

# 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.
  - 20<sup>th</sup> 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.

# Traditional Economies

- Traditional Economy – Economic system that relies on habit, custom, or ritual to decide questions of production and consumption of goods and services.
- Revolves around the family
- Boys tend to take up the occupations of their fathers, while girls follow in the footsteps of their mothers.
- Traditional economies are usually communities that tend to stay relatively small and close.
- Often these societies work to support entire groups, rather than just themselves or their immediate families
- Agriculture and hunting usually lie at the heart of the people's lives, laws, and religious beliefs.