

Economic Systems and Decision Making: Chapter 2 (2.1)

An economic system is a collection of institutions, laws, activities, controlling values, and human motivations that collectively provide a framework for economic decision-making and answering the three basic economic questions of What to produce, How to produce, and for Whom to produce.

I. Traditional Economies

- A. Roles and economic decisions are defined by custom
- B. Examples: Central African Mbuti, Australian Aborigines, northern Canadian Inuits
- C. Advantages = everyone knows which role to play and there is little uncertainty about WHAT, HOW, and FOR WHOM to produce
- D. Disadvantages= discouragement of new ideas and new ways of thinking...leading to a lower standard of living than in other societies

II. Command Economies

- A. A central authority determines WHAT, HOW and FOR WHOM to produce
- B. Examples: North Korea, Cuba, People's Republic of China (and the former Soviet Union)
- C. Advantages = the ability to drastically change direction in a relatively short period of time and many basic health and public services are available at little or no cost.
- D. Disadvantages =
 - 1. consumer needs may not be met;
 - 2. hard work is not rewarded;
 - 3. necessary decision-making bureaucracy delays decision;
 - 4. little flexibility to deal with day-to-day problems;
 - 5. individual initiative goes unrewarded (i.e. entrepreneurs need not apply)

III. Market Economies

- A. Producers and consumer determine WHAT, HOW, and FOR WHOM to produce. The consumer "\$\$" acts as a "vote", ensuring that producers continue to bring to market the goods and services that consumers want to buy.
- B. Examples: US, Canada, Japan, South Korea, Singapore, and parts of Western Europe
- C. Advantages =
 - 1. ability to adjust to change;
 - 2. the high degree of individual freedom (start a business, the ability to work nights, part-time job, two jobs, etc.);
 - 3. the small degree of government involvement;
 - 4. the ability to have a voice in the economy;
 - 5. the variety of goods and services created;
 - 6. the high degree of consumer satisfaction
 - 7. high standard of living
- D. Disadvantages =
 - 1. inability of the market to meet every person's basic needs
 - 2. inadequate job in providing highly valued services like justice, education, and health care
 - 3. high level of personal uncertainty and the prospect of economic failure

IV. Mixed Economies

- A. Contains characteristics of two or more of the pure economic systems (example: in US we have the USPS, which is run by the government; Canada has socialized medicine)
- B. Every existing economy uses a different "mix" of allocating mechanisms to respond to the basic economic questions

Chapter 2.3

Alexander Hamilton believed that the Free Enterprise system (as opposed to birth or inherited wealth) was a great equalizer and would allow men to rise to their level of ability. He envisioned the United States as a country in which citizens of differing aptitudes could achieve happiness. He spoke of equality in its highest sense: the distribution of rewards in accordance with true virtue rather than conventional distinctions such as birth or wealth; indeed, this was Hamilton's definition of liberty. To facilitate this, it was necessary to create a nation that rewarded merit and ambition, the essence of liberal capitalism.

Adam Smith wrote The Wealth of Nations in 1776. He believed that individuals left on their own would work for their own self-interests. The “invisible hand” of competition would achieve maximum good for the society.

I. The Five Characteristics of Competition and Free Enterprise

- A. Economic Freedom: Capitalism is a market economy;
 1. Private citizens own the factors of production—there is limited government interference and businesses are free to compete.
 2. People and businesses are free to make their own economic choices.
- B. Voluntary exchange, in which buyers and sellers are free to decide whether or not to complete a transaction, results in both buyers and sellers believing that the good or service obtained is of more value than the money or product given up.
- C. Private property rights motivate people to succeed ... they keep the rewards they earn.
- D. The profit motive encourages entrepreneurship and is largely responsible for the growth of a free enterprise economy. Profit is what remains after all expenses have been met.
- E. Competition among sellers helps lower prices and/or increase quality.

II. The Role of the Entrepreneur

- A. Use land, capital, and labor to make a profit.
- B. When an entrepreneur is successful, everybody benefits. Successful entrepreneurs attract other firms to the industry.
- C. The entrepreneur's search for profits lead tot new products, greater competition, more production, higher quality, and lower prices for consumers.

III. The Role of the Consumer

- A. Consumers have power in the market place. Consumer sovereignty describes the role of the consumer as ruler of the market... “the customer is always right”.
- B. In the US economy consumers express their wants in the form of purchases in the marketplace. Dollars spent = votes for products.

IV. The Role of Government

- A. Protector... may pass and enforce laws meant to prevent the abuse of consumers and workers
- B. Both providers and consumers; the US government provides education and welfare and is the second largest consuming group in the economy after consumers.
- C. As a regulator, the government works to preserve competition.
- D. The promoting of national goals is an important role of any government. In the US, achieving economic equity and security has resulted in a mixed economy, or modified private enterprise economy.