ▶ how to allocate (distribute) enough food, clothing and hundreds of other everyday things that people need and want
 - ▶ While at same time allocating resources needed for construction projects, transportation and other public works



Command Economies

- ▶ Command economies were very inefficient.
- ▶ Often faced shortages
- ▶ Or, occasionally, surpluses of goods and many resources were wasted.



Command Economies

- ▶ **Other Disadvantages of command economies:**
 - ▶ Cannot respond quickly to changing needs and conditions
 - ▶ Provide no incentives to workers or producers to work hard and use resources efficiently
 - ▶ wages are not based on a worker's performance
 - ▶ producers are not able to earn profits



Command Economies

- ▶ Citizens in these Communist nations had a certain level of security in keeping their jobs
- ▶ They had no freedom to make their own decisions
- ▶ No opportunities to improve their standard of living



Command Economies

- ▶ Eventually, the failure of their command economies led both Russia and China to begin transforming their societies to become more like the market economies of North America and Europe



Market Economies

- ▶ Based on private ownership
- ▶ Private individuals and companies control resources
- ▶ Private companies decide what to produce and how to produce it



Market Economies

- ▶ Distribution of goods and services determined by prices (which reflects laws of supply and demand)
 - ▶ When a product is scarce (low supply), the demand for it is high.
 - ▶ Those who want the product most and can afford it will get it.
 - ▶ If companies set prices too high, they won't be able to sell enough products to make a profit



Market Economies

- ▶ Market systems are very efficient - based on competition
- ▶ Producers compete with each other to sell the products people want most, driving down prices
- ▶ Consumers (people who buy things) compete to buy scarce products, driving up prices.
- ▶ When producers' supply a product and consumers' demand for it are equal, prices stabilize, or stop changing



Market Economies

- ▶ Because of competition and the incentive to make a profit, market economies respond quickly to changing needs and wants in a society
- ▶ Give consumers and producers lots of freedom to make their own choices and improve their standards of living



Market Economies

- ▶ Also known as *capitalist*, or *laissez-faire* (to leave alone) economies
- ▶ Pure market economy, government does not interfere with free markets – it leaves them alone
- ▶ Allocation of goods and services is based on prices and profits



Market Economies

- ▶ Unfortunately, in a pure market economy, one without any government control, also gives people the “freedom” to starve
- ▶ Market economies always result in an unequal distribution of wealth
- ▶ Cannot guarantee equity, or fairness
- ▶ Some are lucky or clever enough to make a fortune
- ▶ While others remain poor



Market Economies

- ▶ Producers have no profit motive to provide goods and services for the poor
- ▶ Greed for profits can encourage producers to supply goods such as dangerous products, when the demand for them is high
- ▶ Greed can also encourage producers to sacrifice product safety, in order to lower their costs



-
- ▶ Since uncontrolled markets do not always serve the public good, most economies today are based on a mixture of market forces and government control



Mixed Economies

- ▶ National economies are based on various combinations of market forces and government intervention
- ▶ At the very least, governments enforce property rights, contracts, patents, and copyrights
- ▶ They provide a stable supply of money to make voluntary exchange between producers and consumers possible



Mixed Economies

- ▶ In nations such as the U.S., Canada, and England, most economic decisions are based on markets (with only limited government controls)
- ▶ In European nations such as Sweden, France, and Germany, the government provides extensive economic “safety nets” to protect workers, consumers and families from dangers of the market system



Mixed Economies

- ▶ Still, the U.S. government plays an important role in providing goods and services such as public schools, highways, parks, low-income housing, etc.

