

## **Chapter Two: Comparative Economic Systems**

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### **2.1 Economic System**

To understand meaning of economic systems, it refers to the role or model of distribution and production which take place in the society. Business is considered as an organized economic activity. The primary objective of any business is to produce and sale goods or services. It exists to serve people living in the society with different means. There are some questions which an economic system must answer:

- What to produce and service to provide?
- The organization of both the production and services.
- What are the methods to distribute products and services?

Everyone knows that resources are limited and must be utilized in a manner to get maximum output. In a country, people must decide what to produce and also define the quantity. This decision involves many factors like development level of a country, resource available, prevailing culture and economic and social status of individuals in society.

### **2.2 Capitalism**

Capitalism is often thought of as an economic system in which private actors own and control property in accord with their interests, and demand and supply freely set prices in markets in a way that can serve the best interests of society.

The essential feature of capitalism is the motive to make a profit. As Adam Smith, the 18th century philosopher and father of modern economics, said: “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.” Both parties to a voluntary exchange transaction have their own interest in the outcome, but neither

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can obtain what he or she wants without addressing what the other wants. It is this rational self-interest that can lead to economic prosperity.

In a capitalist economy, capital assets—such as factories, mines, and railroads—can be privately owned and controlled, labor is purchased for money wages, capital gains accrue to private owners, and prices allocate capital and labor between competing uses (see “Supply and Demand”).

Although some form of capitalism is the basis for nearly all economies today, for much of the past century it was but one of two major approaches to economic organization. In the other, *socialism*, the state owns the means of production, and state-owned enterprises seek to maximize social good rather than profits.

### **2.2.1 Pillars of Capitalism**

Capitalism is founded on the following pillars:

- i. Private property, which allows people to own tangible assets such as land and houses and intangible assets such as stocks and bonds;
- ii. Self-interest, through which people act in pursuit of their own good, without regard for sociopolitical pressure. Nonetheless, these uncoordinated individuals end up benefiting society as if, in the words of Smith’s 1776 *Wealth of Nations*, they were guided by an invisible hand;
- iii. Competition, through firms’ freedom to enter and exit markets, maximizes social welfare, that is, the joint welfare of both producers and consumers;
- iv. a market mechanism that determines prices in a decentralized manner through interactions between buyers and sellers—prices, in return, allocate resources, which naturally seek the highest reward, not only for goods and services but for wages as well;
- v. freedom to choose with respect to consumption, production, and investment—dissatisfied customers can buy different products, investors can pursue more lucrative ventures, workers can leave their jobs for better pay; and
- vi. Limited role of government, to protect the rights of private citizens and maintain an orderly environment that facilitates proper functioning of markets.

The extent to which these pillars operate distinguishes various forms of capitalism. In free markets, also called *laissez-faire* economies, markets operate with little or no regulation. In *mixed economies*, so called because of the blend of markets and government, markets play a dominant role, but are regulated to a greater extent by government to correct market failures, such as pollution and traffic congestion; promote social welfare; and for other reasons, such as defense and public safety. Mixed capitalist economies predominate today.

### **2.2.2 The Many Shades of Capitalism**

Economists classify capitalism into different groups using various criteria. Capitalism, for example, can be simply sliced into two types, based on how production is organized. In *liberal market economies*, the competitive market is prevalent and the bulk of the production process takes place in a decentralized manner akin to the free-market capitalism seen in the United States and the United Kingdom. *Coordinated market economies*, on the other hand, exchange private information through non-market institutions such as unions and business associations—as in Germany and Japan (Hall and Soskice 2001).

More recently, economists have identified four types of capitalism distinguished according to the role of entrepreneurship (the process of starting businesses) in driving innovation and the institutional setting in which new ideas are put into place to spur economic growth (Baumol, Litan, and Schramm 2007).

In *state-guided capitalism*, the government decides which sectors will grow. Initially motivated by a desire to foster growth, this type of capitalism has several pitfalls: excessive investment, picking the wrong winners, susceptibility to corruption, and difficulty withdrawing support when it is no longer appropriate. *Oligarchic capitalism* is oriented toward protecting and enriching a very narrow fraction of the population. Economic growth is not a central objective, and countries with this variety have a great deal of inequality and corruption.

*Big-firm capitalism* takes advantage of economies of scale. This type is important for mass production of products. Entrepreneurial capitalism produces breakthroughs like the automobile, telephone, and computer. These innovations are usually the product of individuals and new firms. However, it takes big firms to mass-produce and market new products, so a mix of big-firm and

entrepreneurial capitalism seems best. This is the kind that characterizes the United States more than any other country.

### **2.2.3 The Keynesian Critique**

During the Great Depression of the 1930s, the advanced capitalist economies suffered widespread unemployment. In his 1936 *General Theory of Employment, Interest, and Money*, British economist John Maynard Keynes argued that capitalism struggles to recover from slowdowns in investment because a capitalist economy can remain indefinitely in equilibrium with high unemployment and no growth. Keynesian economics challenged the notion that laissez-faire capitalist economies could operate well on their own without state intervention to promote aggregate demand and fight high unemployment and deflation of the sort seen during the 1930s. He postulated that government intervention (by cutting taxes and increasing government spending) was needed to pull the economy out of the recession. These actions sought to temper the boom and bust of the business cycle and to help capitalism recover following the Great Depression. Keynes never intended to replace the market-based economy with a different one; he asserted only that periodic government intervention was necessary.

The forces that generally lead to the success of capitalism can also usher in its failure. Free markets can flourish only when governments set the rules that govern them—such as laws that ensure property rights—and support markets with proper infrastructure, such as roads and highways to move goods and people. Governments, however, may be influenced by organized private interests that try to leverage the power of regulations to protect their economic position at the expense of the public interest—for example, by repressing the same free market that bred their success.

Thus, according to Rajan and Zingales (2003), society must “save capitalism from the capitalists”—that is, take appropriate steps to protect the free market from powerful private interests that seek to impede its efficient functioning. When political interest and the capitalist class combine, “crony capitalism” may emerge, and nepotism will be more rewarding than efficiency. The concentration of ownership of productive assets must be limited to ensure competition. And, because competition begets winners and losers, losers must be compensated. Free trade and strong competitive pressure on incumbent firms will also keep powerful interests at

bay. The public needs to see the virtues of free markets and oppose government intervention in the market to protect powerful incumbents at the expense of overall economic prosperity.

Economic growth under capitalism may have far surpassed that of other economic systems, but *inequality* remains one of its most controversial attributes. Do the dynamics of private capital accumulation inevitably lead to the concentration of wealth in fewer hands, or do the balancing forces of growth, competition, and technological progress reduce inequality? Economists have taken various approaches to finding the driver of economic inequality. The most recent study analyzes a unique collection of data going back to the 18th century to uncover key economic and social patterns (Piketty 2014). It finds that in contemporary market economies, the rate of return on investment frequently outstrips overall growth. With compounding, if that discrepancy persists, the wealth held by owners of capital will increase far more rapidly than other kinds of earnings (wages, for example), eventually outstripping them by a wide margin. Although this study has as many critics as admirers, it has added to the debate on wealth distribution in capitalism and reinforced the belief among many that a capitalist economy must be steered in the right direction by government policies and the general public to ensure that Smith's invisible hand continues to work in society's favor.

## **2.2.4 Main Characteristics of Capitalism**

- A. Right to own property
- B. Profit motive
- C. Private ownership of means of production
- D. Consumer's sovereignty
- E. Economic freedom
- F. Social division of people
- G. Price mechanism

### **In a word we can say that**

1. It is an economic system in which each individual in his capacity as a consumer, producer and resource owner is engaged in economic activity with a great degree of economic freedom.
2. The factors of production are privately owned and managed by individuals.

3. The main motive behind the working of the capitalist system is the profit motive. The entrepreneurs initiate production with a view to maximize profits.
4. Income is received in monetary form through the sale of services of the factors of production and from profits of private enterprise.
5. Capitalist economy is not planned, controlled or regulated by the government. In this system, economic decisions and activities are guided by price mechanism which operates automatically without any direction and control by the central authorities.
6. Competition is the most important feature of the capitalist economy. It means the existence of large number of buyers and sellers in the market who are motivated by their self-interest but cannot influence market decisions by their individual actions.
7. Thus, capitalism has many characteristic features. But capitalism of the pure type does not exist anywhere in the world. There are many variations with imposed limitations and the concept of the 20th century capitalism is entirely different.

### **2.2.5 Advantages of Capitalism**

- Reduction in cost of production due to efficient control
  - Efficient control of production process
  - Improved quality of goods
  - Consumer's choice is given full weight
  - Varieties of products
1. It is the dominant economic system in developed countries. A lot would argue that there isn't any country in the world that practices a true form of capitalism. While that may seem to be the case, there are a number of countries that employ some form of capitalism, and these include: The United States of America, United Kingdom, Canada, Australia, Japan, Switzerland, Singapore and Spain – that's just to name a few.
  2. Some tenets of capitalism are cornerstones of representative government. Capitalism rose when the system of feudal economies ended. It has since grown to be a dominant economic system, particularly in developed countries around the world. There are specific tenets of capitalism like property rights which supporters believed to be cornerstones of representative government. In addition, wage labor – another tenet of capitalism – can be counted in this regard.

3. It is linked with economic growth. In a capitalist system, the production and price of goods are determined by the market rather than the government. With private property rights, private individuals are given the freedom to create the goods and services to sell in the market.

### **2.2.6 Disadvantages of Capitalism**

- A. Inequality in the distribution of national wealth
- B. Fluctuations in the level of employment
- C. Class conflicts
- D. Waste of talents
- E. Heavy expenses on publicity result into increase in cost and price of the commodity.

## **2.3 Socialism**

In socialist economic system means of production are owned and managed by the State. Ownership of means of production is not allowed. In socialism economic activities are carried on mainly for social gains and personal interest is of less significance. In this economic system the anti-social activities like smuggling and hoarding find no place. Economic activities are planned with the motive of social benefit by a central planning authority.

### **23.1 Types of Socialism**

Socialism is an economic and political ideology concerned with greater equality of distribution and proposing solutions which involve greater co-operation and social solutions. Socialism is often associated with the concept of state ownership of the means of production. The aim is to run industry in the interests of society rather than in the interests of a few property owners. However, there are many variants of socialism from the Command economy of State-Communism (e.g. Soviet Union) to libertarian socialism which advocates voluntary councils of workers taking responsibility for their local business.

Traditional economic theory is based on principles of individual ownership of property and a free market, where individuals and business are free to take actions to maximize their utility. From an economic perspective, this is considered to be a method which leads to an efficient allocation of resources. Different types of socialism all offer a critic of this free-market economy, arguing that it leads to inequality and abuse of monopoly power. Socialism is a challenge to this market economy.

1. **Democratic Socialism** advocates Socialism as an economic principle (the means of production should be in the hands of ordinary working people), and democracy as a governing principle (political power should be in the hands of the people democratically through a co-operative commonwealth or republic). Democratic socialism differs from state communism in that the state is not all-powerful, and the political system remains democratic. Democratic socialism is associated with the Socialist parties of Western Europe. They generally propose a mixed economy – with state ownership of key industries, like coal, electricity, water and gas, but allow private enterprise to operate in the rest of the economy. Democratic socialism proposes a progressive tax system to redistribute wealth from the rich to the poor – through the provisions of a welfare state.

### **Aspects of Democratic socialism**

- Advocates nationalization of key industries (often the natural monopolies, like electricity, water)
  - Prices set by the market mechanism, except public goods, such as health and education.
  - Provision of a welfare state to provide income redistribution
  - Support for trade unions in wage bargaining
  - Use of minimum wages and universal income to raise low-income wages
  - Progressive tax and provision of public services. For example, marginal income tax rates of 70%. Tax on wealth
2. **Market Socialism** is a term used to define an economic system in which there is a market economy directed and guided by socialist planners, and where prices would be set through trial and error (planning as shortages and surpluses occur) rather than relying on a free price mechanism. Market socialism refers to various economic systems that involve either public ownership and management or worker cooperative ownership over the means of production, or a combination of both, and the market mechanism for allocating economic output, deciding what to produce and in what quantity. In state-oriented forms of market socialism where state enterprises attempt to maximize profit, the profits can fund government programs and services eliminating or greatly diminishing the need for various forms of taxation that exist in capitalist systems. Some forms of market socialism are based on neoclassical economic theory, with the aim of attaining pareto efficiency by setting price to equal marginal cost in public enterprises.



The term market socialism has also been applied to planned economic systems that try to organize themselves partially along market-lines while retaining centralized state ownership of capital. Examples of market socialism include economic democracy, the Lange model, liberal socialism, market-oriented left-libertarianism, mutualism the New Economic Mechanism and Ricardian socialism. Other types of market socialist systems such as mutualism are related to the political philosophy of libertarian socialism.

### **2.3.2 The Main Features of Socialism**

- a. The means of production are collectively and socially owned and are not the property of private individuals as in capitalism.
- b. Economic decisions regarding the allocation of resources to various ends, the goods to be produced and the methods of production are taken by a central authority and not left to the individuals as in the capitalist economies,
- c. The pricing process does not operate freely under the influence of market forces, but works under the control of the central planning authority,
- d. Broad objectives of a socialist economy are to increase the material and cultural standards of the people, to attain full employment and to achieve economic equality.
- e. The government which has all the important resources with it and private companies or individual cannot use the resources for its own benefit rather it is the government which uses these resources for the social welfare of the people.
- f. Another feature of socialism is that it does not pay attention to economics in the sense that price is not decided by the demand and supply rather it is decided according to the government social welfare schemes.
- g. Lack of monopoly is another feature of socialism because it is the government which holds the majority of resources and chances of private companies or individuals forming a monopoly by taking over the important resources is very less under socialism.
- h. The lackluster attitude of government employees towards decision making and bureaucratic work style is another feature of socialism which in turn leads to inefficient use of resources leading to the loss for a country in terms of economic growth and development.

- i. Another feature of socialism is the absence of class on the basis of money so upper, middle or lower class is not there in case of socialism because in theory all people are considered to be equal.
- j. In the case of socialism, the choice as far consumer is concerned is limited because goods are produced keeping in mind the necessities of life and not on the luxuries of life.
- k. Due to lack of competition and no reward for doing hard work chances of the country producing great entrepreneurs diminishes under socialism.

## **Advantages of Socialism**

There is a balance between wealth and earnings: One of the advantages of being in a socialist country is the availability of basic services to members of the society who are below the poverty line. This is because industries such as utility companies and housing are owned or controlled by the government. Whereas if these companies are owned by private sectors, prices for services is unregulated, making them costly. When it comes to taxes, this form of government also protects low income earners in a way that their taxes are lower as opposed to high earners who have higher taxes.

**There is equal access to health care and education:** As opposed to capitalism with high health care and education costs, socialism makes education available for every citizen regardless of social class. Moreover, members of the community have access to medical attention since health care costs are more affordable. This is due to the fact that the government owns health care facilities and hospitals as well as medical services which are offered for low costs or free.

**It breaks down social barriers:** There is a distinct separation between people in the upper class and the lower class and socialism ensures this is evenly leveled to bridge the gap between the rich and the poor members of society since there is communal ownership. Socialistic economy can bring about efficient and best utilization of resources, because of

- centrally directed planning;
- absence of private property;
- absence of profit motive and
- well defined objective.

Planning is done methodically after studying comprehensively the available resources and the

basic needs of the economy. So, there will be no question of mis-using the resources in the production of unwanted and unwarranted commodities. Within the framework of the objective defined, the planning would aim to produce and distribute to all the citizens. Absence of private property and profit motive would deter the economy in producing remunerative goods or luxury goods wasting the resources. Since it is a planned economy over-production, underproduction, wastage of resources, misallocation of resources can be completely avoided. There will not be business uncertainties, fluctuations, depressions, etc.

**Elimination of Unemployment:** Since the economy is a planned one, it can reduce the forces causing instability and unemployment. The system eliminates cyclical fluctuations in the economy and tries to attain stability. During the 'Great Depression' in the early Thirties, when all countries of the world were under the grip of depression and unemployment, Russia was markedly unaffected by the worldwide depression; the reason being the socialistic type of economy which protected against business and economic instability. There are elaborate procedures in capitalist economies too to fight cyclical fluctuations. This will be done through public expenditure, monetary policies, etc. In spite of all these measures, capitalism can only mitigate the severity of depression; but under socialism this can be altogether eliminated.

**Economic Equality:** The most important merit of Socialism is its attempt to bring about a far greater degree of economic equality than what is possible under capitalistic enterprise. Inequality cannot be justified under any circumstances; morally, socially, politically and economically. It leads to suffering and degradation. It denies equality of opportunity and prevents the poor with ability to rise to a full stature. Though attempts are made to reduce inequalities even in capitalistic economies, it cannot go or succeed beyond a certain stage.

**Maximum Social Welfare:** Socialistic economy tries to ensure maximum social welfare through maximization of satisfaction. This means that in socialistic economy maximum number of people will have maximum satisfaction. In a capitalistic economy, because of profit motive, things will be produced for consumers who are willing to pay. Because of inequalities, only rich people can get the commodities wanted by them. The rich alone, who are minorities in the community will get maximum satisfaction. The poor will not get even the basic necessities of life. But in socialism, commodities needed by the poor will be produced. Hence the satisfaction will be maximum for the large number of people.

### **2.3.3 Disadvantages of Socialism**

#### **It runs on bureaucracy**

One of the disadvantages of being in a socialist society is bureaucracy that hampers the delivery of services to people. This is because people have to pass through different channels to access basic services. As a result, they are not given immediate service or assistance that should be accorded to them.

#### **People are unmotivated to develop entrepreneurial skills**

With the government controlling most of the industry sectors, people who want to capitalize will be discouraged to do so since they know that the government will have a say on their businesses. This is also because they are aware that if they earn more, they will be subjected to higher taxes.

With socialism, apart from communal ownership and the government being in control of certain industries and facilities, people feel that they are dictated upon on how to live their lives, where they live and how much they should be paid for their services and goods. Socialism centers on common ownership and this can either go for or against the people in a society or nation. This is why since the global crisis almost a decade ago there have been talks about reviving socialism. But is this really the answer? Weighing the pros and cons and hearing what the people have to say are two important actions to be taken by the government.

#### **Absence of Price Mechanism and Misallocation of Resources**

The guiding mechanism, allocation of resources between different uses will be made arbitrarily. Improper calculation of costs and determination of prices arises in socialist economy because:

- a. the factors of production are entirely owned by the government and hence they do not have a price;
- b. in the absence of free pricing of factors, the cost of a commodity cannot be calculated; and therefore
- c. it becomes very difficult to decide what to produce and in what quantities.

#### **Loss of Efficiency and Productivity**

Efficiency and productivity in an economy depend on powerful incentives. Hope of gain and fear

of loss are the powerful motives which sustain efficiency and productivity in a capitalistic economy. But in socialism these two motives are absent. Where private property and profit motive are absent, there is the danger of fall in efficiency as well as production in the economy leading to serious decrease in national income.

### **Complexities of Administration**

The burden of administration in socialism is very heavy. Because of government interference in every activity of the people, there should be some authority for deciding all problems relating to the economy. Under capitalism the quantity and quality of output, rate of capital formation and other problems relating to the economy are decided automatically through the price-profit mechanism

### **Loss of Liberty**

One of the main dangers of socialism is that it not only curtails individual liberty but also take away freedom completely. Under socialism there is no scope for consumers sovereignty; the workers will have no choice of occupation, and labor, just like any other economic resource, will be under planned management. The consumers should take what is given and workers should work in such places as the authorities will decide. Of course, there will be no unemployment, but this is hardly an advantage because the terms of employment (hours, wages etc.,) will be fixed by the central authorities. Security of employment is no compensation for loss of liberty. There is no unemployment even in prison.

## **2.4 Communism**

Communism is an ideology that bases itself on the belief that the means of production in a society should belong to the state. Through central ownership, it aims for a classless society with economic equality between individuals. The history of communism began in the second half of the nineteenth century in Europe.

Communism is a political and economic doctrine that aims to replace private property and a profit-based economy with public ownership and communal control of at least the major means of production (e.g., mines, mills, and factories) and the natural resources of a society. Communism is thus a form of socialism—a higher and more advanced form, according to its advocates. Exactly

how communism differs from socialism has long been a matter of debate, but the distinction rests largely on the communists' adherence to the revolutionary socialism of Karl Marx.

Although the term *communism* did not come into use until the 1840s, societies that may be considered communist were described as long ago as the 4th century BCE, when Plato wrote the *Republic*. That work described an ideal society in which the governing class devotes itself to serving the interests of the whole community. The first Christians practiced a simple form of communism, and in *Utopia* (1516) the English humanist Thomas More described an imaginary society in which money is abolished and people share meals, houses, and other goods in common. However, communism is most widely identified with Karl Marx, who outlined the system with Friedrich Engels in *The Communist Manifesto* (1848). Marx's embrace of communism was motivated in part by the inequities caused by the Industrial Revolution.

#### **2.4.1 Origin of Communism**

Marx, the German political critic and philosopher classified people into social groups according to the production process. He considered this classification crucial rather than segregating people into groups of religion, language, nationality, or other similar elements. He believed that people in similar social positions in the production process would eventually form a class because they shared similar interests and objectives due to the prevailing conditions. When production technology and social relations change, it has an impact on the mode of production. This results in tension and conflicts between the classes

#### **2.4.2 Characteristics of Communism**

The idea of communism as a philosophy of government or society is predominantly based on the ideas of Karl Marx. It shares its ideals with Marxism or socialism. Given below are a few characteristics of the ideology: -

##### **Classless society**

A classless society is where there are no differences between the rich and the poor. Society is otherwise divided into the bourgeoisie and the proletariat, who are the owner class and the worker class, respectively.

### **Common ownership of all resources**

For society to be classless, people need to abolish the existing system of control and division. Common ownership is the best way to achieve this goal. Therefore, the community as a whole produce, and the community as a whole enjoys its benefits.

### **Private property**

When private people enter production, they tend to focus more on profit. As their earning capacity increases, their quality of life changes, resulting in dramatic lifestyle changes. Obviously, this will be different for those who do not have money. Therefore, abolishing private property is an essential characteristic of communist ideology.

### **Social equality**

The basis of the communist ideology is the achievement of social equality. In other words, an egalitarian society in which there are no differences or discrimination between the rich and the poor.

### **Against democracy**

Democracy involves the liberty to enter private organizations or players into the market, among other things. Communist ideology does not accept privatization as it is a deterrent in the path of a classless society. Communism in China is an example where they oppose the idea of democracy.

### **List of Communist Countries**

Only five examples of Communist countries exist at present. Nevertheless, they have adopted communism as their standard form of government: communism in China is one of the most popular examples. Other examples include North Korea, Laos, Cuba, and Vietnam. None of these, however, satisfies the true definition of communism. Instead, they are more in being a transition between the end of capitalism and the beginning of communism.

## **2.4.3 The Differences between Communism and Socialism**

The main difference is that under communism, most property and economic resources are owned and controlled by the state (rather than individual citizens); under socialism, all citizens share equally in economic resources as allocated by a democratically-elected government.

<b>Communism vs. Socialism</b>		
<b>Attribute</b>	<b>Communism</b>	<b>Socialism</b>
Basic Philosophy	From each according to his ability, to each according to his needs.	From each according to his ability, to each according to his contribution.
Economy Planned By	Central government	Central government
Ownership of Economic Resources	All economic resources are publicly owned and controlled by the government. Individuals hold no personal property or assets.	Individuals own personal property but all industrial and production capacity is communally owned and managed by a democratically elected government.
Distribution of Economic Production	Production is intended to meet all basic human needs and is distributed to the people at no charge.	Production is intended to meet individual and societal needs and distributed according to individual ability and contribution.
Class Distinction	Class is abolished. The ability to earn more than other workers is almost nonexistent.	Classes exist but differences are diminished. It is possible for some people to earn more than others.
Religion	Religion is effectively abolished.	Freedom of religion is allowed.

### **Key Similarities**

Communism and socialism both grew out of grass-roots opposition to the exploitation of workers by wealthy businesses during the Industrial Revolution. Both assume that all goods and services will be produced by government-controlled institutions or collective organizations rather than by privately-owned businesses. In addition, the central government is mainly responsible for all aspects of economic planning, including matters of supply and demand.

### **Key Differences**

Under communism, the people are compensated or provided for based on their needs. In a pure communist society, the government provides most or all food, clothing, housing and other



necessities based on what it considers to be the needs of the people. Socialism is based on the premise the people will be compensated based on their level of individual contribution to the economy. Effort and innovation are thus rewarded under socialism.

## **2.5 Mixed Economy**

### **Concept and common features of a mixed economic system**

A mixed economy is defined by the co-existence of a public and private sector. The specific mix between public and private can vary significantly from one mixed economy to another, however. Based on their respective natures, the private sector is subservient to the public sector. Private exchange can only take place where the government has not forbidden it or already assumed that role.

Mixed economies fall in between free markets and command economies. The free market is most closely associated with pure capitalism. A command economy is most closely associated with socialism. Mixed economies, with state-supervised markets, are most related to fascism (in the economic sense) and have several common features.

### **Resource Ownership**

In a command economy, all resources are owned and controlled by the state. In a mixed system, though, private individuals are allowed to own and control some (if not most) of the factors of production. Free market economies allow private individuals to own and trade, voluntarily, all economic resources.

### **State Intervention**

Government intervention and political self-interest play a key role in a mixed economy. This intervention can take many forms, including subsidies, tariffs, prohibitions and redistributive policy.

Some of the most universally applied mixed economic policies include legal tender laws, monetary control by a central bank, public road and infrastructure projects, tariffs on foreign products in international trade and entitlement programs.

### **2.5.1 Changing Economic Policy**

One important and understated feature of a mixed economy is its tendency for reactionary and

purposeful economic policy changes. Unlike in a command economy (where economic policy is very often directly controlled by the state) or a market economy (market standards arise only out of spontaneous order), mixed economies can go through dramatic changes in the "rules of the game," so to speak.

This is because of the changing political pressures in most mixed economies. An example of this can be seen in the aftermath of the Great Recession when most governments moved to regulate tight control over financial markets and central banks lowered interest rates.

### **Coexistence of Public and Private Sector**

In a mixed economy, public and private sector work in parallel to each other. Usually, the public sector is responsible to provide transport, communication, defense, currency management, utilities like telephone, water, gas, electricity etc. All the other industries are in the ownership of private sector.

### **Government Regulation and Prices**

Unlike in Capitalism, Government intervenes in the market to regulate prices. Governments give subsidies to encourage production of necessities and their cheap availability to the poor masses. On the other hand, high tariff rates are imposed on luxuries with inelastic demand.

### **Government Regulation and Market Imperfection**

Government intervenes in industries where cartels are formed. It disallows cartels and regulates oligopoly, and monopoly. The government sometimes set a ceiling price for goods and services to put check on monopolies and reduce the burden of inflation on poor people.

### **Government Intervention and Income distribution**

Government intervenes to redistribute income through progressive taxes, setting ceiling prices for necessities and setting minimum wages. The government also provides tax holidays, tax credits, tax rebates and other concessions and incentives to promote a particular social activity, economic activity or socioeconomic class

### **Public Sector and Social Objectives**

Usually, the public sector is responsible to provide transport, communication, defense, currency management, utilities like telephone, water, gas, electricity etc. Government provides subsidies to public enterprises so that these enterprises do not increase their prices to cover their losses. Government sometimes bears losses to avoid public displeasure in the

form of inflation.

### **Promotion of Private Sector**

Even though the government intervenes in the hour of need, it still provides incentive to the private sector and a level playing field to compete with the public sector. In industries where, public sector and private sector coexist, government lets the market forces work and does not crowd out the private sector.

### **Deregulation, Liberalization and Privatization**

Governments in mixed economies encourage private sector to take on public sector enterprises that are not running efficiently or can be better run by the private sector. It enables the government to act as a regulator rather than a business entity.

## **2.5.2 Advantages of Mixed Economy**

- Producers and consumer have sovereignty to choose what to produce and what to consume but production and consumption of harmful goods and services may be stopped by the government.
- Social cost of business activities may be reduced by carrying out cost-benefit analysis by the government.
- As compared to Market economy, a mixed economy may have less income inequality due to the role played by the government.
- Monopolies may be existing but under close supervision of the government.

### **Critical Analysis of Mixed Economy**

Though Mixed economy has solved some of the problems in laissez-faire and Anarcho-Capitalism, but it still lacks an ethical foundation to foster social optimization and development at a grand scale i.e. to influence social and human development. Secondly, it has retained interest free financial system which has created at least two havocs i.e. one in East Asia in 1990s and the Great Recession since 2007 in the short two decade long post-Soviet Union era. Therefore, much of the criticism that is made on Capitalism holds true for Mixed economy as well.