

Chapter Two: Comparative Economic Systems

What is 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 sell 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.

Types of Economic Systems

There are four types of economic systems namely

- Capitalism or Private Enterprise Economy
- Socialism
- Communism
- Mixed Economy or Government and Private Sector

Capitalism

Because of the fact that there is scarcity of resources and unlimited wants, it is always a problem to allocate resources in an efficient manner. We are constantly facing three basic questions. These are:

- What to produce?
- How to produce?
- For whom do we produce?

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Main Characteristics of Capitalism

- Right to own property
- Profit motive
- Private ownership of means of production
- Consumer's sovereignty
- Economic freedom
- Social division of people
- Price mechanism

In a word we can say that

(i) 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.

(ii) The factors of production are privately owned and managed by individuals.

(iii) The main motive behind the working of the capitalist system is the profit motive. The entrepreneurs initiate production with a view to maximize profits.

(iv) Income is received in monetary form through the sale of services of the factors of production and from profits of private enterprise.

(v) 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.

(vi) 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.

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.

Advantages and Disadvantages of Capitalism

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

Disadvantages of Capitalism

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

What is 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.

Types of Socialism

- **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).
- **Libertarian Socialism** aims to create a society without political, economic or social **hierarchies**, in which every person would have **free, equal access** to tools of information and production.
- **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** (making adjustments as shortages and surpluses occur) rather than relying on a **free price mechanism**.
- The main features of socialism are:

- The means of production are collectively and socially owned and are not the property of private individuals as in capitalism.
- 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,
- The pricing process does not operate freely under the influence of market forces, but works under the control of the central planning authority,
- 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.

List of Advantages of Socialism

1. *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.

2. *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.

3. *It breaks down social barriers.*

4. *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.

5. *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.

6. *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.

7. No Labour Exploitation

There is only one class in a socialistic economy hence there is no question of exploitation. There are no concept of strikes and lock-outs. Everybody works in a well-knit family way.

8. Proper Utilization of Resources:

Under this economy, all types of natural resources are utilized in a most organized manner. Its main objective is to exploit these resources for the welfare of society.

9. No Wasteful Advertisement:

The government is virtually the owner of almost every sector. Hence, all the individual producers are also more according to the plan targets. Therefore, the competition among the producers is almost nil. Hence, very less money is spent on wasteful advertisement.

10. Proper Planning:

In order to solve various problems, which arise from time to time, there is proper economic plan in this type of economy. Thus, with the help of economic plans socialist economy will adopt the balanced development strategy.¹¹

11. No Cyclical Fluctuations:

Under socialist economy, no cyclical fluctuations are found. It means economy faces no boom, depression, unemployment or over production etc. Economic stability is maintained by the government on the basis of economic planning.

12. Social Welfare:

The aim of socialist economy is to maximize social welfare of the society. It provides equal opportunities of employment to all individual according to their abilities.

13.. Rapid Economic Development:

The Central Planning Authority is the main figure in a socialist economy. It coordinate the natural, human and physical resources to attain economic progress of the country. In turn it accelerates the path of tremendous progress and people enjoy higher standard of living.

14. Most Suitable to Developing Countries:

This type of economic system is most suitable to the needs of developing countries as all means of production are controlled by the government.

List of Disadvantages of Socialism

1. 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.

2. 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.

3. The government has too much control

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..

4. Absence of Price Mechanism and Misallocation of Resources

The guiding mechanism, allocation of resources between different uses will be made arbitrarily.

5. 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.

6. 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.

7. Loss of Liberty

One of the main dangers of socialism is that it not only curtails individual liberty but also take away freedom completely.

What are some 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 forbid 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.

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.

Advantages

- **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.

Islamic Economic System

Islamic economic system in its true sense is not present in any country. However, its salient features and important values can be discussed. It is a blend of natural features present in Capitalism i.e. right to private property, private pursuit of economic interest, use of market forces etc used along with some distinct features derived through Islamic economic teachings i.e. interest free economy, moral check on unbridled self-pursuit and provision of socio-economic justice to achieve the goals of Socialisms far as is naturally possible without denying individual freedom and incentives.

Fundamental Features of Islamic Economic Order

Some of the distinct features of an Islamic economic system are discussed below:

- Allah is the Sustainer
- Allah is Real Owner of Everything and Man is Merely a Trustee
- Everything Created for Service and Use of Man

- Concept of Halal and Haram
- System of Sadaqat and Zakat
- Prohibition of Interest
- Ban on Hoarding of Wealth
- Policy of Moderation
- Condemnation of Monasticism and Materialism
- Equity and not Equality