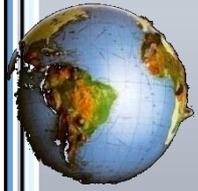




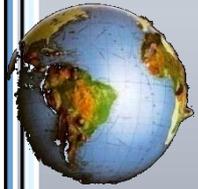
Economies in Transition Part I

The most important single central fact about a free market is that no exchange takes place unless both parties benefit.

-Milton Friedman



TYPES OF ECONOMIC SYSTEMS

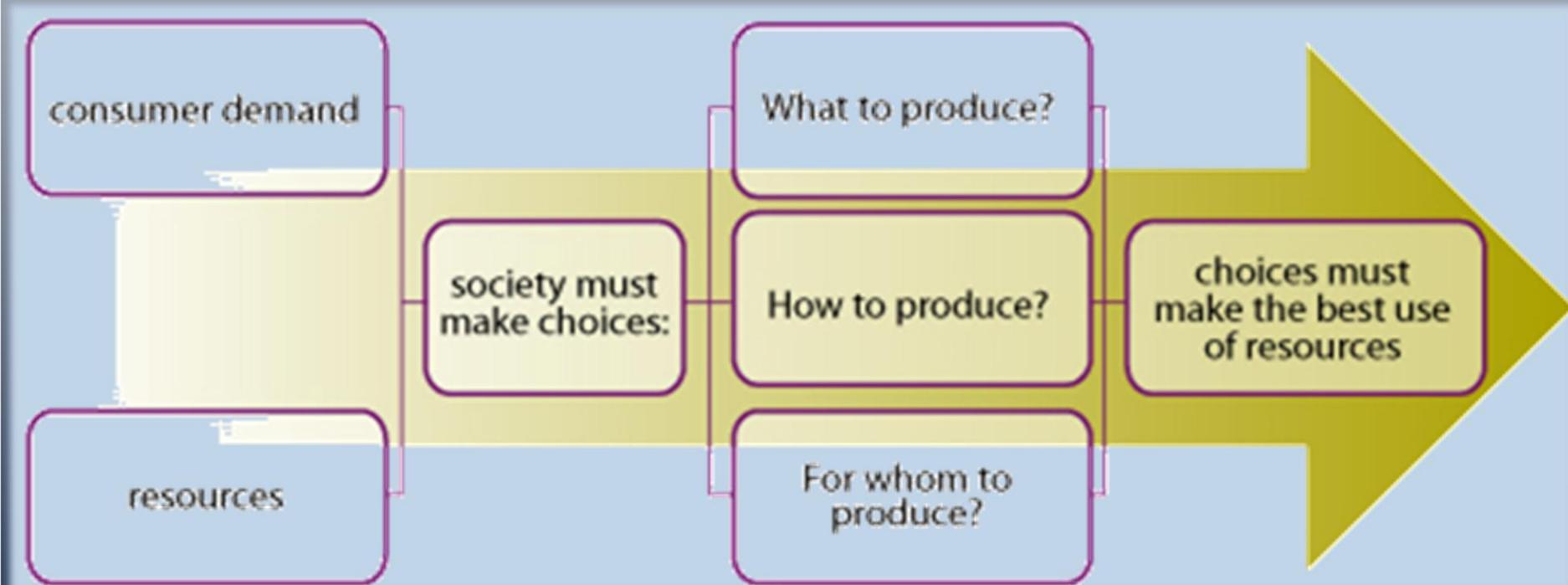


Economic System

Determines what is produced, how it is produced & for whom it is produced.



Model of an Economic System





Types of Economic Systems

- Traditional
- Command
 - Socialism
- Market
 - Capitalism
- Mixed
- Communism



Traditional Economy

A system in which traditions & habits answer the what, how & for whom production questions (“We do it this way because we’ve always done it this way.”)



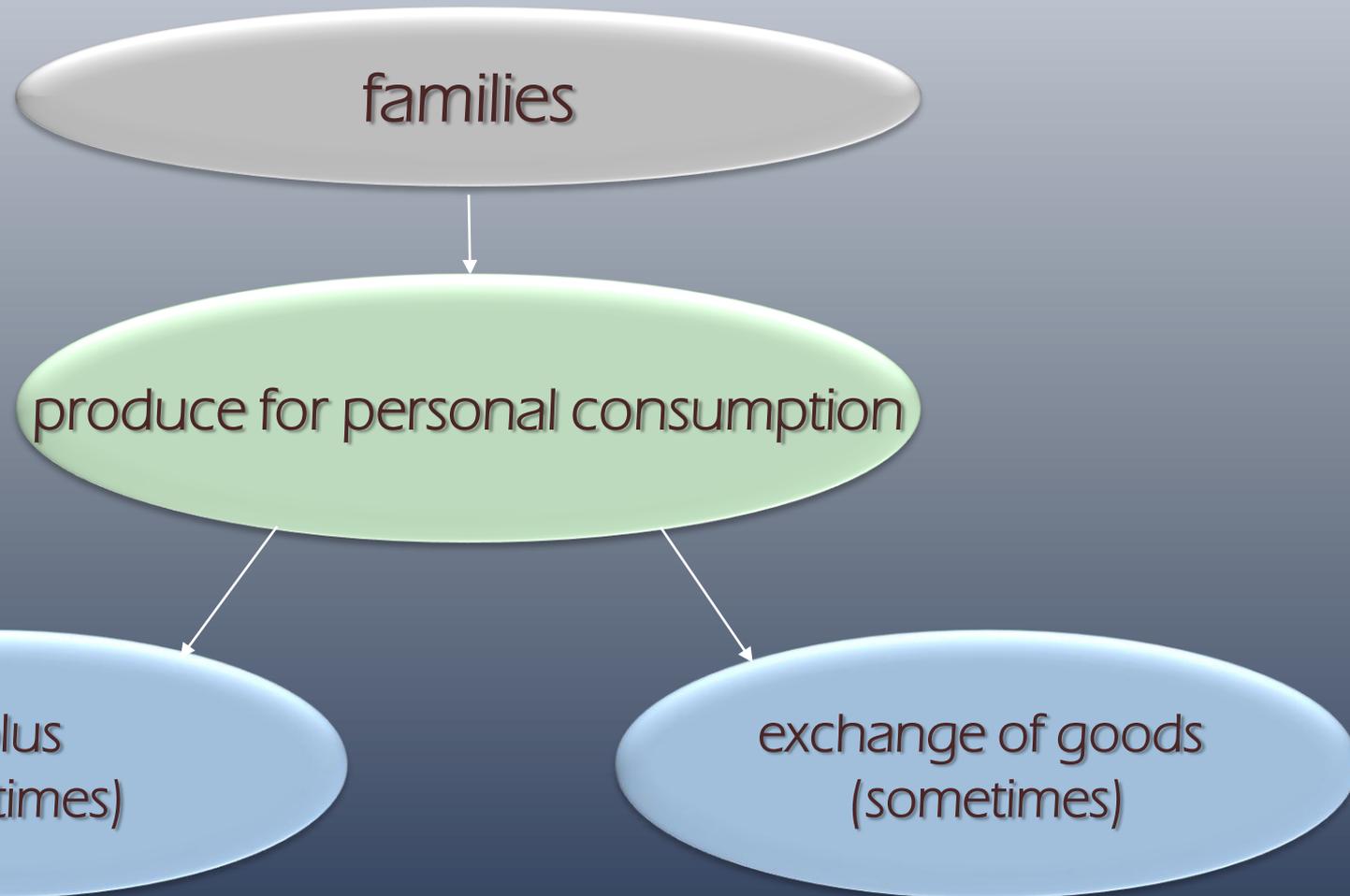
Advantages of a Traditional Economy

There is little friction among members
because relatively little is disputed.



Disadvantages of a Traditional Economy

- Restricts individual initiative .
- Lacks advanced goods.
- Lacks new technology.
- Experiences little growth.



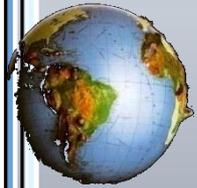
Traditional Economic System



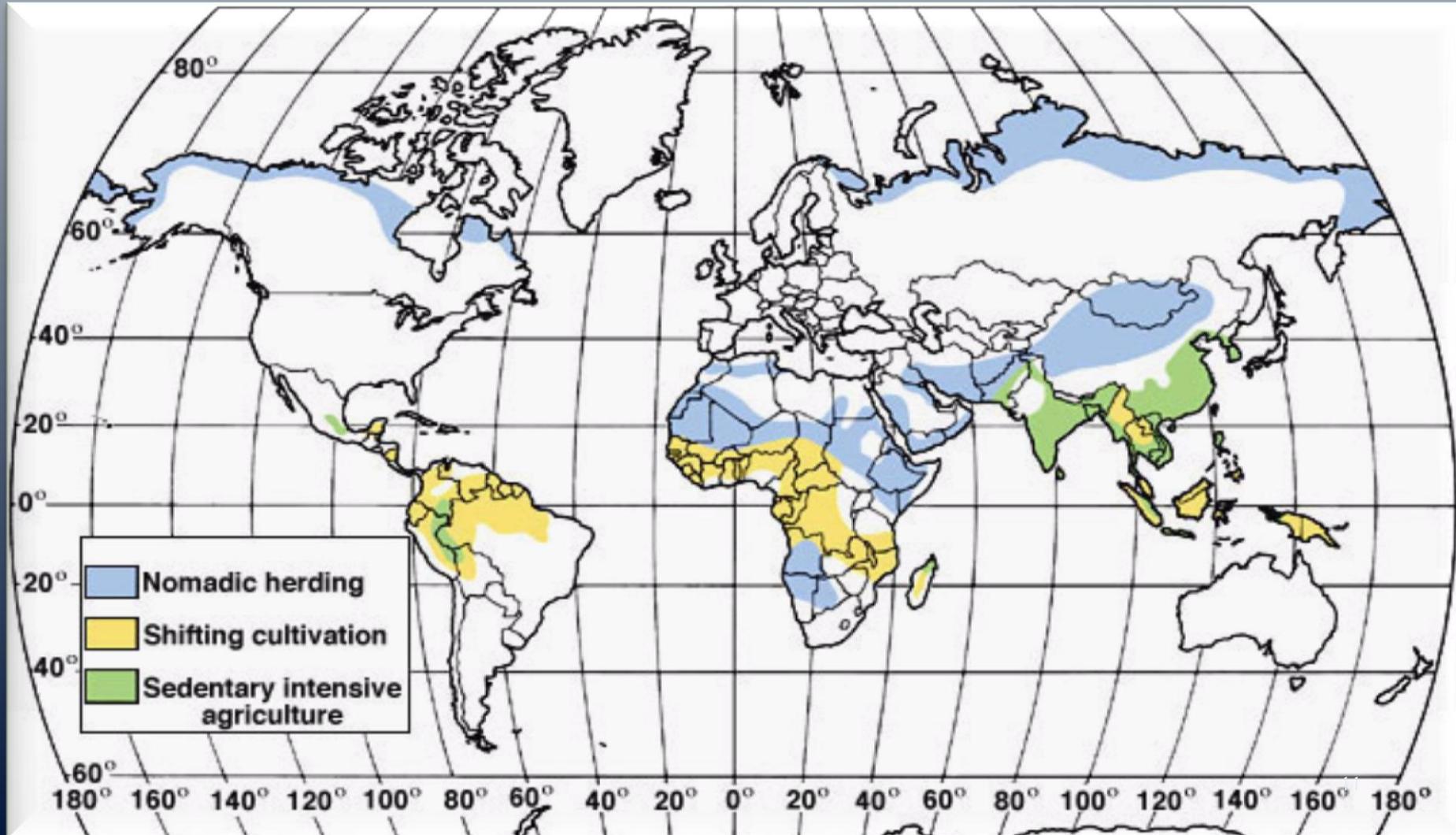
- an economic system of relatively simple technology in which people produce most or all of the goods to satisfy their own & their family's needs
- Portions of crops or domestic animals are often bartered to fill gaps but little exchange occurs outside the immediate or extended family.

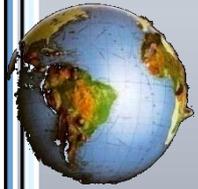


Traditional Economy



Areas with Traditional Economic Systems



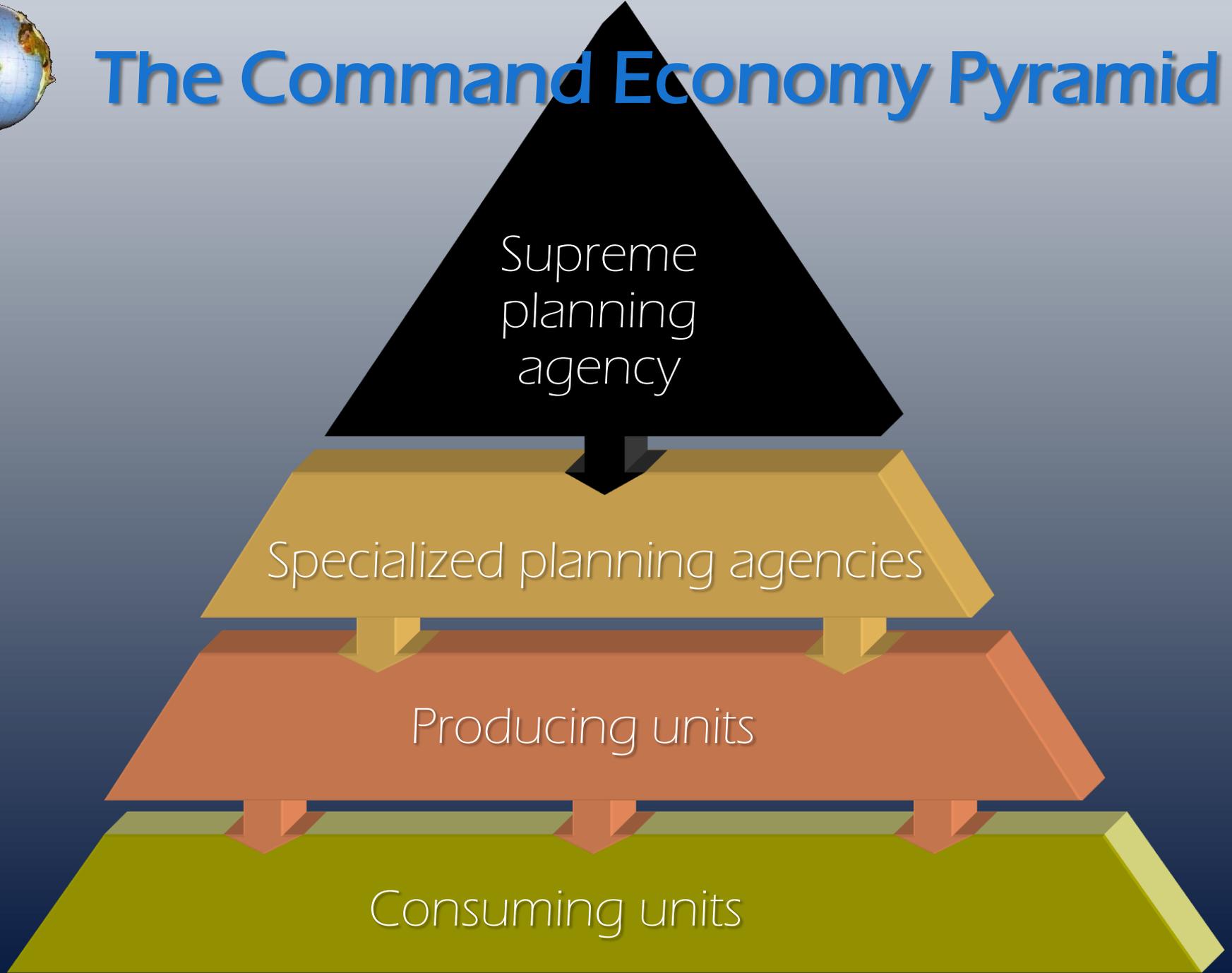


Command Economy

A system in which a central authority answers the what, how & for whom production questions, giving the system a pyramid-like organization.



The Command Economy Pyramid



Supreme
planning
agency

Specialized planning agencies

Producing units

Consuming units



Strengths of a Command Economy

- Economic change can occur very quickly.
- Social welfare can be enhanced.

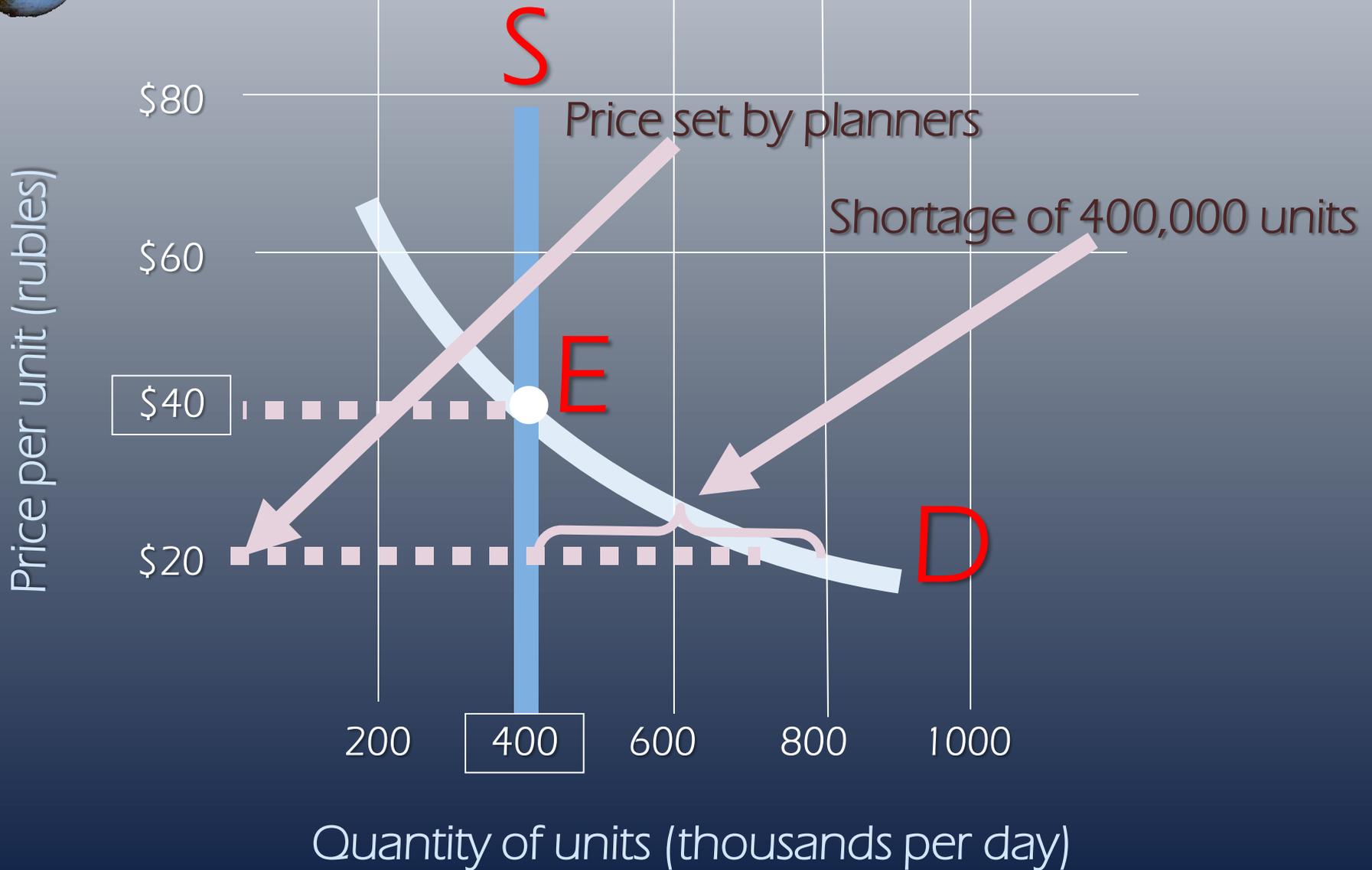


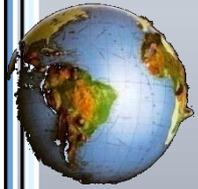
Weaknesses of a Command Economy

- Decision makers have the power to be absolutely wrong.
- The quality & variety of goods suffer.

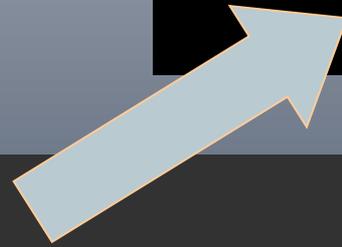


Central Planners Fix Prices

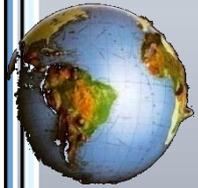




Shortage of products



Planners set the price of products below equilibrium



government

Government controls everything, even profits.

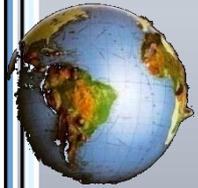
owns all businesses

determines production ... type, location, amount

operates businesses, decides wages of workers

all profits go to government

Command Economy



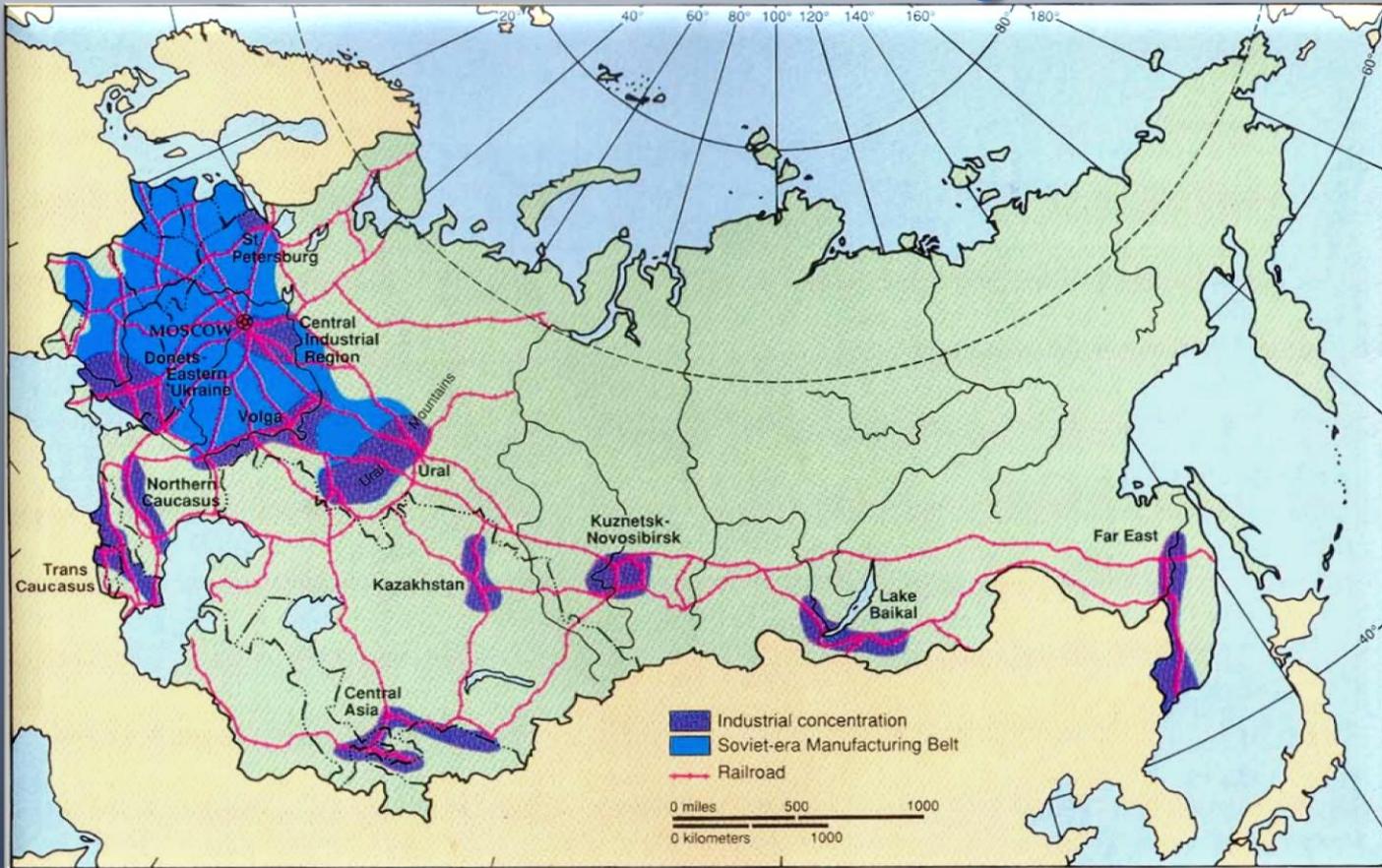
Command Economy

- a system of production of goods & services usually consumed or distributed by a governmental agency, in quantities, at prices & in locations determined by the government
- rigidly programmed by a central planning department without benefit of the cost or demand information a free market economy regularly supplies





Command Economy Industry



The Volga, Central Industrial & St. Petersburg (Leningrad) concentrations within the former Soviet manufacturing belt were dependent on transportation, labor & market pulls. Other planned industrial regions had a strong orientation to materials & were developed despite their distance from population centers & western markets.



Socialism

An economic system characterized by government (public) ownership of resources & centralized decision making (centralization).



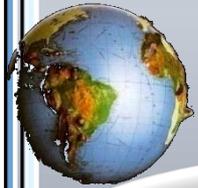
The Strengths of Socialism

- an equitable distribution of income
- rapid growth is possible
- no unemployment



The Weaknesses of Socialism

- leads to inefficiencies – in production, use of resources, etc
- stifles growth



government

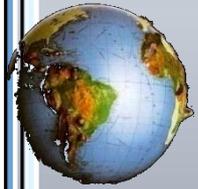
free market
(private industry)

joint economic decisions ...
government decides
industry ownership

state provides
certain benefits & services for all ...
sometimes called "welfare state"

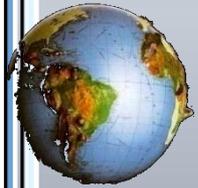
private industry
keeps profits

Socialism: Mixed Economy

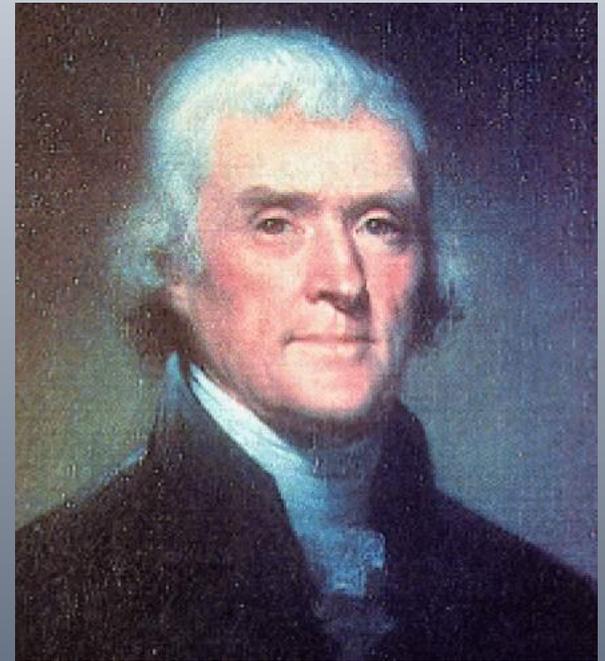


Market Economy

A system in which the free market answers
the what, how & for whom production
questions



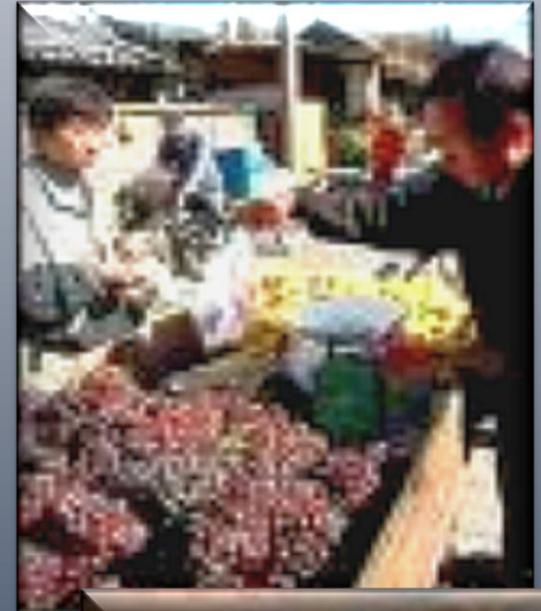
Adam Smith



- father of modern economics
- theorized that a free market economy acted like an “invisible hand” – belief that the best interests of society are served when individuals are allowed to act in their own self-interest
- wrote *The Wealth of Nations*, published in 1776



- a system of production of goods & services for exchange in comparative markets where price & availability are determined by supply & demand forces
- Supply and demand determine price & quantity.
- Market competition is the primary force shaping production decisions & distribution.

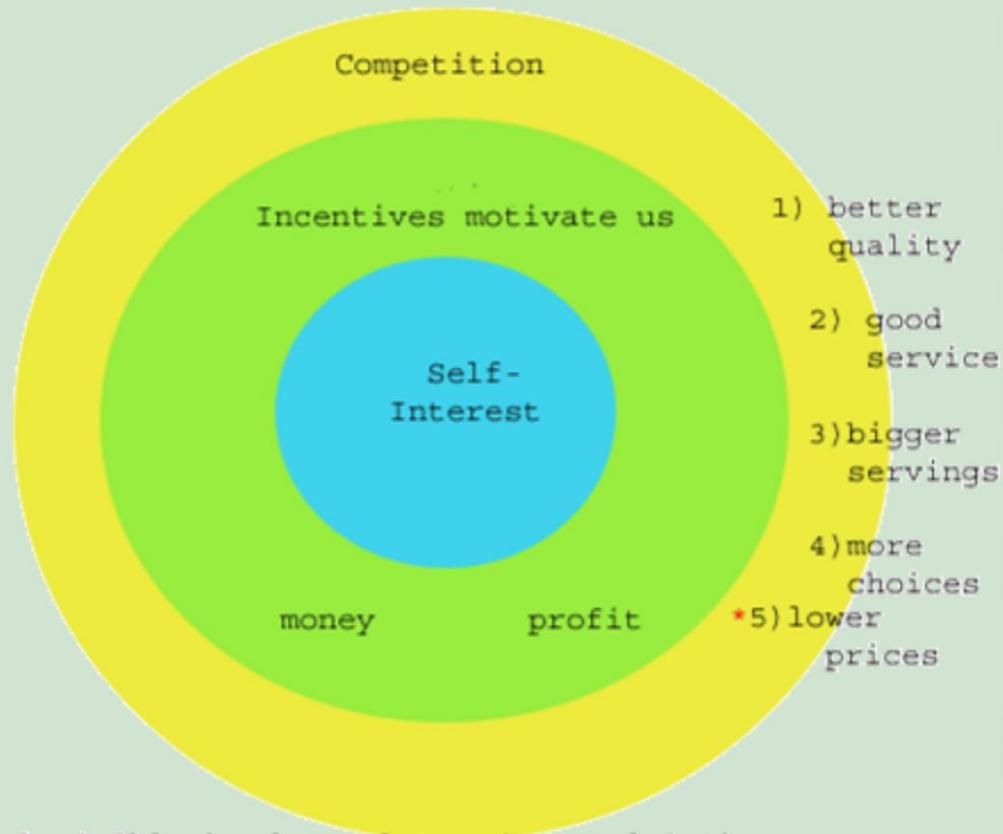


Market Economy



Advantages of a Market Economy

The Invisible Hand



It provides a wide variety of goods & services that buyers & sellers exchange at the lowest prices.

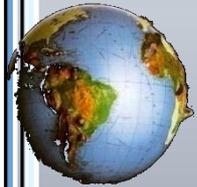
The invisible hand regulates (controls) the economy without a central plan.



Criticisms of a Market Economy

- lack of competition
- externalities
- lack of public goods
- income inequality





Capitalism

- An economic system characterized by private ownership of resources & markets
- Consumer Sovereignty – the freedom of consumers to cast their dollar votes to buy or not to buy, at prices determined in competitive markets
- No nation in the world precisely fits the criteria for capitalism, but the US comes close.



laws of supply & demand

Private industry
assumes production
risks & so gets profits.

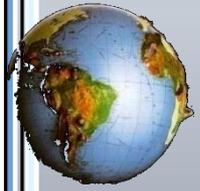
consumers

private enterprise

government regulations

all above determine prices & production

Capitalism: Market (*demand*) Economy

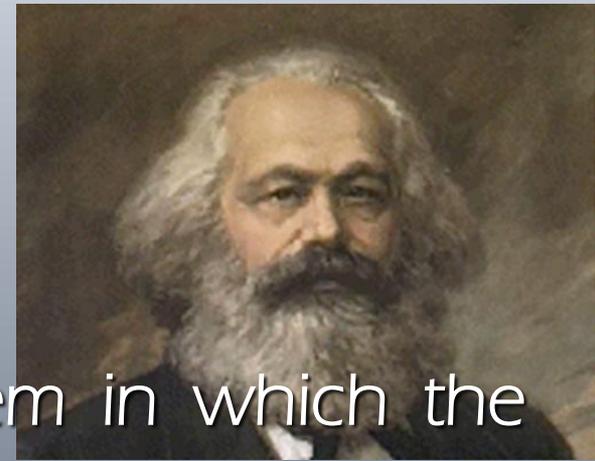


Mixed Economy

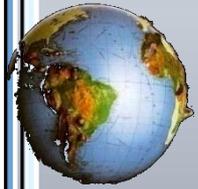
An economic system that answers the basic questions of production through a mixture of traditional, command & market systems



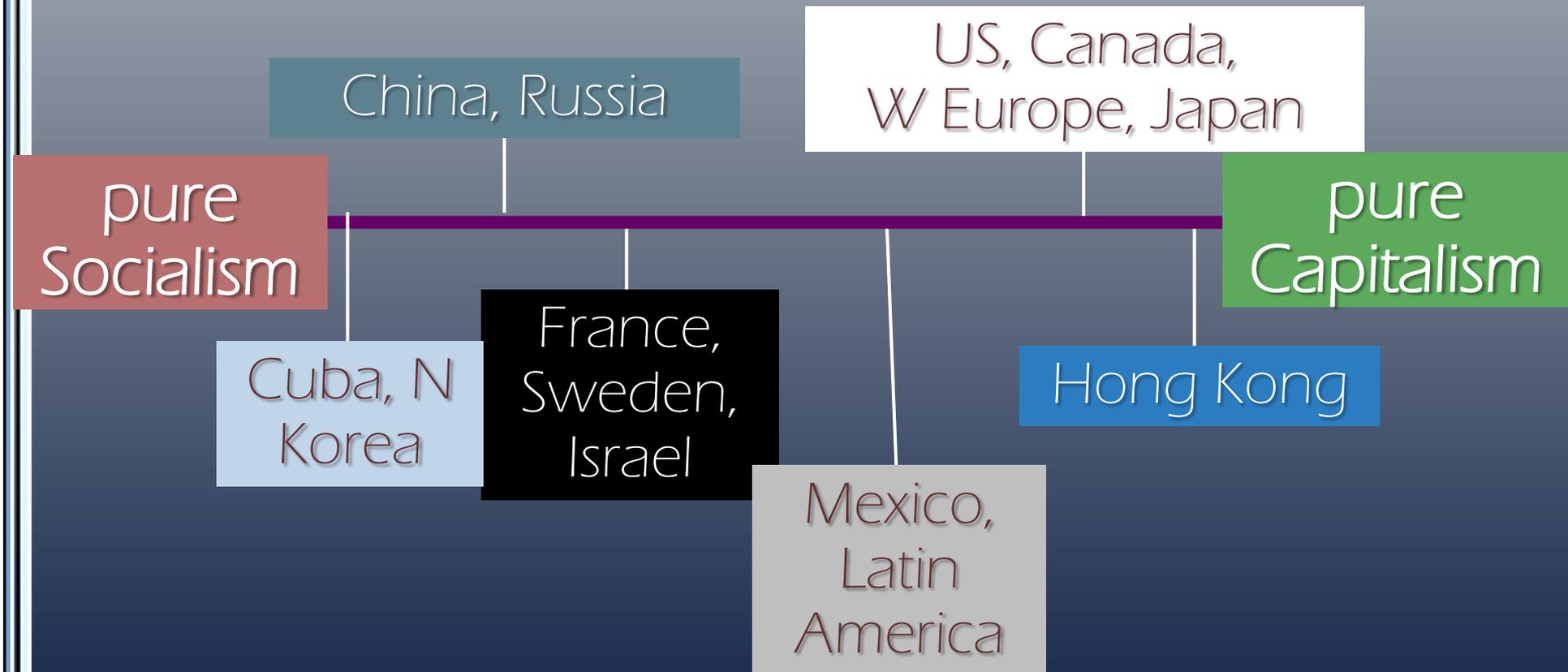
Communism



- A stateless, classless economic system in which the factors of production are owned by everyone who shares in accordance to their needs
- Karl Marx wrote two books – *The Communist Manifesto* (1848) & *Das Kapital* (1867-1885) – in which he criticized capitalism & thereby advanced communism as an alternative
- A theoretical economic system ... no communist economic system has ever existed



A Classification of Economic Systems





Governments Take a Different Role in Each System



No Government
Control

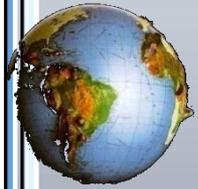
Lots of Economic
Freedom

Total Government
Control

No Economic
Freedom



**The move toward capitalism is a
global trend.**



Market vs. Command Economy

CHARACTERISTIC	COMMAND ECONOMY	MARKET ECONOMY
ownership of resources	government ownership	private ownership
decision making	centrally planned	by the market
motivation	social good	self interest & profit
prices & wages	set by the government often distorted	set by the market change with market
result	inefficient full employment low inflation low standard of living shortages more equal distribution	economic efficiency periods of unemployment periods of inflation high standard of living wide range available less equal distribution
problems	corruption = self interest lack of incentives distorted prices inefficiency	monopoly = inefficiency inequality changing prices instability pollution
OVERALL	LESS FOR MORE (INEFFICIENT)	MORE FOR LESS (EFFICIENT)



CONTINUED IN
*ECONOMIES IN
TRANSITION PART II*