

## INTRODUCTION

In book one, we noted that the society faces many economic problems which arise as a result of limited and scarce resources available in relation to the society's numerous needs. In this chapter, we shall discuss the various ways through which the society organizes itself in order to solve most of its economic problems. These ways are often referred to as economic system.

## OBJECTIVES

At the end of this chapter, students should be able to:

- ◆ Provide the definition of an economic system;
- ◆ Explain the following types of economic system: capitalist or market, socialist or command, mixed economies;
- ◆ Explain the features of capitalist or market, socialist or command, mixed economies;
- ◆ Highlight the advantages of capitalist or market, socialist or command, mixed economies;
- ◆ Highlight the disadvantages of the capitalist, socialist and mixed economies.

### 8.1 Definition of an Economic System

An economic system can be defined as the system or pattern that a society adopts in solving its economic problems of how to make full use of its available resources, how to efficiently allocate these scarce resources among competing uses and how to maintain and expand it's capacity to produce goods and services every year.

### 8.2 Types of Economic Systems

In modern times, there are three main economic systems through which various societies can organize themselves in order to solve their basic economic problems. These include: capitalist or market oriented economy, socialist oriented economy and mixed economy.

#### 8.2.1 Capitalist or Market-Oriented Economy

This may be defined as an economic system in which private individuals are legally granted the right of ownership and the use of all productive resources and property including labour. We can also say that it is an economy in which all economic decisions relating to production, consumption and distribution are coordinated by the market or price mechanism (forces of demand and supply).

##### 8.2.1.1 Features of a Capitalist Economy

- i. There is private ownership and use of factors of production and wealth e.g. land, factories, machinery, estate etc.
- ii. Economic activities are carried out without any form of government intervention and under a pure competitive conditions.
- iii. Production is mainly on commercial basis, meant for sale in competitive markets and not for personal consumption or for subsistence.
- iv. The major aim of all producers is to maximize profits while the primary objective of all consumers is to maximize the satisfaction they derive from consuming various commodities.
- v. Factors of production and economic goods and services are allocated

and distributed among the various activities and uses by the forces of demand and supply.

- vi. Economic decision making is highly decentralized because it allows individual economic units (consumers and producers) take independent decisions, while market serves as the only coordinating mechanism.

### **8.2.1.2 Advantages of a Capitalist Economy**

- i. A capitalist economy promotes freedom of choice among different economic units. Producers are allowed to freely compete among themselves, and consumers are free to buy from producers of their choice or consume any commodity they deem fit for consumption.
- ii. The existence of competition in a capitalist economy promotes economic efficiency.
- iii. It offers the greatest incentive for hard work through the absence of government intervention.
- iv. The capitalist system promotes rapid economic growth by supporting the pursuit of self-interest.

### **8.2.1.3 Disadvantages of a Capitalist Economy**

- i. A capitalist economy encourages the exploitation of man by man as well as class struggle.
- ii. The system fails to deal with externalities in production and consumption. It does not, for example, settle the problem of air and water pollution arising from production activities of some firms.
- iii. There may be economic wastes arising from very severe competition among producers of similar commodities. These wastes may arise as a result of expensive advertising and under-pricing aimed at outselling rivals and new comers into the business.
- iv. The system may have difficulty in encouraging economic growth which does not emanate automatically from the price mechanism.
- v. Public goods and some desirable private goods may not be adequately produced because they are not profitable or inadequate to attract private entrepreneurs.
- vi. A capitalist economy is characterized by frequent class struggles and crises between the capitalists (i.e. owners of means of production) and the oppressed workers most of whom receives subsistence wages.

## **8.2.2 Socialist or Command Economy**

A socialist or command economy is essentially an economy where there is public ownership and use of the means of production and wealth. Example The Soviet Union (Russia).

### **8.2.2.1 Features of a Socialist Economy**

- i. There is collective ownership and uses of means of production.
- ii. This means that the state owns virtually everything such as land, capital, natural resources and business enterprise among others.
- iii. All decision concerning production is made by a highly organized bureaucracy or authority.
- iv. Output and income distribution in a socialist economy is based mainly on the law of distribution according to work done by each member of the society.
- v. All economic decisions are coordinated through planning matters than the market mechanism as in the case of capitalist economics.

### **8.2.2.2 Advantages of a Socialist Economy**

- A socialist economy is relatively more successful in terms of growth due

to the absence of inflation and unemployment.

- This is because price levels are determined largely by central planning authority and workers are employed by the state.
- Income is more equally distributed making the gap between the rich and the poor much narrower.
- Extreme exploitation of man by man is totally absent because extreme accumulation of wealth is reigned out due to state ownership of virtually all means of production.
- There is full utilization of scarce resources due to central planning.
- A socialist economy makes possible the elimination of waste arising from cut-throat competition among firms in different industries.
- A socialist economy is crisis free from an economic point of view due to the absence of class struggle as found between capitalist and workers.
- A socialist economy can also be judged to be relatively successful in term of stability and security.

### **8.2.2.3 Disadvantages of a Socialist Economy**

- i. The socialist system results in some restrictions on economic freedom.
- ii. The system is not efficient in allocation of resources because the central planning authority simply cannot know the varying amounts of additional satisfaction that an increasing number of products will provide.
- iii. A socialist economy does not offer adequate incentives that can encourage hard work.
- iv. The socialist system is characterized by frequent shortages of goods which leads to long queues and rationing among thousands of customers.
- v. Effective coordination of all types of decisions in a command economy requires a large number of bureaucrats of officials of various cadres. Apart from the inefficiency that results from bureaucratic set up, it may lead to wasteful use of labour resources.

## **8.2.3 Mixed Economy**

The combination of features of capitalist and those of socialism is called mixed economy. In mixed economy, the private ownership of means of production is combined with public ownership of means of production.

### **8.2.3.1 Features of a Mixed Economy**

- i. Private ownership of the means of production exists side by side with the public or state ownership of these resources.
- ii. Coordination of economic decisions is effected by means of both the market mechanism and government intervention and planning.
- iii. In a mixed economy, the decision as to what to produce, in what quantities, how and when to produce and for whom are taken both by the public and private sectors.

### **8.2.3.2 Advantages of a Mixed Economy**

- i. A mixed economy enables the government to provide socially desirable goods and services which private sector may either be unwilling or unable to provide e.g. electricity, water supply, good roads etc.
- ii. Government intervention in a mixed economy curbs excessive profits and exploitation.
- iii. The presence of government in the system usually solves the problems of externalities like air and water pollutions.

- iv. The system provides a wide range of commodities that may be produced in the economy as well as making greater freedom of choice by consumer.
- v. Government intervention will ensure maximum utilization of available scarce resources through the supply of skilled manpower.

### **8.2.3.3 Disadvantages of a Mixed Economy**

Substantial public sectors in most mixed economies lead to inefficiency and heavy expenditure because many government enterprises survive on hinge subsidies.

There is little or no incentive to hard work due to the absence of profit motive in the public sector.

It leads to many inefficient administrative controls and price distortions such as price control, import restrictions, wage fixing/freezing and foreign exchange control.

It leads to wasteful competition for scarce resources between the private and public sectors e.g. most state owned forms give preferential treatment to government than to the private sector.

The difference in incentives between the public and private sectors often leads to powerful private sectors and weak public sectors.

Excessive government interventions often lead to the formation of very powerful but inefficient state monopolies whose performances needs much to be desired.

## **Summary**

This chapter has discussed:

- i. An economic system or pattern that a society adopts in solving its economic problems of how to make full use of its available resources that are scarce.
- ii. The types of economic systems which are: Capitalist or market oriented economy, Socialist or Command Economy, and Mixed Economy. The features of these systems, advantages and disadvantages were also x-rayed.

## **Class Activity**

Students should visit the internet and find out if there are other economic systems that we have other than the ones examined in this textbook. They are to bring such findings to the class for further discussion in the class.

## **Revision Questions**

### **Objective Questions**

1. Mixed economic system combines the characteristics of both:
  - (a) planned and capitalist
  - (b) exchange and subsistence economies
  - (c) subsistence and planned economies
  - (d) capitalist and exchange economies (**SSCE 2006**)
2. The economy in which the state takes the economic decisions through detailed planning is:
  - (a) capitalism
  - (b) socialism
  - (c) traditional economic system
  - (d) mixed economic system (**SSCE 2006**)
3. An economic system where the central planning authority determines what goods to produce and in what quantity is known as a:

- (a) market economy**
- (b) socialist economy**
- (c) welfare economy**
- (d) traditional economy (SSCE 2009)**

4. The economic system which relies mainly on the price mechanism for the allocation of scarce resources is known as:

- (a) capitalist economic system**
- (b) command economic system**
- (c) combined economic system**
- (d) traditional economic system (SSCE 2009)**

5. In a capitalist economy, resources are:

- (a) collectively owned**
- (b) jointly owned**
- (c) privately owned**
- (d) communally owned (SSCE 2009)**

## Essay Questions

1. Explain comprehensively the differences between the mixed economy and the command economy.
2. Tabulate the features of the socialist and capitalist economy.
3. **(a)** What is a market economy? **(b)** Highlight the features of a market economy. **(SSCE 2002)**
4. **(a) (i)** What is an economic system? **(ii)** Outline any **four** features of a capitalist economy. **(SSCE 2006)**  
**(b)** Explain any **three** characteristics of a mixed economic system.  
**(c)** State **two** disadvantages of a mixed economic system. **(SSCE 2007)**

## Glossary

**Economic system:** It is the system or pattern that a society adopts in solving its economic problems of how to make full use of its available resources that are scarce.

**Capitalist or market oriented economy:** This is an economic system in which private individuals are legally granted the right of ownership and the use of all productive resources and property including labour.

**Socialist or Command Economy :** A socialist or command economy is essentially an economy where there is public ownership and use of the means of production and wealth.

**Mixed Economy:** The private ownership of means of production is combined with public ownership of means of production.