Chapter Six Economic Systems and Policies

1 economic system

An **economic system**, or **economic order**, is a system of production, resource allocation and distribution of goods and services within a society. It includes the combination of the various institutions, agencies, entities, decision-making processes, and patterns of consumption that comprise the economic structure of a given community.

An economic system is a type of social system. The mode of production is a related concept. All economic systems must confront and solve the four fundamental economic problems:

- What kinds and quantities of goods shall be produced: This fundamental economic problem is anchored on the theory of pricing. The theory of pricing, in this context, has to do with the economic decision-making between the production of capital goods and consumer goods in the economy in the face of scarce resources. In this regard, the critical evaluation of the needs of the society based on population distribution in terms of age, sex, occupation, and geography is very pertinent.
- How goods shall be produced: The fundamental problem of how goods shall be produced is largely hinged on the least-cost method of production to be adopted as gainfully peculiar to the economically decided goods and services to be produced. On a broad note, the possible production method includes labor-intensive and capital-intensive methods.
- How the output will be distributed: Production is said to be completed when the goods get to the final consumers. This fundamental problem of how the output will be distributed seeks to identify the best possible medium through which bottlenecks and the clogs in the wheel of the chain of economic resources distributions can reduce to the barest minimum and optimize consumers' satisfaction.
- When to produce: Consumer satisfaction is partly a function of seasonal analysis as the forces of demand and supply have a lot to do with time. This fundamental economic problem requires an intensive study of time dynamics and seasonal variation vis-a-vis the satisfaction of consumers' needs. It is noteworthy to state that solutions to these fundamental problems can be determined by the type of economic system.

The study of economic systems includes how these various agencies and institutions are linked to one another, how information flows between them, and the social relations within the system (including property rights and the structure of management). The analysis of economic systems traditionally focused on the dichotomies and comparisons between market economies and planned economies and on the distinctions between capitalism and socialism.] Subsequently, the categorization of economic systems expanded to include other topics and models that do not conform to the traditional dichotomy.

Today the dominant form of economic organization at the world level is based on market-oriented mixed economies.] An economic system can be considered a part of the social system and hierarchically equal to the law system, political system, cultural and so on. There is often a strong correlation between certain ideologies, political systems and certain economic systems (for example, consider the meanings of the term "communism"). Many economic systems overlap each other in various areas (for example, the term "mixed economy" can be argued to include elements from various systems). There are also various mutually exclusive hierarchical categorizations.

Types of Economic Systems

There are many types of economies around the world. Each has its own distinguishing characteristics, although they all share some basic features. Each economy functions based on a unique set of conditions and assumptions. Economic systems can be categorized into four main types: traditional economies, command economies, mixed economies, and market economies.

A. Traditional economic system

The traditional economic system is based on goods, services, and work, all of which follow certain established trends. It relies a lot on people, and there is very little division of labor or specialization. In essence, the traditional economy is very basic and the most ancient of the four types.

Some parts of the world still function with a traditional economic system. It is commonly found in rural settings in second and third world nations, where economic activities are predominantly farming or other traditional income-generating activities.

There are usually very few resources to share in communities with traditional economic systems. Either few resources occur naturally in the region or access to them is restricted in some way. Thus, the traditional system, unlike the other three, lacks the potential to generate a surplus. Nevertheless, precisely because of its primitive nature, the traditional economic system is highly sustainable. In addition, due to its small output, there is very little wastage compared to the other three systems.

B. Command economic system

In a command system, there is a dominant centralized authority – usually the government – that controls a significant portion of the economic structure. Also known as a planned system, the command economic system is common in communist societies since production decisions are the preserve of the government.

If an economy enjoys access to many resources, chances are that it may lean towards a command economic structure. In such a case, the government comes in and exercises control over the resources. Ideally, centralized control covers valuable resources such as gold or oil. The people regulate other less important sectors of the economy, such as agriculture.

In theory, the command system works very well as long as the central authority exercises control with the general population's best interests in mind. However, that rarely seems to be the case. Command economies are rigid compared to other systems. They react slowly to change because power is centralized. That makes them vulnerable to economic crises or emergencies, as they cannot quickly adjust to changing conditions.

C. Market economic system

Market economic systems are based on the concept of free markets. In other words, there is very little government interference. The government exercises little control over resources, and it does not interfere with important segments of the economy. Instead, regulation comes from the people and the relationship between supply and demand.

The market economic system is mostly theoretical. That is to say, a pure market system doesn't really exist. Why? Well, all economic systems are subject to some kind of interference from a central authority. For instance, most governments enact laws that regulate fair trade and monopolies.

From a theoretical point of view, a market economy facilitates substantial growth. Arguably, growth is highest under a market economic system.

A market economy's greatest downside is that it allows private entities to amass a lot of economic power, particularly those who own resources of great value. The distribution of resources is not equitable because those who succeed economically control most of them.

D. Mixed system

Mixed systems combine the characteristics of the market and command economic systems. For this reason, mixed systems are also known as dual systems. Sometimes the term is used to describe a market system under strict regulatory control.

Many countries in the developed western hemisphere follow a mixed system. Most industries are private, while the rest, composed primarily of public services, are under the control of the government.

Mixed systems are the norm globally. Supposedly, a mixed system combines the best features of market and command systems. However, practically speaking, mixed economies face the challenge of finding the right balance between free markets and government control. Governments tend to exert much more control than is necessary.

2 Economic policies

The economy of governments covers the systems for setting levels of taxation, government budgets, the money supply and interest rates as well as the labour market, national ownership, and many other areas of government interventions into the economy.

Most factors of economic policy can be divided into either fiscal policy, which deals with government actions regarding taxation and spending, or monetary policy, which deals with central banking actions regarding the money supply and interest rates.

Such policies are often influenced by international institutions like the International Monetary Fund or World Bank as well as political beliefs and the consequent policies of parties.

Types of economic policy

A -fiscal policy

Fiscal policy is the use of government spending and taxation to influence the economy. Governments typically use fiscal policy to promote strong and sustainable growth and reduce poverty. The role and objectives of fiscal policy gained prominence during the recent global economic crisis, when governments stepped in to support financial systems, jump-start growth, and mitigate the impact of the crisis on vulnerable groups. In the communiqué following their London summit in April 2009, leaders of the Group of 20 industrial and emerging market countries stated that they were undertaking “unprecedented and concerted fiscal expansion.” What did they mean by fiscal expansion? And, more generally, how can fiscal tools provide a boost to the world economy?

Historically, the prominence of fiscal policy as a policy tool has waxed and waned. Before 1930, an approach of limited government, or laissez-faire, prevailed. With the stock market crash and the Great Depression, policymakers pushed for governments to play a more proactive role in the economy. More recently, countries had scaled back the size and function of government—with markets taking on an enhanced role in the allocation of goods and services—but when the global financial crisis threatened worldwide recession, many countries returned to a more active fiscal policy.

B –Monetary policy

Monetary policy is the control of the quantity of money available in an economy and the channels by which new money is supplied.

Economic statistics such as gross domestic product (GDP), the rate of inflation, and industry and sector-specific growth rates influence monetary policy strategy.

A central bank may revise the interest rates it charges to loan money to the nation's banks. As rates rise or fall, financial institutions adjust rates for their customers such as businesses or home buyers.

Additionally, it may buy or sell government bonds, target foreign exchange rates, and revise the amount of cash that the banks are required to maintain as reserves.

C -Trade policy

Let's get right into the trade policy definition. A trade policy is set in place by a government and affects the number of goods and services a country exports and imports. Policy-makers might want to employ a trade policy to benefit the domestic market and its industries.

A trade policy is a government policy that affects the number of goods and services a country exports and imports.

Free trade is when there are no government restrictions on trade.

Protectionism is when governments set trade restrictions to help domestic industries.