

Three Basic Economic Questions



- ▶ All nations must address these basic questions:
 1. **What** goods and services will be produced?
 2. **How** will they be produced?
 3. **For whom** will they be produced?
- ▶ Nations must make choices about how to use their *productive resources*

Economic Systems

- ▶ How a nation addresses the 3 basic questions determines it's economic system
 1. Traditional
 2. Command
 3. Market
 4. Mixed



Invisible Hand of Markets

- ▶ According to **Adam Smith**, self-interest regulates the market, as if by an “invisible hand”
- ▶ **Government involvement:**
 - ▶ Conflicts with self-interest
 - ▶ Limits the invisible hand’s ability to regulate



Traditional Economy



- ▶ Shaped largely by custom, ritual or religion
- ▶ Family relations have significant roles in economic activity
- ▶ Bartering activities



Command Economy

- ▶ All resources government-owned
- ▶ Production coordinated by government central planners
- ▶ Individuals have little or no say in economic choices



Market Economy



- ▶ All resources are privately owned
- ▶ Free exchange of goods and services [*the market*] controls what is bought and sold
- ▶ Income derived from selling resources goes exclusively to the owner

Mixed Economy



- ▶ **Combines elements of traditional, command and market economic models**
- ▶ **Three categories of mixed economies:**
 1. Authoritarian socialism (communism)
 2. Capitalism
 3. Democratic Socialism
- ▶ **Varying degrees of government involvement in the market**

Problems with Centrally Planned Economies

- ▶ Little freedom
- ▶ Central planning can be inefficient
- ▶ Resources are wasted

Problems with Pure Market Economies

- ▶ **Difficulty enforcing property rights**
- ▶ **Some people have few resources to sell**
- ▶ **Firms may try to monopolize markets**
- ▶ **No public goods**
- ▶ **Externalities**



Mixed Economies

- ▶ **Capitalism** → Features the Market w/government regulations



Democratic Socialism

- ▶ **Elected government**
- ▶ **Government planning involved**



Authoritarian Socialism

- ▶ **Command features**
- ▶ **Ruled by unelected government**
 - ▶ **Or sham, 1-party elections**

