THEME 2. ECONOMIC SYSTEMS

1. Types of economic systems. Market economy.

The economic role of the state in market conditions

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Let us recall again the simplest scheme of economic circulation, given in the last paragraph of the previous theme. This scheme is universal in the sense that it is applicable to any society. Indeed, social production in any case presupposes interrelations between people as owners of all productive resources and the firms transforming these resources into finished products. It is another matter that these interrelations may be carried out in different ways, and it is these differences that distinguish one economic system from another.

An economic system is a way of organizing the relationships between economic agents that determines the answers to the questions: "What to produce?", "How to produce?" and "For whom to produce?"

In the course of the historical development of human society, four main economic systems were formed:

- traditional economy;
- A centrally controlled economy;
- market economy;
- mixed economy.

In a traditional economy, the distribution of resources and finished products is based on established traditions and customs. This system played a great role in the life of society up to the Middle Ages, when many activities were passed on by inheritance, there were rigid boundaries of living standards for different social groups, shop and communal insularity, etc.

At present, the traditional economy has retained its significance in underdeveloped countries, but its remnants can also be observed in quite "modern" society. They are manifested in the division of professions into "male" and "female," the prevailing stereotypes concerning "normal" income differentiation, and some ways of distributing consumer goods.

In Russia, elements of the traditional economy are manifested in the semi-feudal dependence of workers on employers, the preservation of the institution of registration of citizens at the place of residence, the presence of objects of socio-cultural sphere on the balance sheets of enterprises, etc.

In a centrally controlled economy, the distribution of economic goods is based on top-down instructions. The basis of such an economy is state ownership of production resources. The leading role in management is played by state planning authorities, which determine for each enterprise what products it should produce, what technology it should use, and, finally, to whom it should supply what it produces. Such an economy rests on three "pillars": centralized production planning, centralized supply of resources (funding), and centralized pricing.

An important distinguishing feature of a centrally controlled economy is the ability to quickly mobilize resources to achieve the goals set from above. Under certain, usually extreme, conditions (wars, natural disasters, etc.) this is the virtue of the system. It is no coincidence that the role of centralized regulators increases during wars, even in the most market economies. In Russia, the command economy showed its potential most clearly during the period of industrialization in the 1930s.

At the same time, the system also has a number of inherently serious shortcomings. They stem primarily from the fact that the system, contrary to propaganda declarations, is not democratic: key decisions are made by the party elite, concerned about self-preservation and consolidation of its power. Undemocratic power feels best under conditions of emergencies - wars, conflicts, upheavals - and for self-preservation it constantly provokes such situations and maintains a state of emergency in society, be it to repel an external threat (most often imaginary) or to fulfill the next five-year plan.

The main strategic goal of the authorities or the basic economic law of a centrally controlled economy under such conditions is the maximum production of means of internal and external oppression - weapons systems, the "services" of the secret police and propaganda organs. As for consumer goods, funds for them are allocated on a residual basis at the level of the necessary minimum. This is no accident: wealthy people are not natural allies of the system, since they are more concerned with increasing their own wealth and are not very eager to make sacrifices "in the name of the party and the people.

Proof of this was the Soviet economy, which offered its citizens miserable housing, substandard cars, and inedible food, but at the same time produced in unimaginable quantities, unimaginable to "potential enemies", the most modern tanks, warplanes and submarines, and maintained a gigantic army.

Today's example of such a policy is the impoverished but constantly threatening North Korea. The Chinese Communists (although China's economy is rather in transition from a centrally controlled to a market economy) also need enemies like independent Taiwan, Japan, which is still "not properly repenting" for the sins of World War II, and the United States to maintain their power.

But even when the system does allocate resources to meet the needs of the population, it is confronted with the fact that from a single center it is impossible to correctly identify such needs. Some products are therefore constantly produced in excessive quantities, others in insufficient quantities, and still others are not produced at all.

All of the above means that a centrally controlled economy does not make rational use of limited resources in terms of public needs. In other words, the system's answer to the first question of economic choice: "What to produce?" is not conducive to maximizing public welfare.

The system is no more satisfactory in answering the second question: "How to produce?" Once the decision to produce is made, the question of economical use of resources recedes into the tenth plan. Moreover, objectively, producers become interested in overconsumption of resources, because the superior bodies evaluate their work by the volume of output in rubles, which is the greater the more resources are "mastered.

From this essential characteristic of the system - that producers work not to meet the needs of the consumers of their products, but to report to their superiors - come such significant disadvantages of production as low quality and insensitivity to technical progress.

No less detrimental to public welfare is the arbitrary distribution of the social pie by the state between regions, labor collectives and individual citizens (the answer to the question: "For whom do we produce?"). This way of distribution "according to the higher officials' reasoning" stimulates not conscientious and effective labor, but the ability to please the bosses, to be attached to a profitable distributor, etc.

A market economy involves the distribution of economic goods through voluntary exchange. In its pure form, the market mechanism excludes any government interference in determining prices or volumes of production; each economic agent here decides independently, based on its own interests, how much and what goods to offer to the market, to whom and at what prices to sell them.

The economic basis of the system is private ownership of the factors of production, respectively the finished product, and the driving motive for the behavior of economic agents - their egoistic desire to maximize their own well-being.

Is it good or bad in terms of the public interest? One of the greatest economists of all times, A. Smith, gave an affirmative answer to this question in the 18th century. In his economic activity, he stressed, every man is an egoist - thinking only about his own profits. At the same time, the "invisible hand of the market" directs individual egoisms toward the general welfare.

Take the baker, for example. When he bakes first-class bread, he is not motivated by the desire to make his fellow citizens happy; his goal is money. But at the same time, the market and competition compel him to produce exactly what society needs, with high quality and minimum cost. Otherwise, our baker would simply go bankrupt. "In pursuing his own interests, he often serves the interests of society more validly than when he really seeks to do so," wrote A. Smith.

Here we see two most important advantages of the market. First, the market directs production to meet the needs of consumers, expressed in their ability to pay. Second, through prices the economy receives signals for production. Price for the entrepreneur is like a beacon for the captain of a ship. If it rises, profits from investments in this sphere rise, and that is where resources are directed. On the contrary, a fall in price signals a decrease in social demand for the product, and thus encourages the withdrawal of resources from the industry. It follows that the market mechanism ensures the fullest and most efficient use of limited resources.

But is the picture painted here too idyllic? There are numerous examples from the Russian reality, when the market activity of economic agents only undermines the public welfare. These examples are manifold and generated by various reasons. Nevertheless, these reasons can be divided into two groups:

- The reasons are related to the shortcomings of the market as such. The point here is that even the most perfect market mechanism cannot solve a number of economic problems and needs to be adjusted by the government. Such market imperfections will be discussed in the next section;

- Reasons related to the shortcomings of the specific market mechanism that has emerged in Russia today.

The fact is that the efficiency of the market system depends on the dominant types of markets. Thus, in highly competitive markets it is virtually impossible for individual economic agents to increase their own profits without contributing to the maximization of public welfare. On the contrary, the dominance of monopolies leads to the fact that enterprises with market power are able to increase their profits by reducing output and raising prices. Thus, their welfare is built on the basis of redistribution in their favor of public wealth, i.e., to the detriment of the interests of society. It is the latter situation that is characteristic of modern Russia, which inherited from the centrally controlled system a record high degree of monopolization of the economy.

Another reason for the low efficiency of today's Russian market is related to the problem of property. Effective private property, which is, as noted, the basis of the market system, is far from being fully formed in our country. The absence of a real effective owner, with his own capital responsible for the course of affairs, prevents the adoption of rational management decisions, leads to squandering of resources.

An acute problem is the arbitrariness and abuses of the top managers of joint-stock companies in relation to their owners, the weak legal protection of private property.

A mixed economy is an economic system that combines the use of market and centralized regulators. This system is a compromise between a centrally controlled economy, where major decisions are made by government agencies, and a pure market, where economic agents make their own decisions without any government restrictions.

Obviously, both a centrally controlled and a market economy are as impossible in their pure form as absolutely pure water. We can only say that the economy of a particular country is more or less close to one of the two extremes. For example, the USSR, especially during the Stalin period, was very close to the ideal of a centrally controlled system.

Today, the Heritage Foundation and The Wall Street Journal publish an annual Index of Economic Freedom. The Index analyzes the economies of each of the 155 countries under consideration according to 50 indicators reflecting the government's tax, monetary and trade policies, the degree of government intervention in the economy, the level of protection of property rights, etc. As a result, all countries are divided into 4 categories: "free", "mostly free", "mostly unfree" and "repressive", and each country receives its economic freedom rating, which ranges from 1.0 (ideal free economy) to 5.0 (absolutely unfree economy).

Hong Kong has consistently been recognized as the freest economy (1.35 in 2005). Hong Kong first topped the rating when it was still a British colony and managed to maintain its leadership by becoming a special administrative region of China. In addition to Hong Kong, another 16 countries - Singapore, Luxembourg, Ireland, Great Britain, Chile, the United States, Switzerland and several others - are considered to be economically free. Of the post-Soviet countries, only Estonia, which was in fourth place in 2005 with a rating of 1.65, has made it into the leading group.

At the other end of the list is the DPRK, which has consistently received the highest score of 5.0 for economic unfreedom. Thus, North Korea can now be considered a bastion of a centrally controlled economy. As for Russia, in 2004 it shared 114th place with the African state of Malawi, and in 2005, after getting a score of 3.56, it moved down to 124th place, which it no longer shares with anyone.

All developed capitalist countries today are mixed economies: with the leading role of market relations in them the guiding hand of the state is also quite visible, although the degree of state intervention in the economy varies there.

In this regard, we now have to consider the main functions of the state in a modern mixed economy, to determine the limits of effective state intervention in the operation of the market.

The economic role of the state in market conditions

There are two extreme views among economists regarding the role of the state in a market economy.

Some economists believe that the market economy is efficient by itself, and that government intervention only undermines that efficiency. Such economists advocate the minimization of government functions, calling for every opportunity to replace government regulation with market regulation. A corresponding current of economic thought is now represented by modern neoconservatives.

At the same time, other economists hold the opposite viewpoint, according to which the free market by itself is not able to ensure the effective functioning of the economy, and therefore needs constant government adjustment. This position was substantiated by the greatest economist of the 20th century D. Keynes, and today it is defended by his followers - neo-Keynesians.

Despite these theoretical divergences, virtually all economists today agree that the market is not omnipotent in any case. In other words, it is incapable of performing a number of important economic functions, and behind each of these tasks that the market does not solve, there is a need for state intervention. This approach allows us to outline the minimum limits of state intervention in the economy, which will be discussed below.

A. Minimum economic functions of the state

1. The market is unable to provide the economy with the optimal amount of money. Let us imagine that the central bank of the country disappeared one day along with the paper money it issued. The place is not empty, and the economy, having recovered from the initial shock, will switch to commodity money produced by private enterprises.

In the history of mankind, the most common monetary commodity has been gold. In this case, however, the price level turns out to be tied to the productivity of the gold mines: as new deposits are discovered, there is more gold, and so the prices of other goods expressed in gold go up. And vice versa. As a result, during the reign of the gold standard, prices jumped up and down: a year with high inflation was as likely to be followed by a year with high as with low inflation. But unpredictable price hikes are as bad for the economy as sudden acceleration or deceleration is for the human body, because long-term business planning becomes impossible. Who will carry out a serious business project without knowing what the price of resources and finished products and the interest rate will be in a year?

As a result, paper money is not exchanged for gold, its quantity is not tied to the gold reserve of the country, but is determined solely by the policy of the Central Bank. Being weighted, this policy avoids price shocks. Therefore, the regulation of the money supply is the prerogative of the state.

2. The market needs a legal basis for its functioning. Thus, private property must be protected by law, as well as the execution of contracts. No less important is such aspect of legislative activity of the state as bans on sale of harmful and adulterated products, imposing obligations on sellers to fully inform buyers about quality features of goods.

This is because sellers and buyers of goods often have inconsistently complete (asymmetrical) information about their quality. When you buy a used car, in particular, you cannot know all of its defects, which are well known to the owner. Similarly, it is not written on vegetables whether they were grown in a favorable ecological zone or in the Chernobyl area. Under such conditions, purely market relations (without state intervention) obviously do not contribute to the optimal allocation of resources, respectively maximizing public welfare: why try to make something of quality if you can create a defect and pass it off as a candy.

Economists call this one of the "market failures. Its existence prompts states with developed market economies to carefully regulate such aspects of market relations.

The aforementioned areas of legal activity of the state allow us to liken its role in the economy to that of a soccer referee. The latter does not prevent teams from identifying the strongest, but with strict observance of the rules of the game: you cannot kick your opponent, play with your hands, etc.

3. The market mechanism is not immune to the emergence of monopolies, the harm of which was discussed in the previous paragraph. Here we should emphasize again that when a monopoly arises, the prices of goods are higher and their output lower than under competitive conditions. Monopolists can, therefore, influence the market to their own advantage and to the detriment of society as a whole. We will discuss in detail the societal losses due to the establishment of a monopoly in Topic 9, Section 3.

As a result, monopoly generates irrational use of economic resources, which leads to the need for anti-monopoly public policy.

4. The market is unable to provide the economy with the necessary amount of public goods, i.e., co-consumption goods. The latter include national defense, law and order, environmental protection, fundamental science, public utilities, transport communications, etc.

The pure public good has two properties:

(a) The consumption of such a good by one person does not reduce its usefulness for another person (the property of indiscriminate consumption);

b) it is impossible to prevent a person who has not paid for the good from consuming it (the property of non-excludability from consumption).

For example, an air defense system that protects a country from an air attack protects not only the bona fide taxpayer, who paid for its maintenance with his taxes, but also the homeless person, who never paid any taxes in his life. It is impossible to protect a taxpayer without also protecting a homeless person.

By comparison, private goods are goods that, while being consumed by one person, cannot be simultaneously consumed by another. Typical examples are food, clothing, housing, etc. For example, if you eat a chocolate bar, no one else can eat it. The production and consumption of private goods is usually quite effectively regulated by the market: whoever paid for the chocolate bar eats it.

At the same time, the above-mentioned properties of public goods lead to the fact that individual consumers tend to avoid paying for them, reasoning something like this: "Even if I don't pay, others will pay, and I will use the good equally with everyone else. As a result, purely market relations (without state intervention) often lead to a situation in which public goods are not produced or are produced in insufficient quantities.

In this regard, the function of customer and distributor of many public goods on behalf of society as a whole is assumed by the state. Without the state, we would have no tanks, no airplanes, no missiles. Instead, everyone with a Kalashnikov assault rifle (a private good) would be defending his own apartment!

5. Market activity generates side (external) effects, both negative and positive. External effects are the costs (benefits) of market transactions not reflected in prices.

A serious example of a negative external effect is the suffering of city residents due to pollution by a chemical factory. The plant produces a first-rate detergent, using certain production resources, the cost of which is built into the price of the detergent. Consumers and manufacturers alike are thus satisfied. And the residents of the city? They lose the community resources (clean environment) they previously had. The mill received these resources free of charge. He paid, therefore, only a fraction of the resources he actually consumed.

There are also examples of positive externalities. For example, the residents of the village benefit from the fact that one of them improves the area adjacent to his house for free.

Obviously, the existence of externalities undermines public welfare. In particular, the above-mentioned factory would have to compensate for the damage caused by its fault to the residents of the city, which it does not yet do. Similarly, the beneficiaries of a positive effect would have to pay an amount equivalent to their benefit to the producer of this effect by assuming a part of its costs. As a result of both, the externalities would disappear.

When externalities exist steadily in the economy, the government must be involved in solving them. It eliminates externalities by, for example, taxing producers of negative effects (a fine imposed on a factory for air and water pollution, with compensation paid to victims), or by paying subsidies to producers of positive effects. Thus, the state subsidizes education, because students benefit not only themselves, but society as a whole, i.e., they create a positive external effect on other people.

The problem of externalities and public goods will be discussed in more detail in Topic 12.

6. The market generates an unjustifiably high differentiation of income from the point of view of society and does not ensure people's right to work. In this sense it can be likened to a soulless machine: as long as a person possesses a resource valuable to the market (labor of the right qualifications, land, capital), his income is high; otherwise, he has to make do with low income or starve to death - the market will not blink an eye. Purely market relations recognize as fair any legally obtained income, regardless of whether it is earned through hard work, natural talent, or rich inheritance.

But what is fair for the market is not always acceptable to society. Therefore the state implements a variety of social programs to support the needy: it pays benefits for poverty and unemployment, organizes retraining courses, provides free medical care, food stamps, etc. These are so-called transfer payments - through taxes, money is taken from the rich and given to the poor.

Contemporary neoconservatives do not deny the importance of government social policies to overcome poverty, but they emphasize that each person must, first and foremost, help himself. In this regard, they believe that the task of the state is not simply to pay benefits, but to encourage people to work.

Б. The Actual Limits of Modern State Intervention in the Economy

The activity of the modern state is subordinated to four main goals: stable economic growth, full employment, curbing inflation, and maintaining the balance of payments. In the long run, these goals go hand in hand, but in the short run they may contradict each other. Thus, the stimulation of production and reduction of unemployment often turns into higher inflation and deterioration of the balance of foreign trade.

In pursuing these goals, the state is nowhere limited to the performance of its six minimal listed functions, but implements a large-scale stabilization (countercyclical) as well as structural policy.

Stabilization policy is a set of measures for overcoming crises and maintaining uniform and sustainable growth of production. It includes fiscal, monetary (fiscal) and income policies.

Fiscal policy is implemented through government spending on the purchase of goods and services and the levying of taxes on individuals and firms. In times of recession, government spending usually rises and taxes fall, and vice versa. Monetary policy means controlling the money supply in the economy. The government usually increases the amount of money during an economic downturn and restrains it during an upturn. Similarly, during recessions, the state's income policy is expressed primarily as an across-the-board restriction of wage growth; during booms, the rigidity of this policy is relaxed.

At the same time, according to non-conservative economists, such stabilization policies are ineffective. They believe that a competitive market system in principle ensures stable economic development, while the observed economic fluctuations are precisely the result of arbitrary government manipulation of the budget and the money supply.

Hence the practical recommendations: reduce government spending and a stable, predetermined increase in the money supply of about 4% a year. Then the economy will grow steadily according to its natural capacity, and cyclical fluctuations will be a thing of the past.

If stabilization policy can be likened to various methods of treating a sick organism, structural policy is a policy of "healthy living. Its goal is to achieve a balanced development of the economic organism, so that it becomes immune to all kinds of diseases. A policy that promotes competition and limits monopolistic tendencies plays a crucial role in this process. Another area of structural policy is combating unemployment by organizing the retraining of workers in accordance with the requirements of modern production. A very important element of structural policy is the support of sectors that are especially important for the development of the national economy or a given region. The production of public goods, mentioned above, is also an essential part of structural policy. Sometimes the state considers it necessary to place a particular industry or enterprise under its direct control by nationalizing it. In the opposite case, it transfers enterprises to private ownership (privatization process).

At present, privatization is a characteristic feature of the state structural policy implemented in absolutely all developed countries. This situation reflects the modern understanding that the state, with few exceptions, should not engage directly in production, this is the sphere of private business.

B. The State in the Russian Economy

The state has a special role to play in economies in transition, such as Russia's. The specifics of our country is that radical economic transformations took place under conditions of a weak state. By the beginning of the 1990s, virtually all institutions of state power had been destroyed, and their restoration was, in fact, the central political task of the first post-communist decade. At the same time, economic reforms progressed only as state institutions were restored, resulting in a much slower pace of change than in most other countries that had embarked on the path of building a market economy. Today we can talk about the restoration of state power and the achievement of political stabilization in society.

At the same time, expectations that a strong state will firmly implement liberal market reforms are not fully justified today. A strong state, adequate to the needs of a market economy and democratization of society, is not a state capable of arbitrary rule with impunity. In fact, both central and regional authorities constantly take on functions that essentially undermine the development of the market. The specifics of the Russian mixed economy is that many decisions of formally independent economic entities are taken only with the permission or by direct order of the authorities. The seizure of private property with the use of the so-called "administrative resource" under the guise of "independent" courts and prosecutors became a common phenomenon. As a result, market relations are replaced by administrative diktat, and the state serves not so much society as individual officials, parasitic on the economy, and businesses closely associated with them.

The primary task of the state in a transitional economy is to create an efficient market. To this end, it is necessary to implement deep structural, institutional changes aimed at decisive liberalization of the economy, freeing enterprises from excessive tutelage and control on the part of government agencies.

This is not to say that the state should withdraw from economic management altogether. Only the state is capable of creating and protecting the basic rules and institutions of a market economy. First of all, these are the institutions of private property, market infrastructure, public administration, and independent judiciary. It is important that the "rules of the game" developed by the state be the same for all entrepreneurs. Without the latter, it is impossible to create a highly competitive market environment.

In the field of expenditures, the state must stop being a cash cow that directly finances enterprises, or a "welfare state" that guarantees a "decent life" for everyone. Instead, budgetary money should be used to create a network of insurance and similar funds that protect investors and share their risks. Along with this, the state is responsible for financing the production of public goods, supporting those members of society who are truly unable to provide for themselves.

To summarize, it should be emphasized that the very fact of state intervention in the economy does not guarantee economic efficiency. The role of the state has to be accepted in cases where the market definitely fails to cope with certain economic functions. However, any attempts by the state to appropriate "additional powers" to itself, much less to fetishize its capabilities, are fraught with the most serious economic troubles.

SELF-STUDY ASSIGNMENTS

Explain the main features of a market economy. What are the most important advantages and disadvantages of the market?

2. According to A. Smith's concept of a competitive market economy, the selfishness of economic agents:

А. Harmful to society;

Б. Leads to the sale of low-quality goods at high prices;

В. Forces firms to strive to improve quality and reduce costs;

Г. Makes state intervention unnecessary.

Justify the correct answer.

3. What are the main functions of the state under market conditions? What are the peculiarities of stabilization and structural policy of the state?

4. In a market system, the state intervenes in the economy in order to:

А. Reduce competition;

Б. To provide consumers with goods of higher quality and cheaper than in the private sector;

В. Guarantee profits for all firms;

Г. Reduce the negative side effects of market activities.

Justify the correct answer.

5. A disgusting broken road leads to the dacha village. All the dacha residents grumble, but no one is willing to do anything to rectify the situation. Something did, however, having a dacha in the village, the head of public utilities of the nearby city. From the resources saved on landscaping, he allocated a couple of dump trucks for repairs. A few particularly outstanding potholes disappeared, but the road has not become significantly better. Explain this situation, based on the theory of public goods. What would you recommend that we do to improve the situation?

6. A small group of economists believes that the elimination of the state monopoly on the issue of national currency and its replacement by the free circulation of multiple currencies issued by private banks ("Bank of Moscow", for example, issues its own rubles, "Bank of St. Petersburg" - its own, etc.) is useful. These currencies would compete with each other on the money market. Do you agree? Assess the positives and negatives of such an innovation.