

Reading Booklet

(# 1)

An Introduction to Economic Systems

What is the best, most efficient way for a nation to use its resources and to provide for its people? In traditional, agricultural societies the answer to this question was relatively straightforward. Since the Industrial Revolution, however, increasingly large and complex economies have struggled to find solutions to deal with the wealth, poverty, and diversity created as a result of industrialization. Each new generation of citizens and leaders have continued to find both new answers and new problems, as economic ideas and systems continue to evolve.

Individualism and Collectivism

An economy may be defined as the set of processes, rules, and procedures that groups of people in a nation use to meet their wants and needs. The basic problem in every economy is **scarcity**; there are never enough **resources** to fulfill these wants and needs. Even in a relatively wealthy nation like Canada we speak of shortages and economic problems. The economy and the people decide how the resources in a society will be utilized to stretch as far as possible. Immediately, however, decisions must be made as to whether these resources will be used to try to satisfy every individual equally or to allow each individual to attain their own level of wealth, or in other words, whether an economy will emphasize **collectivism** or **individualism**.

This distinction is not as clearly defined as it seems. No society leaves each individual entirely on their own, or provides absolute equality. Instead, it is more a question of what balance of individualism and collectivism will be emphasized. An economy that leans more toward collectivism will tend to stress each person's right to enjoy a decent standard of living and have access to the same economic and social opportunities as other citizens. Such systems tend to offer **welfare, unemployment insurance, universal health care, public education**, and other types of **social assistance** to achieve these goals. Usually it is the government that oversees the economy in order to achieve these goals, using methods that range from **government regulations** to direct control of economic activities through **central planning**.

Economies that favor individualism stress the need to allow each citizen to make his or her own economic decisions, without undue government interference. Supporters of this type of economy argue that this economic freedom, aside from being valued in its own right, benefits society by being more productive in the long term. Resources are more efficiently used and individuals are rewarded for taking risks. Individualist-oriented economies have few **social services** compared to collectivist ones, and instead stress the need for each person to create and to fulfill their own opportunities.

Capitalist and Centrally Planned Economies

The two economic systems respectively that are based on the principles of individualism and collectivism are **capitalism** and **central planning**. Capitalism (also referred to as a **market system, decentralized economy, price system, free enterprise, laissez faire economy, private enterprise**, and other such terms) is founded on the simple concept that what is good for an individual is good for the economy. Individuals are free to pursue their own **economic self-interest**, and in doing so will benefit the economy as a

whole. **Adam Smith**, the writer who defended capitalism in his book The Wealth of Nations, believed that this **invisible hand** of profit would motivate workers to work harder and produce more, and owners to create better products at lower prices. In both cases, the consumer would benefit from the "greed" of all others. In a **model** (theoretical) system of pure capitalism, individuals may get rich or starve to death, depending on their efforts; this is the ultimate incentive. This capitalist system depends on **competition** in which **supply and demand** rules the marketplace. Therefore the economy must be free of any government intervention or regulation.

Supporters of capitalism argue that unrestricted individual self-interest results in phenomenal growth and wealth, as was seen during the **Industrial Revolution** in England. Furthermore, these benefits will "trickle down" through the economy in the form of wages and spending. But critics of capitalism claim that it suffers from two glaring weaknesses:

First, there is a lack of overall control of the economy and a reliance on supply and demand creates a **boom and bust** cycle that often leads to severe economic instability.

Second, the wealth generated does **not** necessarily trickle down but stays mostly at the top in the hands of the rich. The end result, these critics claim, is that great levels of economic inequality are created.

Some critics of capitalism suggest that both these problems could be solved in a centrally planned system.

Central planning (also known as a **centralized economy**, a **command economy**, or **public enterprise**) is usually, although not necessarily, connected with communist systems and the ideas of **Karl Marx**. His ideas are developed in two books: The Communist Manifesto and Das Kapital.¹ The collective welfare of all citizens is ensured by government control of the use of resources, production of goods, and distribution of wealth. In a model centrally planned economy, a **government planning authority** decides what goods need to be produced and, based on the availability of resources and the cost of production, how these goods will be made. Greater economic equality is guaranteed by the control of wages and prices. All citizens, planners would argue, deserve to have an equal share of the nation's resources. Furthermore, these resources are used more efficiently by a government that has the long-term welfare of its citizens in mind, instead of individual **entrepreneurs** aiming for personal profit. Attacks on the theory of central planning focus on two main criticisms:

First, by aiming for equality such a system takes away the personal incentive needed to succeed, thus reducing the initiative and competitive drive found in capitalism.

Second, the overall government control of the economy is, in fact, wasteful of resources and unable to respond effectively to change.

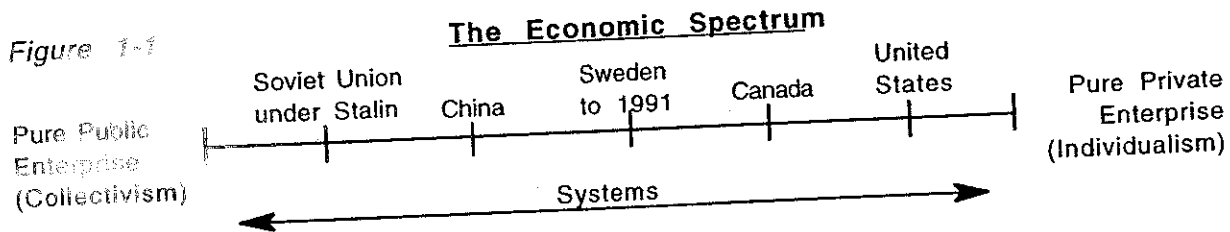
Critics of both capitalism and central planning often suggest that there is a "middle ground" in which the best aspects of individualism and collectivism are combined to create what is called a **mixed economy**.

¹Command economies may also, in a few examples, direct private enterprise to produce what is needed by the state. Nazi Germany is the best example of this.

Mixed Economies

As mentioned earlier, capitalism and central planning in their pure states are only theoretical models. In the real world, true capitalism does not exist. All governments intervene to some extent and no economic system is totally indifferent to the plight of those who do not or cannot fend for themselves. Central planning is also non-existent in its pure form and its theory and practice is fading rapidly in other ways as well. The collapse of the Soviet Union in 1991 signalled an end for centrally planned economies, which now only exist in several relatively minor nations. Even China, with its economic direction still largely dictated by government, has more privately-owned than publicly-owned businesses.

A **mixed economy** is one that incorporates elements of both capitalism and centrally planned economies. From the United States, a market-oriented economy, to China, a command-oriented economy, virtually all nations have developed their own unique blend of the two systems. Mixed economies exist in as many forms as there are governments that oversee them. The greatest variable is the degree of government involvement in the economy.



In general, as systems move to the left on the spectrum there is

- more government ownership
- more planning of the economy by government
- less individual economic freedom
- more equality
- more government involvement in business
- more social services

Mixed economies that lean toward capitalism tend to emphasize economic freedom. Governments that support this position tend to pass laws that regulate business, such as minimum wage laws or banking regulations, but in general believe that private businesses are more efficient than government in the creation of jobs and the production of goods and services. Social services are usually provided, but not at an extensive level, for they are believed to reduce the incentive to work hard. The result of the relatively low level of services is lower levels of taxation. Further to the left (see Figure 1-1) are mixed economies that place greater emphasis on taking collective action. For example, in Canada there is a universal health care service (Medicare) funded by tax money, that is based on the belief that all Canadians should have a right to good medical care, regardless of their wealth. Of course, critics of this and other types of services claim that they require excessively high levels of taxes to fund them.²

²Supporters of social services often oppose their association with high taxes, and claim that a reformed and fairer system of taxation is needed to make businesses and the wealthy pay their "rightful share" of taxes.

Left-leaning mixed economies tend to favour more government regulation and ownership of business. Many of these governments have taken control (this process is called **nationalization**) of essential services such as utilities or transportation. Some governments are also direct owners of companies that produce goods, especially goods seen as too important to leave to the uncertainty of private profits. An example of this was Petrocan, an oil company created by the Canadian government.

Disagreements in most economies today center not on whether government should be involved, but on how much; not on whether social services should be offered, but on what kinds. We live in an era where the economic experiments of the two extremes of the economic spectrum have evolved into systems that offer various degrees of compromise on the collectivist-individualist debate. And it is important to note that economies evolve and change over time as social and economic conditions change.

Critics of mixed economies tend to represent views that come from the left and the right of the spectrum shown in Figure 1-1 above. There are basically two main criticisms of mixed economies:

First, critics of the right maintain that the high level of taxes needed to maintain social services in a mixed economy limits individual initiative and provides few financial incentives for individuals to develop new products.

Second, critics of the left assert that mixed economies do not go far enough in promoting economic equality and that serious inequalities in income still exist in mixed economies.

Thinking It Over

1. Use the chart below to describe how an individualist and a collectivist would respond to each of the situations described. The first example is done for you.

Situation	Individualist's Solution	Collectivist's Solution
a. A nation is faced with high rates of unemployment.	Let private business create more jobs. Reduce taxes and government controls which hold business back from investment and growth.	Government should take action by increasing employment insurance and creating jobs.
b. People living on pensions request an increase to keep up with inflation.		
c. Laid-off workers ask for assistance in job retraining.		
d. A business asks for government aid to prevent bankruptcy.		

2. Use the chart below to explain how a supporter of capitalism, a supporter of planned economies, and a supporter of mixed economies would answer the three basic economic questions.

Economic Question	Planned Economies	Mixed Economies	Capitalism
a. What goods, and how many, will be produced with the resources available?			
b. How will these goods be produced?			
c. How will these goods be distributed to citizens?			

3. By taking measures to reduce social services and to **privatize** (sell to private owners) government-owned services, is the Alberta government moving to the left or right on the economic spectrum? Explain your answer in 2 or 3 sentences.
4. Use your text and other sources to research how health care is provided in Canada and the United States.
- Describe the difference between the provision of health care in these two countries.
 - Explain two advantages and disadvantages to the health care systems in **each** country.
 - Which system for providing health care is, in your opinion, the most desirable? Provide two arguments to support your position.
5. In the chart below, provide two arguments and two supporting examples you could use to explain and defend your position on the following issue:

To what extent should governments emphasize individualism or collectivism in their economies?

Argument #1

Evidence to support Argument #1

Argument #2

Evidence to support Argument #2

