



MODUL PENGURUSAN EKONOMI

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Economic System



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TALKING POINTS

1 What is Economics System?

2 What Types of Economic Systems?

3 How Do Economic Systems Answer The Basic Economic Questions

4 Why It Matters?



Economic system

An economic system is a system of **production** and **distribution** of goods and services as well as **allocation** of resources in a society

What Constitutes An Economic System?

- What goods and services shall be produced, and in what quantities?
- How shall goods and services be produced? That is, by whom and with what resources and technologies?
- For whom shall goods and services be produced? That is, who is to enjoy the benefits of the goods and services and how is the total product to be distributed among individuals and groups in the society?

The Scarcity Problem

- what to produce & how much,
- how to produce it, and
- who gets what is produced.

An economic system is a way of answering these basic questions.

Different economic systems answer them differently.

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What Types of Economic Systems?



"You can't always get what you want." –
Rolling Stones's Song

The basic economic challenge that has confronted individuals and nations throughout history:

1. How we deal with these limitations? how we prioritize and allocate our limited income, time, and resources.

2. How a nation addresses this challenge?
Economists developed different broad economic approaches to manage their resources

Types of Economic Systems

The basic and general economic systems are:

- **Market economy:**
"hands off" systems, such as Laissez-faire capitalism
- **Mixed economy:**
A hybrid that blends some aspects of both market and planned economies
- **Planned economy:**
"hands on" systems, such as state socialism or communism, also known as "command economy"
- **Traditional economy:**
A generic term for older economic systems

Market Economy

Free-market Capitalism:

Prices for goods and services are set freely by the **forces of supply and demand** and are allowed to reach their point of equilibrium **without intervention** by government policy

Adam Smith – Free Market

- ❑ Philosophical handbook for free market: economies function most efficiently and fairly when individuals are allowed to pursue their own interests.
- ❑ Private decisions, made by rational, self-interested individuals, combine to produce a healthy, growing economy.
- ❑ Government intervention: the great threat to economic growth: Government intervention distorted the natural and rational exercise of free
- ❑ The “**invisible hand**” of the market.

Command/ Planned Economic System

- Socialism: social ownership of the means of production and co-operative management of the economy
- The government controls the economy.
- The state decides how to use and distribute resources.
- The government regulates prices and wages

A Traditional Economic System

- A traditional economic system is shaped by tradition. The work that people do, the goods and services they provide, how they use and exchange resources... all tend to follow long-established patterns.
- Economic behaviors and relationships are predictable. You know what you are supposed to do, who you trade with, and what to expect from others.
- Community interests take precedence over the individual.

Mixed Economic System

- In market economies: Economic decisions are made by individuals. Marketplace determines how resources are allocated and goods are distributed. Government is entirely absent from economic affairs.
- A mixed economic system: Combines elements of the market and command economy. Many economic decisions are made in the market by individuals. But the government also plays a role in the allocation and distribution of resources.
- The eternal question: What the right mix between the public and private sectors of the economy should be.

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How Do Economic Systems Answer The Basic Economic Questions



What Goods & Services Shall Be Produced?

Economic System	Solution
Free Market Economy	Determined by the power of demand or consumer spending patterns
Centrally Planned Economy	Determined by the ruling authority/government through a central planning institution. Individuals do not have the freedom to determine the types & quantity of goods to be produced
Mixed Economy	Determined by price mechanism. The government produces goods that are not produced by the private sector.

How Much Goods & Services Should Be Produced?

Economic System	Solution
Free Market Economy	Dependent on the price determined by the market demand
Centrally Planned Economy	Individuals do not have the freedom to determine the types & quantity of goods to be produced. Priority is given to the production of basic necessities and public goods
Mixed Economy	The private sector produces goods based on price mechanism. The government will supply public goods for the use of all members of the society.

How Should Goods Be Produced?

Economic System	Solution
Free Market Economy	Firms will choose a combination of production factors to minimize costs. The determination of production factors is based on the goal of maximizing output while minimizing costs
Centrally Planned Economy	Based on the government's goal of achieving maximum output to fulfil the wants of society. The production technique will also be chosen based on social welfare.
Mixed Economy	Firms will choose the production method that will maximize profits and minimize costs. The government will determine production methods based on current social benefits & social costs.

For Whom Should Goods Be Produced & Distributed?

Economic System	Solution
Free Market Economy	Determined based on individual purchasing power or income. Firms offers goods to parties that are willing to pay the price.
Centrally Planned Economy	Goods are distributed evenly & fairly. The government controls price or practices rationing policies to ensure that each individual is able to enjoy goods that are produced.
Mixed Economy	Determined by price mechanism. The income gap can be resolved through taxation and subsidy policies.

What role should the government play
in the economy? None? Lots?
Something in the middle?

**What Type of Economic
System Does Malaysia Have?**

**Which type of economic system
works best with liberty?**

Adam Smith's metaphor

- Adam Smith's metaphor of the invisible hand remains one of the most important and influential ideas in economics, even today.
- What would Adam Smith think about the stimulus bill? About bailouts for companies judged "too big to fail"?

4 Why It Matters?



Why It Matters Today

- ❑ **Defenders of free markets:** democratic capitalist nations, led by the United States
- ❑ Believers in command economies: the communist bloc, led by the Soviet Union.
- ❑ Cold War fought to decide whether markets or states should control economic affairs.
- ❑ Cold War finally ended not on a battlefield, but because the Soviet economy finally self-destructed by the late 1980s.
- ❑ For most of the world, the Soviet collapse proved that command economies were simply inferior to the market-dominated mixed economies of the capitalist world.

Why Should I Care?

Not every country's economy operates in the same way; not every country has developed the same economic system.

Revolution, by The Beatles



- ❑ “You say you want a revolution”, the Beatles sang, advising:
- ❑ “But if you go carrying pictures of chairman Mao You ain't going to make it with anyone anyhow”

Economic Systems Game

- It's easy to make the big decisions? Take your turn in the hot seat.
- **The situation:** You need to make call on how to ease the burden of the rising cost of living. There are no shortages of opinions from economists, politicians, and industry lobbyists. But who's right and who's blowing smoke?



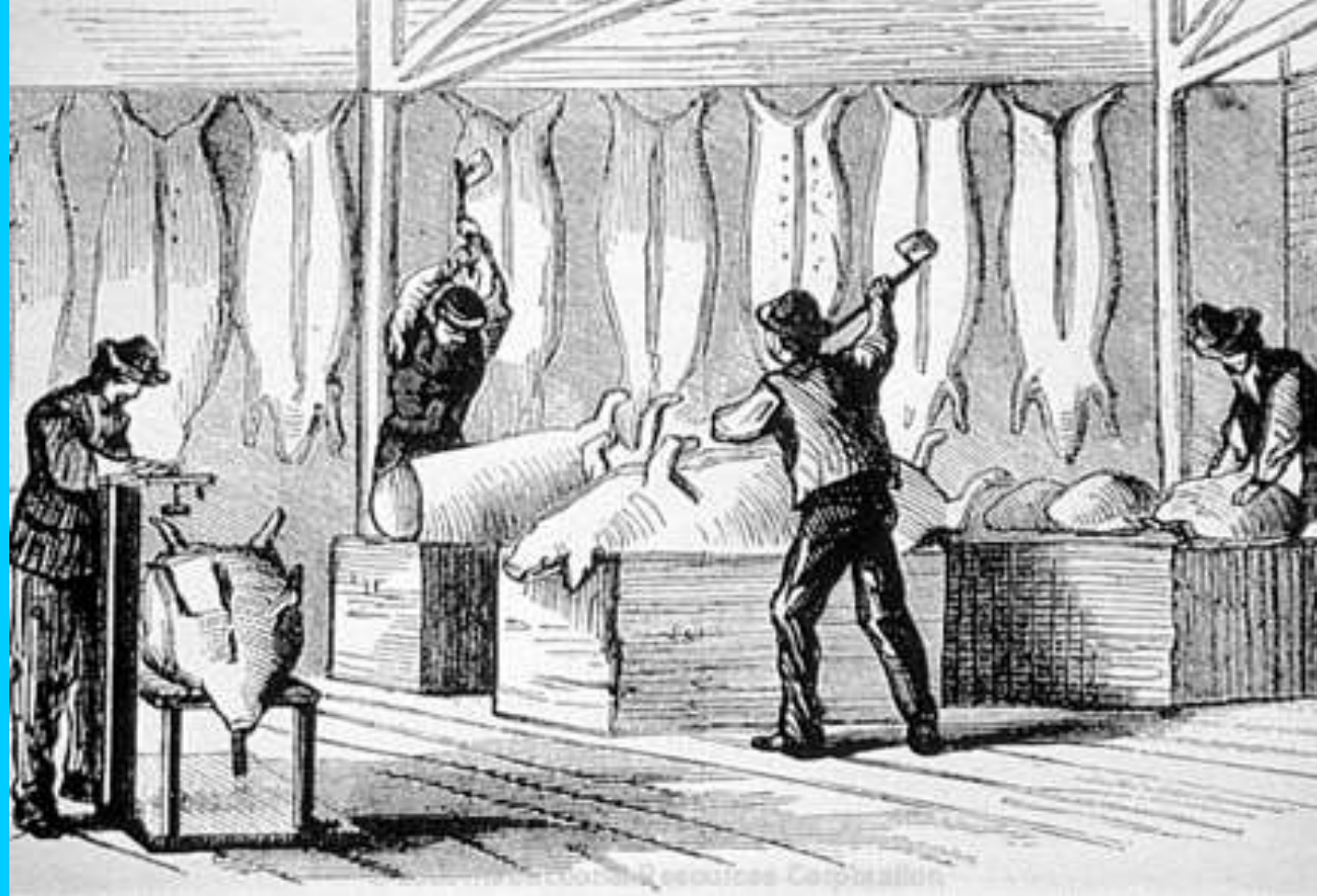
“WE COULD SELL OUR PRODUCTS FOR PERSONAL PROFIT IN WHICH SYSTEM?” - - Name that system!

Market economy



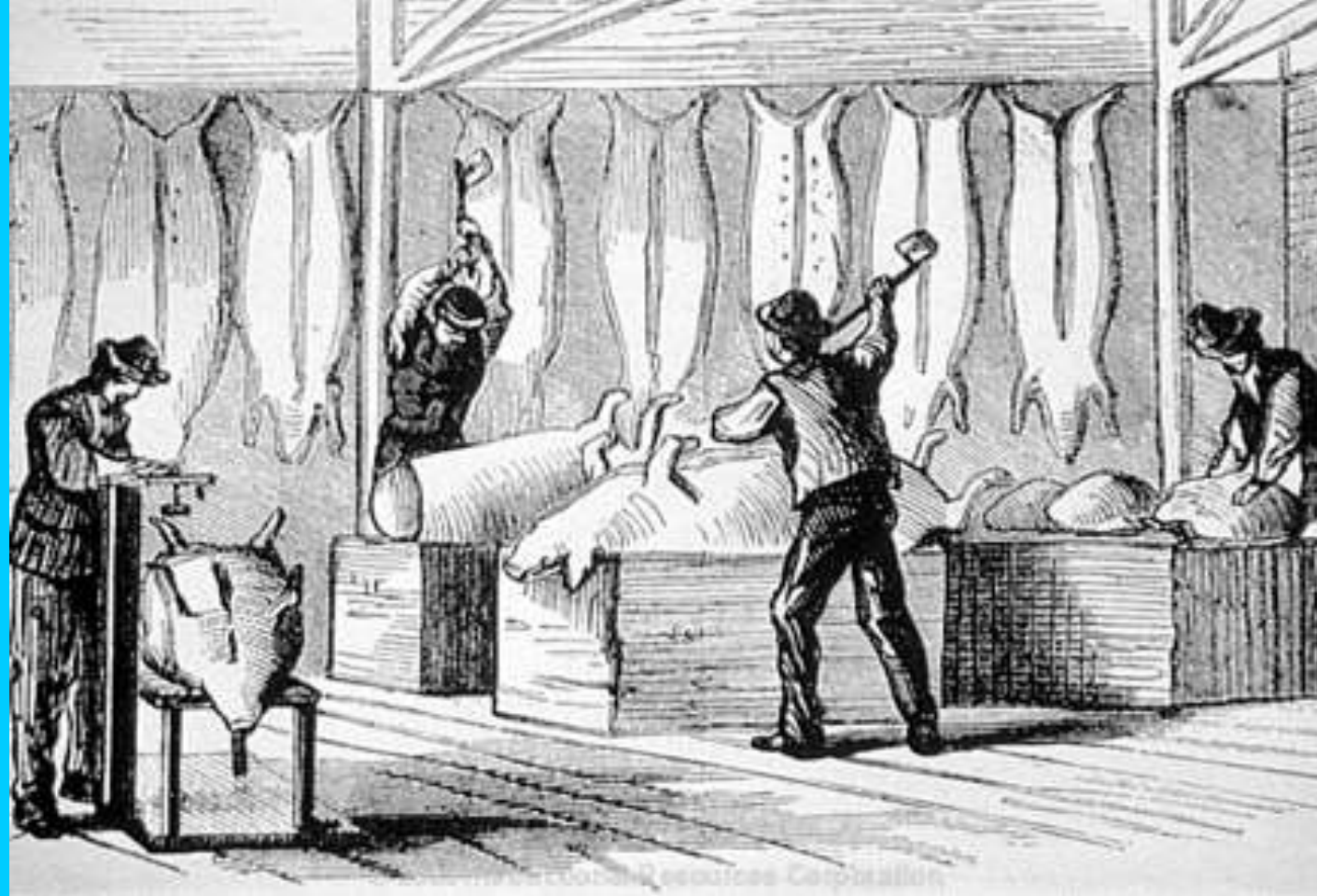
“Our grandmothers taught us to weave, and we have taught our daughters.” - Name that system!

TRADITIONAL ECONOMY



**“We slaughter the hogs because the government tells us to. I hate this job. I’d rather be a carpenter.” -
Name that system!**

COMMAND ECONOMY



“We slaughter hogs better than any of
our competitors!” -
Name that system!

Market economy

Three Debates

Protectionist
policies
vs
Outward-
oriented
policies

State
vs
Market

Traditional
factors of
production
vs
TFP
(Solow
residual)

Krugman (1994):
"The miracle of East
Asian growth is due
to miraculous rates
of investment in
physical and human
capital"



Thank You!

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