

Comparative Economic Systems

Capitalism

- What are the factors of production?
- How can we describe the free enterprise system and the laissez-faire theory?
- What is the role of government in a mixed economy?
- How are business organizations classified?
- What role do profit and loss have in a free enterprise system?

Factors of Production

The **factors of production** are the basic resources which are used to make all goods and services.

Land

- One factor of production is land, which in economic terms includes all natural resources.

Labor

- Labor is the work done by men and women to produce goods and services.

Capital

- **Capital** includes all the human-made resources that are used to produce goods and services. Someone who owns capital and puts it to productive use is called a **capitalist**.

The Role of the Entrepreneur

- An **entrepreneur**—literally, an “enterpriser”—is an individual with the drive and ambition to combine land, labor, and capital resources to produce goods or offer services.

Free Enterprise System

The **free enterprise system** is an economic system characterized by private or corporate ownership of capital goods and investments that are determined by private decision rather than by state control.

Private Ownership

The resources used to produce goods or services are owned by private individuals or corporations.

Profit

The “profit motive” is the desire to gain from business dealings.

Individual Initiative

All individuals are free to start and run their own businesses.

Competition

Competition is a situation in which a number of companies offer the same product or service. Under competitive conditions, prices are determined by the **laws of supply and demand**.

Laissez-Faire Theory and Mixed Economies

Laissez-Faire Theory

- **Laissez-faire theory** holds that government should play a very limited, hands-off role in society.
- The proper role of government in economic affairs should be restricted to functions intended to promote and protect the free play of competition and the operation of the laws of supply and demand.

A Mixed Economy

- Economists usually describe an economy in which private enterprise and governmental participation coexist as a mixed economy.
- The American economy is a mixed economy.
- Government at all levels in American society has some influence on the economy.

Types of Business Organizations

Sole Proprietorships

- **Businesses owned by a single individual are sole proprietorships.**

Partnerships

- **Businesses owned by two or more individuals, called partners, are partnerships.**

Corporations

- **A corporation has many owners, called shareholders. A share is a fraction of ownership in the corporation.**
- **Corporations have the advantage of being able to draw from large pools of investor capital, but also have the disadvantage of having their earnings taxed twice.**

Profit and Loss

- Profit is the amount of money you earn from the business once costs incurred running the business have been subtracted.
- If earnings are less than the costs, the business has not made a profit; instead, it has taken a loss.
- Taking risks and making investments are an essential part of the capitalist system.

Socialism

- What is socialism?
- What are some important characteristics of socialist economies?
- How can we describe socialism in developing countries?
- What are the pros and cons of socialism?

What is Socialism?

- **Socialism** is an economic and political philosophy based on the idea that the benefits of economic activity—wealth—should be equitably distributed throughout a society.
- Socialists emphasize cooperation and social responsibility as ways to achieve a more equitable distribution of both income and opportunity, thus reducing great differences between rich and poor.

The Industrial Revolution

Socialism developed largely in reaction to the poverty and other hardships that accompanied the Industrial Revolution.

Karl Marx

- Karl Marx's theories, mostly worked on with Friedrich Engels, criticized capitalism.
- To Marx, the **proletariat**—the workers—were being so badly abused by the **bourgeoisie**—the capitalists—that they were certain to rise up and overthrow the capitalistic system.

Socialists and Communists

- The socialist movement was split during the nineteenth century: those who believed socialism could only be attained by a violent revolution became communists, and those who believed democratic processes could be used became today's modern socialists.

Characteristics of Socialist Economies

Nationalization

- Placing enterprises under government control, often by taking over privately owned industries, is called nationalization.

Public Welfare

- Socialists aim to guarantee the public welfare by providing for the equal distribution of necessities and services.

Taxation

- Because social welfare services are quite expensive, taxes in socialist countries tend to be high.

Centrally Planned Economy

- In a **centrally planned economy**, government officials plan how an economy will develop over a period of years. A democratic socialist economy may or may not have strict central planning.

Socialism in Developing Countries

- Socialism has won a large following in developing countries.
- One reason for socialism's appeal is that most developing nations are starting from scratch at building industry, often having no local tradition for large-scale industry.
- However, social unrest and political instability are persistent problems in developing nations, and socialist governments often become authoritarian in nature.

Pros and Cons of Socialism

Pros

- **Socialists say that it is fairer to supply everyone with basic needs, such as medical care.**
- **Socialists argue that it is morally superior to capitalism because it evens out inequalities.**
- **Defenders of socialism also argue that it gives workers and ordinary citizens greater control of their everyday lives.**

Cons

- **Critics say socialistic countries have a tendency to develop too many layers of bureaucracy.**
- **In the eyes of socialism's critics, the smooth running of an economy is too complex to be directed by central planners.**
- **Another criticism is that socialism deprives people of the freedom to decide for themselves how to use their income.**

Communism

- What do the theories of Karl Marx describe?
- What characteristics do communist economies have?
- How did communism operate in the Soviet Union, China, and other nations?

Karl Marx's Theory

Communism is often called a collectivist ideology, which calls for the collective, or state, ownership of land and other productive property.

1. *Marx's view of history*

To Marx, all of history was a struggle between social classes competing for control of productive property.

2. *The Labor Theory of Value*

In Marx's view, the value of a commodity was set by the amount of labor put into it.

3. *The Nature of the State*

Marx saw the state and its government as tools by which the capitalists maintained their order and privileges.

4. *The Dictatorship of the Proletariat*

Marx did not believe a "free, classless society" would initially be formed, but rather, in the transition an authoritarian state would represent and enforce the interest of the masses.

Characteristics of Communist Economies

Role of the Communist Party

In any communist-run nation, the Communist Party holds the decision-making power in both the government and the economy.

Central Planning

Government officials plan and supervise production in factories, farms, and stores.

Collectivization

Collective or state ownership of the means of production is one pillar of communism. **Collectivization** is the process of merging small private farms into large government-owned agricultural enterprises.

State Ownership

Industrial enterprises, transportation, and other parts of the economy are also state-owned.

The Soviet Union

The Five-Year Plans

- A series of five-year plans were used to organize and run the Soviet economy, all under the supervision of one large economic planning agency called **Gosplan**.

Gorbachev's Reforms

- Mikhail Gorbachev initiated *perestroika*, a reform which placed more authority in local management, linked salaries to performance, loosened price controls, and allowed some profit incentives.

Transition to a Free Market

- With the fall of the Soviet Union in 1991, Russia has been in a constant transition to a free market. A key component of this transition has been **privatization**, or the return of nationalized enterprises to private ownership.

China and Other Communist Nations

China

- When Mao Zedong took control of China in 1949, the country developed its own version of central planning.
- The Chinese economy today, however, has evolved into a mix of state-controlled enterprises and a growing class of private enterprises.

Cuba

- Fidel Castro led a revolution in Cuba in 1959 to overthrow a corrupt government. In 1961, Castro declared himself a Marxist and the country became communist in nature.

Asia

- North Korea is one of the few remaining communist countries in the world.
- Communism also spread in the Southeast Asian countries of Vietnam, Laos, and Cambodia during the mid-1970s.