

# **Economic Systems**

# Scarcity Means There Is Not Enough For Everyone



Government must step in to help **allocate**  
(distribute) resources

# Scarcity Bus Ride

## Scenario:

**A group of 40 college students get on a bus to go to a dance 30 miles away.**

**Shortly after leaving, the bus finds that it is too heavy to go over a large hill**

**10 students need to get off the bus**

**You and your partner need to find 5 different ways to decide who should get off the bus.**

- 1. Are any of the solutions fair?**
- 2. How are resources allocated in communism?**
- 3. How are resources allocated in capitalism?**
- 4. What role do prices play in capitalism?**

**Every society must answer three questions:**

## **The Three Economic Questions**

- 1. What goods and services should be produced?**
- 2. How should these goods and services be produced?**
- 3. Who consumes these goods and services?**

**The way these questions are answered  
determines the economic system**

**An economic system is the method used by a  
society to produce and distribute goods and  
services.**

# **Economic Systems**

- 1. Centrally-Planned  
(Command) Economy**
- 2. Free Market Economy**
- 3. Mixed Economy**

# **Centrally-Planned Economies (aka Communism)**

# Centrally Planned Economies

In a centrally planned economy (communism) the government...

1. owns all the resources.
2. answers the three economic questions

**Examples:**

**Cuba, North Korea, former Soviet Union, and China?**

**Why do centrally planned economies face problems of poor-quality goods, shortages, and unhappy citizens?**

**NO PROFIT MEANS NO INCENTIVE TO WORK HARDER!!**

# Irrational Soviet Production

**Soviet companies were not guided by prices or profit. Gov't officials determined output quotas based on quantitative measurements. Businesses were paid based on meeting these quotas.**

- 1. Why did a business make desk lamps that were filled with lead that were almost too heavy to carry?  
Production quota based on weight**
- 2. Why did light bulb producers only make tiny night light size bulbs? Production quota based number of bulbs produced**
- 3. Why did oil companies drill many shallow holes when they knew that oil deposits are usually found in deep holes that require slower drilling? Production quota based number of feet drilled**
- 4. Why did a construction superintendent order his workers to remove bathtubs from the first floor and install them in the third floor while he slowly lead inspectors through apartment building. Quota on # of apartments complete at inspection**
- 5. Why did black market vendors sell burned out light bulbs?  
Business got resources before the public so workers would steal good light bulbs from work and replace them with burnt out bulbs**



# Advantages and Disadvantages

## What is GOOD about Communism?

1. **Low unemployment- everyone has a job**
2. **Great Job Security- the government doesn't go out of business**
3. **Equal incomes means no extremely poor people**
4. **Free Health Care**

## What is BAD about Communism?

1. **No incentive to work harder**
2. **No incentive to innovate or come up with good ideas**
3. **No Competition keeps quality of goods poor.**
4. **Corrupt leaders**
5. **Few individual freedoms**



# REVOLUTIONARIES

Even if you spend your whole life combatting the forces of capitalism, you still might wind up on a t-shirt sold in a store owned by the Gap.

# **Free Market System** **(aka Capitalism)**

# Characteristics of Free Market

1. Little government involvement in the economy.  
(**Laissez Faire = Let it be**)
2. Individuals **OWN** resources and answer the three economic questions.
3. The opportunity to make **PROFIT** gives people **INCENTIVE** to produce quality items efficiently.
4. Wide variety of goods available to consumers.
5. Competition and Self-Interest work together to regulate the economy (keep prices down and quality up).

# Example of Free Market

**Example of how the free market regulates itself:  
If consumers want computers and only one  
company is making them...**

- **Other businesses have the INCENTIVE to start making computers to earn PROFIT.**

- **This leads to more COMPETITION....**

- **Which means lower prices, better quality, and more product variety.**

- **We produce the goods and services that society wants because “resources follow profits”.**

**The End Result: Most efficient production of the goods that consumers want, produced at the lowest prices and the highest quality.**

# Example of Communism

**Example of why communism failed:**

**If consumers want computers and only one company is making them...**

- **Other businesses CANNOT start making computers.**
- **There is NO COMPETITION....**
- **Which means higher prices, lower quality, and less product variety.**
- **More computers will not be made until the government decides to create a new factory.**

**The End Result: There is a shortage of goods that consumers want, produced at the highest prices and the lowest quality.**

# The Invisible Hand

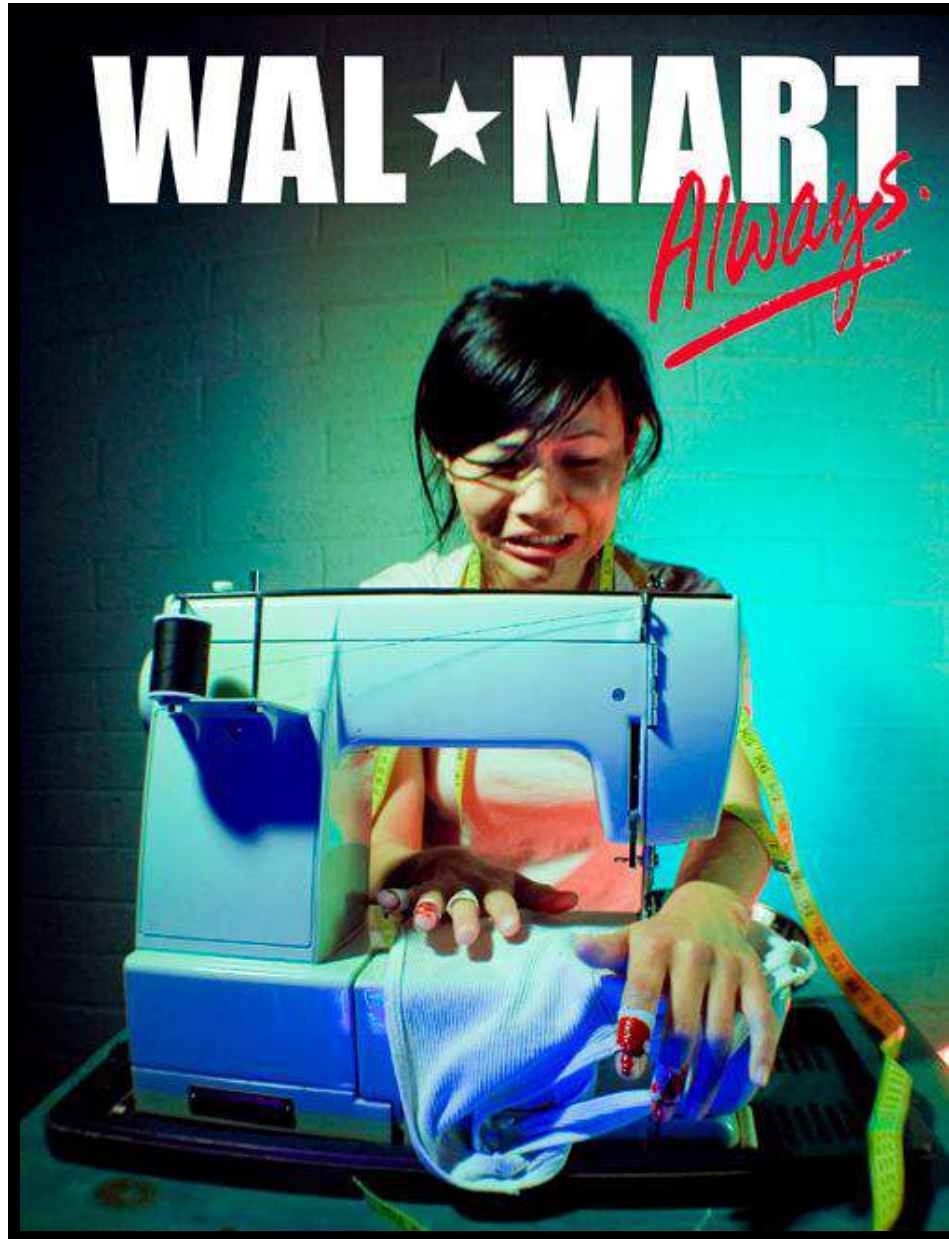
**The concept that society's goals will be met as individuals seek their own self-interest.**

**Example: Society wants fuel efficient cars...**

- Profit seeking producers will make more.**
- Competition between firms results in low prices, high quality, and greater efficiency.**
- The government doesn't need to get involved since the needs of society are automatically met.**

**Competition and self-interest act as an invisible hand that regulates the free market.**

# Attacks Against Capitalism





# Attacks Against Capitalism

- 1. Companies are greedy and do anything to screw over consumers!**
  - Companies have an incentive to satisfy the needs of consumers. If they don't they will go out of business.**
- 2. Capitalism causes companies to outsource US jobs overseas. America suffers because companies want more profit!**
  - How many of you lost your job to outsourcing?**
  - How many of you benefit in the form of lower prices?**
- 3. Capitalism only helps the rich. US companies enslave and exploit third-world workers in sweatshops!**
  - Sweatshop workers are not forced labor. They make the decision to work there voluntarily. Why?**
  - Although the working conditions are far below US standards, working in a sweatshop is better than the alternative**
    - Sweatshop wages in Vietnam, Honduras, and Nicaragua are more than double the country's average wage.**

# Sweatshops

**"My concern is not that there are too many sweatshops, but that there are too few." -Jeffrey Sachs, Harvard University**

## Sweatshops Then



## Sweatshops Now

**Question: Who is to blame for these people being so poor?**

**Answer: Low productivity.**

**If a country doesn't produce very much, it can afford to pay its workers very much.**

**Why do these countries have such low productivity?**

**Corrupt governments, inadequate physical capital and infrastructure, and underdeveloped human capital.**

**What does foreign investment bring to poor countries?**

# Productivity Creates Wealth

## 3rd World Countries

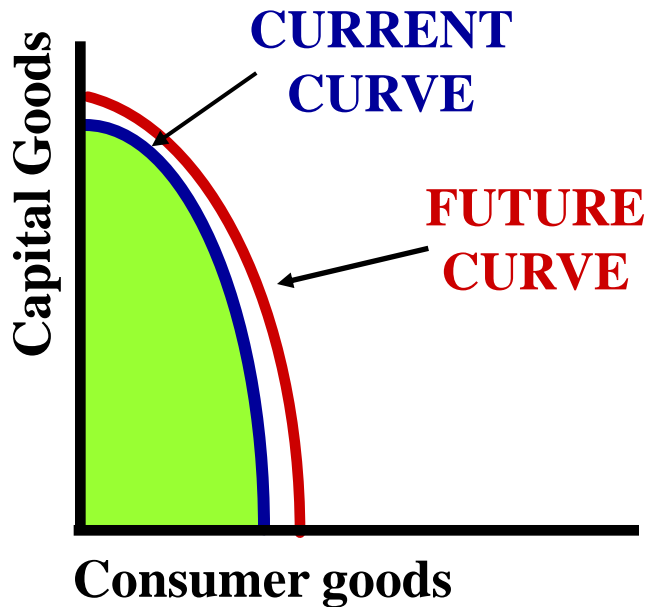


## Developed Countries



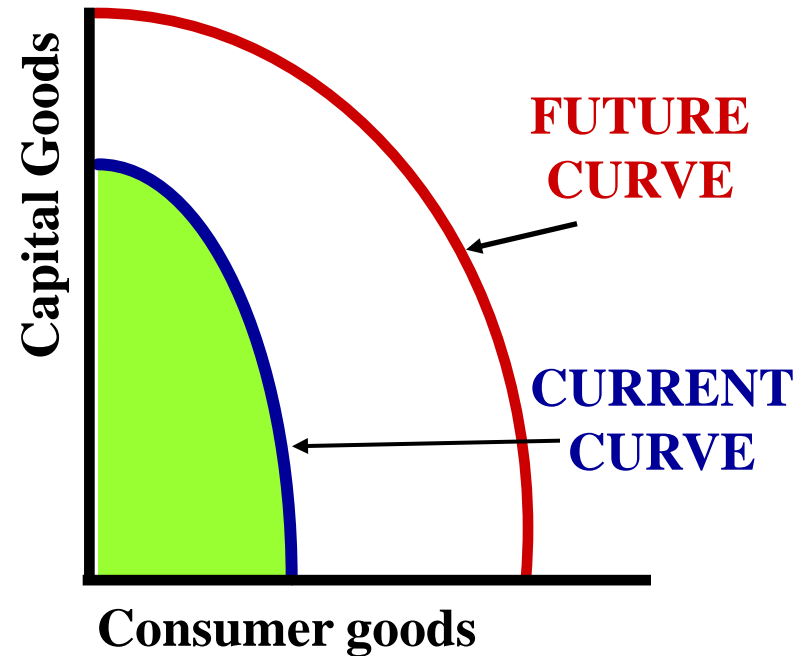
# Connection to the PPC

## Communism in the Long Run



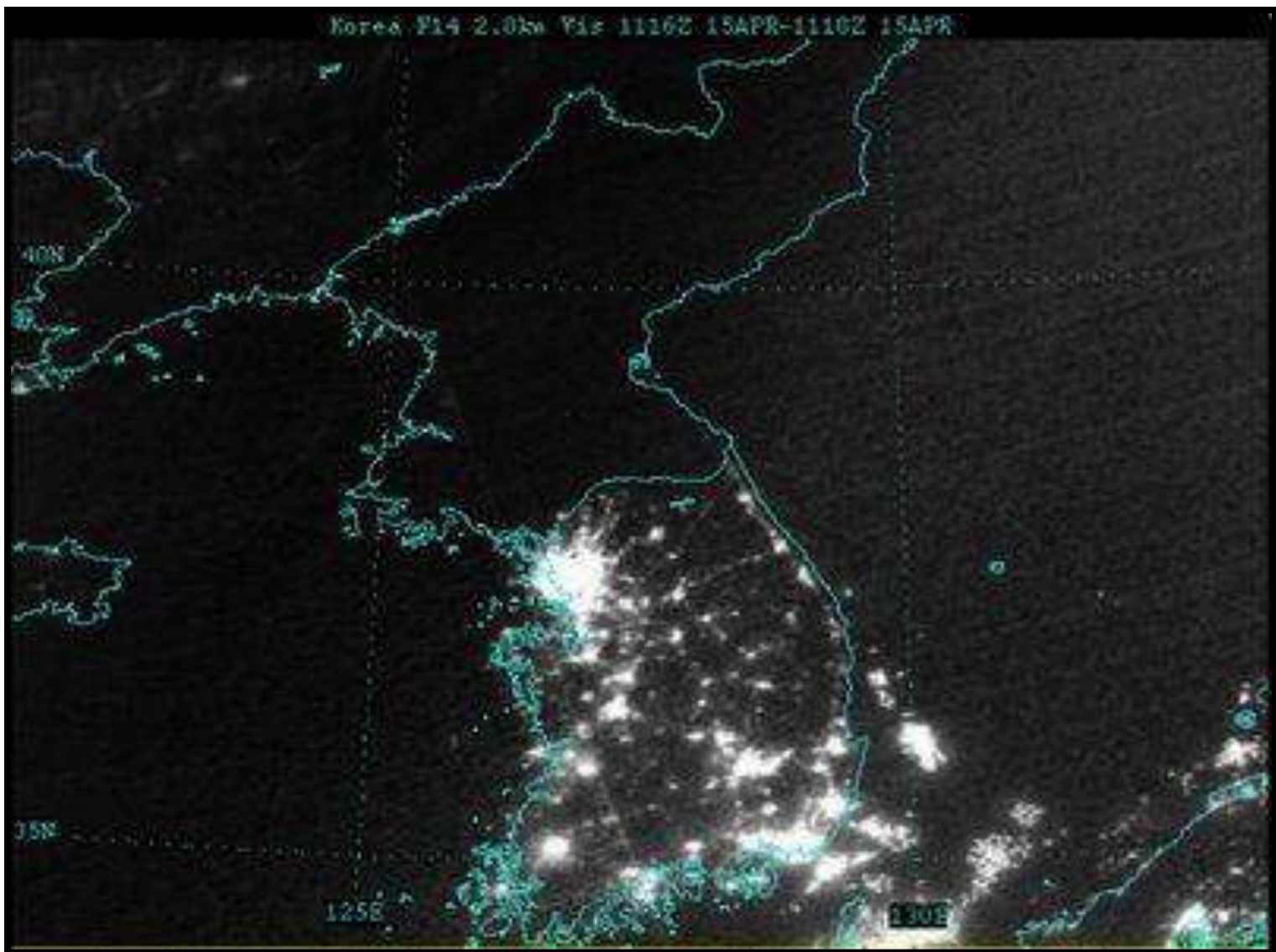
**Cuba**

## Free Markets in the Long Run



**Costa Rica**





**The difference between North and South Korea at night.**

**North Korea's GDP is \$40 Billion**

**South Korea's GDP is \$1.3 Trillion (32 times greater).**

# The Circular Flow Model

## **The Product Market-**

- The “place” where goods and services produced by businesses are sold to households.

## **The Resource (Factor) Market-**

- The “place” where resources (land, labor, capital, and ent.) are sold to businesses.

**DEMAND**

**Resource Market**

**SUPPLY**



**Businesses**

**Individuals**

**SUPPLY**

**Product Market**

**DEMAND<sup>2</sup>**

\$\$\$ Costs \$\$\$

Resources

\$\$\$ Income \$\$\$

Resources  
(Factors of  
Production)

Goods and  
Services

\$\$\$ Revenue \$\$\$

Goods and  
Services

\$\$\$ Spending \$\$\$

