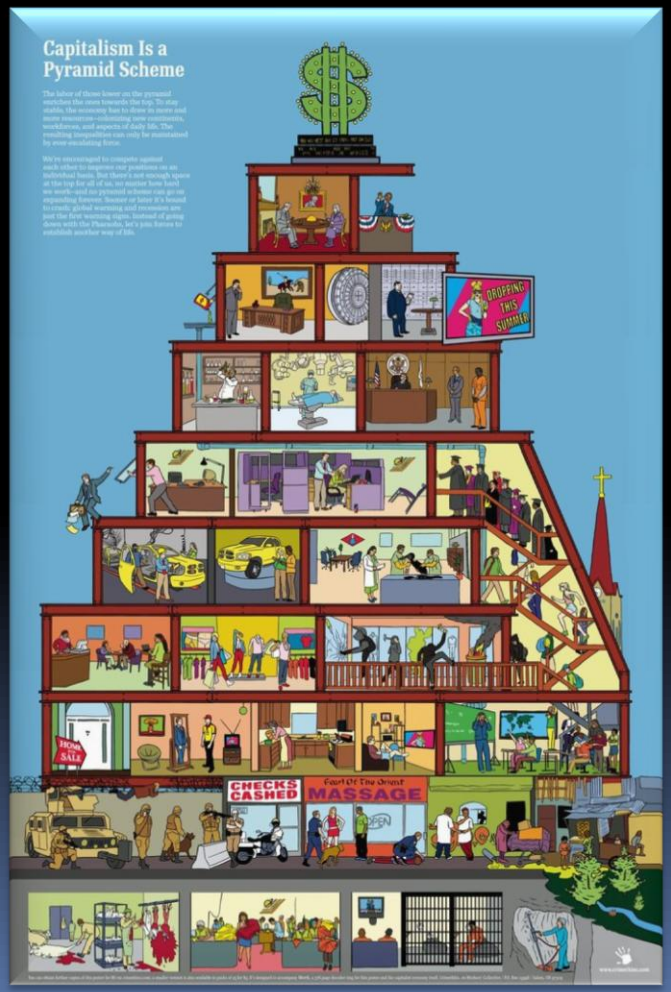
Just believe in yourself.
Even if you don't, pretend that you do and,
at some point, you will.
Venus Williams

TEST YOURSELF: ECONOMIES AND GROWTH

What is an economic system?

An economic system determines what goods are produced, how they are produced and for whom they are produced.

What are the basic types of economic systems?



The basic types of economic systems are:

- Traditional – a system that answers the what, how and for whom questions the way they have always been answered. There is little friction among members because relatively little is disputed but it restricts individual initiative and lacks advanced goods, new technology and growth.
- Command – a system that answers the basic questions by central authority. Its pyramidal structure means that economic changes can occur very quickly and social welfare can be enhanced but decision makers have the power to be wrong, and the quality and variety of goods suffer.

Continued

- Market – a system that answers the basic questions via the free market. It provides a wide variety of goods and services that buyers and sellers exchange at the lowest prices but there can be problems – a lack of competition, externalities, a lack of public goods and income inequality.
- Mixed – a system that answers the basic questions through some mixture of traditional, command and market systems.

Continued

- Capitalism – a system characterized by private ownership of resources and markets. No nation in the world precisely fits the criteria for capitalism, but the US comes close.
- Communism – a stateless, classless system in which the factors of production are owned by everyone and who share in accordance with their needs. In *The Communist Manifesto* (1848) and *Das Kapital* (1867-1885), Karl Marx's criticism of capitalism advanced the idea of communism.

Continued

- Socialism – a system characterized by government ownership of resources, centralized decision making, public ownership and centralization. It provides for an equitable distribution of income, the possibility of rapid growth and full employment but it can be inefficient and stifle growth.

Graphic: Command Economy Pyramid

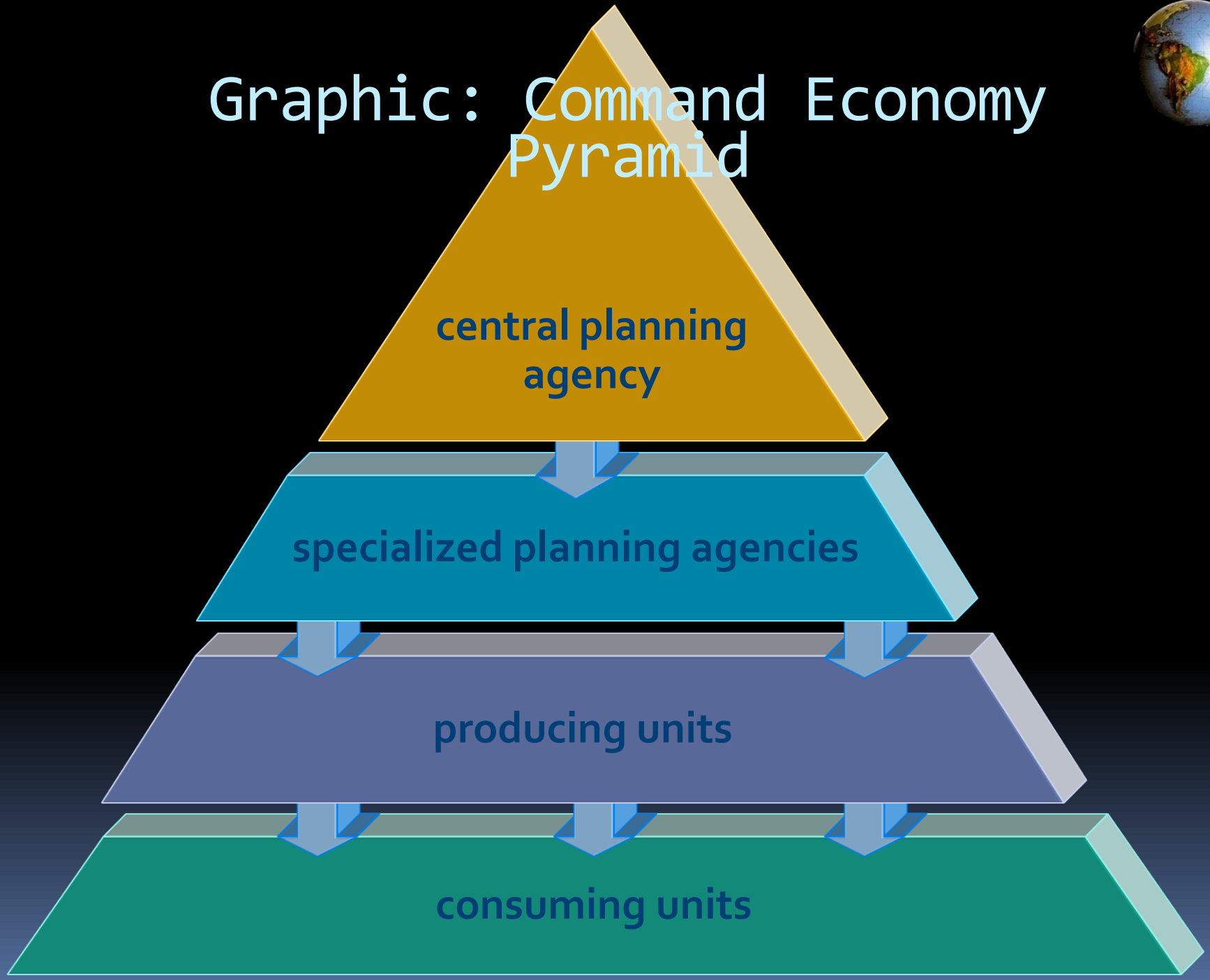
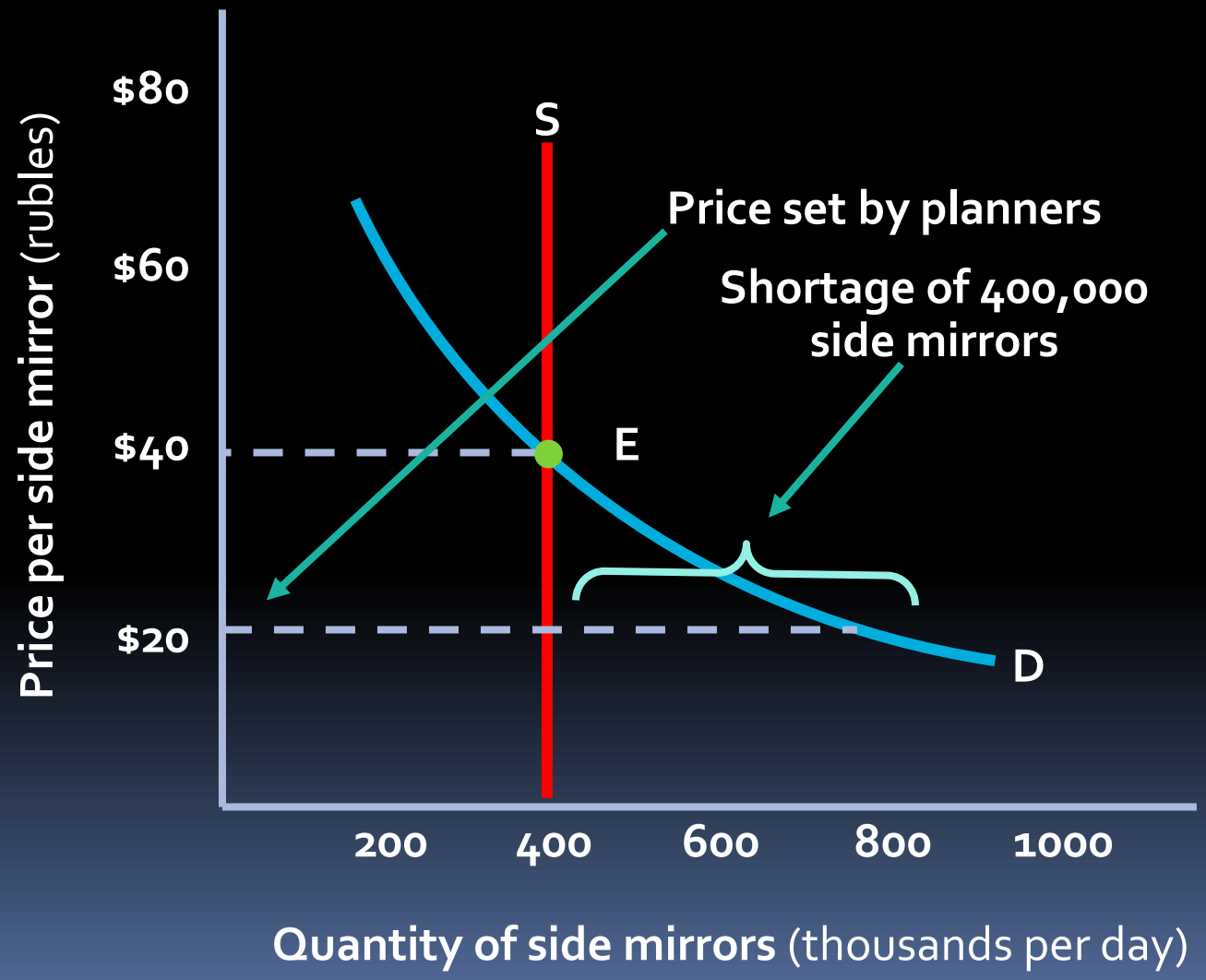


Chart: Central Planners Fix Prices Below Equilibrium



What is the *invisible hand*?

Adam Smith, the father of modern economics and who wrote *The Wealth of Nations* in 1776, believed that a market economy acts like an invisible hand.

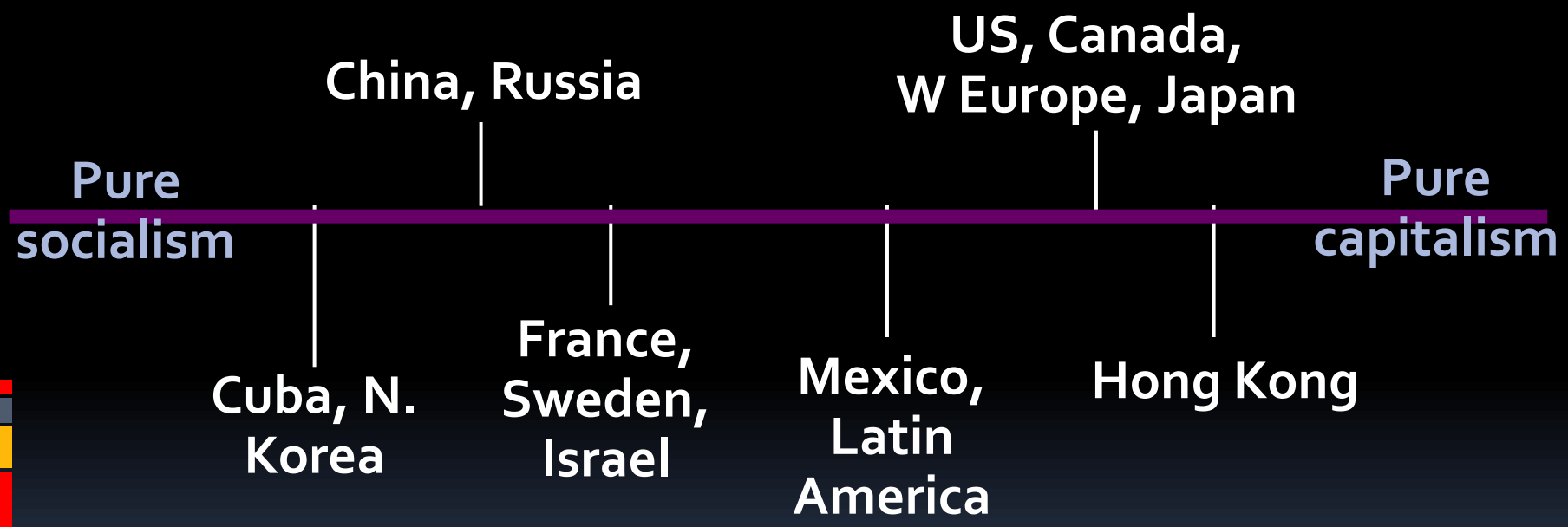
In doing so, the best interests of a society are served because individuals are allowed to act in accordance with their own self-interest.

self-interest + competition = invisible hand

What is consumer sovereignty?

Consumer sovereignty is the freedom of consumers to cast their dollar votes to buy or not to buy, at prices determined in competitive markets.

Graphic: A Classification of Economic Systems



What is one way to compare the well-being of one country to another?

One way to compare the well-being of one country to another is to compare the Gross Domestic Product (GDP) per capita of each country.

GDP per capita is the monetary value of all the finished goods and services produced within a country's borders in a specific time period (usually one year) divided by the country's total population.

There are some problems in comparing GDPs, such as measurement errors (especially with LDCs), income distribution, fluctuations in exchange rates and differences in living standards. However, GDP per capita does correlate with other quality-of-life measures.

What are industrially advanced countries (IACs)?

IACs are high-income nations that have market economies with technologically advanced capital and well-educated labor.

Current IACs are:

the United States

Canada

Australia

New Zealand

Japan

most of the countries of Western Europe

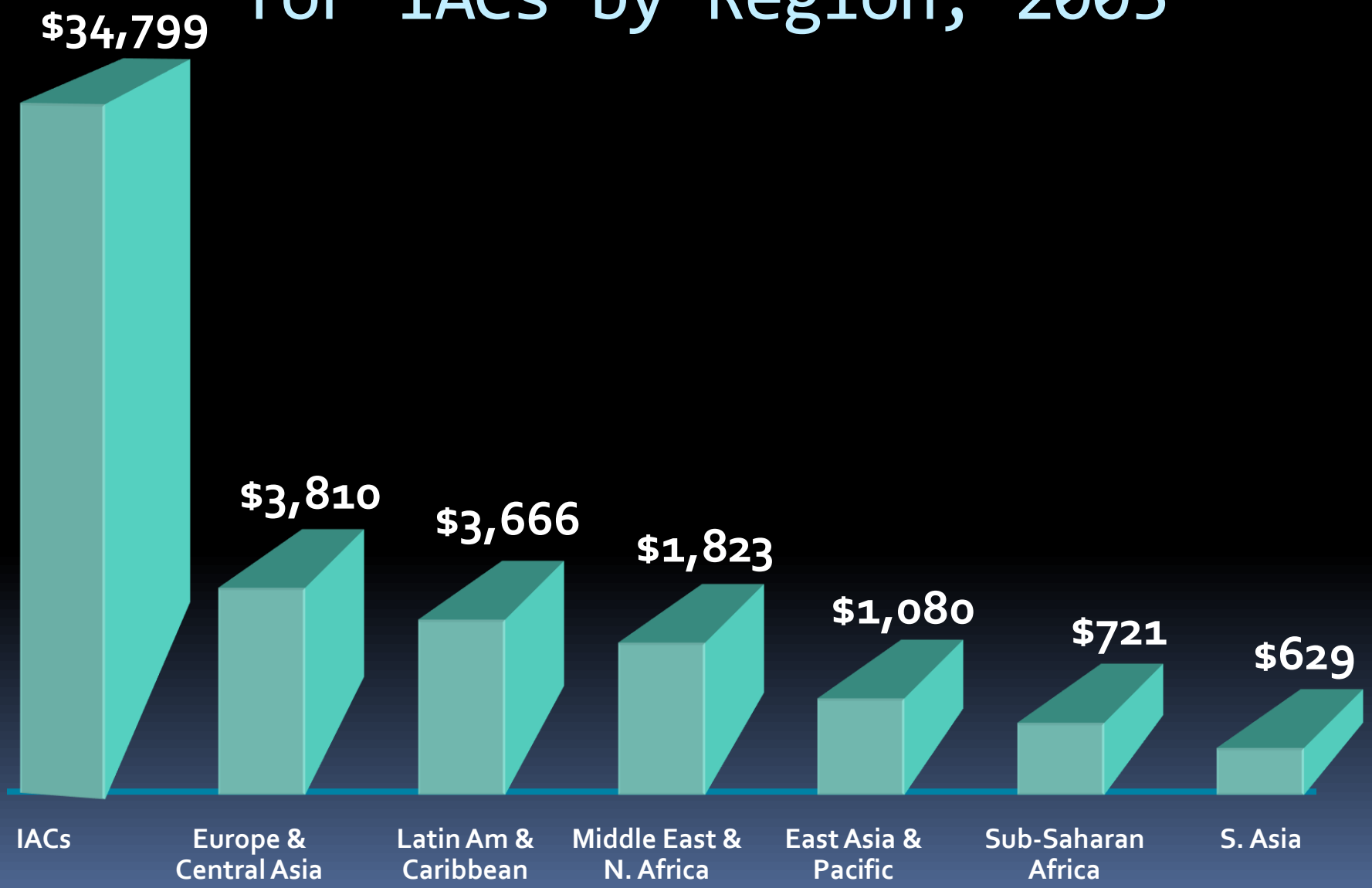
What are less-developed countries (LDCs)?

LDCs are countries whose economies are based on agriculture and which are lacking in technology, advanced capital and well-educated labor.

Most of the countries of Africa, Asia and Latin America are LDCs.

LDCs find themselves in a vicious cycle of poverty … a trap in which countries are poor because they cannot afford to save and invest, but they cannot save and invest because they are poor.

Graphic: Average GDP per Capita for IACs by Region, 2005



What are quality of life indicators?

GDP per capita is essentially an economic measure of well-being but there are also non-economic measures. Individual quality of life indicators include life expectancy, adult literacy, daily calorie supply, energy consumption per capita and others.

There have been numerous attempts in recent decades to formulate composite indices of progress to supplement or supplant GDP, including UNDP's Human Development Index (HDI), the Index of Sustainable Economic Welfare (ISEW), the Genuine Progress Indicator (GPI), Environmentally Sustainable National Income (eSNI), Sustainable Development Indicators (SDI), National Accounts of Well-being (NAW) and others. The most recent is the Human Economic Welfare Index (HEWI).

Graphic: Human Economic Welfare Index

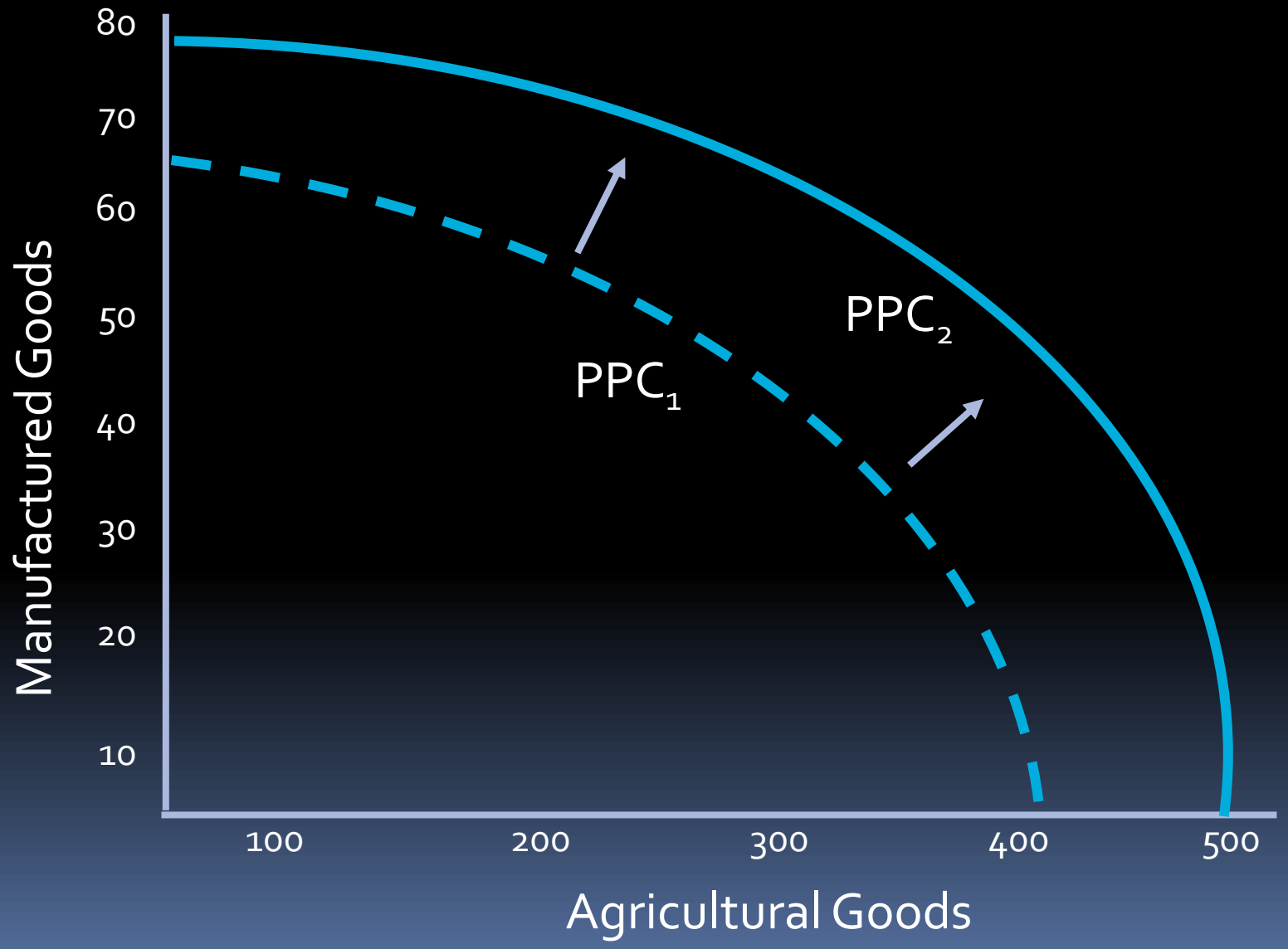
http://www.cadmusjournal.org/node/11#HEWI

What factors come together to produce a country’s economic growth?

There is no single strategy for economic growth and development but some of the factors that contribute to a country's economic growth include:

- natural resources – presence doesn't ensure growth (Africa) and absence doesn't prohibit it (Japan) but they can help
- investment in capital – difficult since developing countries have little to invest
- investment in human capital – education, health, training
- low population growth – absolutely essential
- infrastructure - capital goods usually provided by the government, including highways, bridges, waste and water systems, and airports
- political factors - law and order, international trade, provision of infrastructure

Chart: Economic Growth



What is foreign aid?

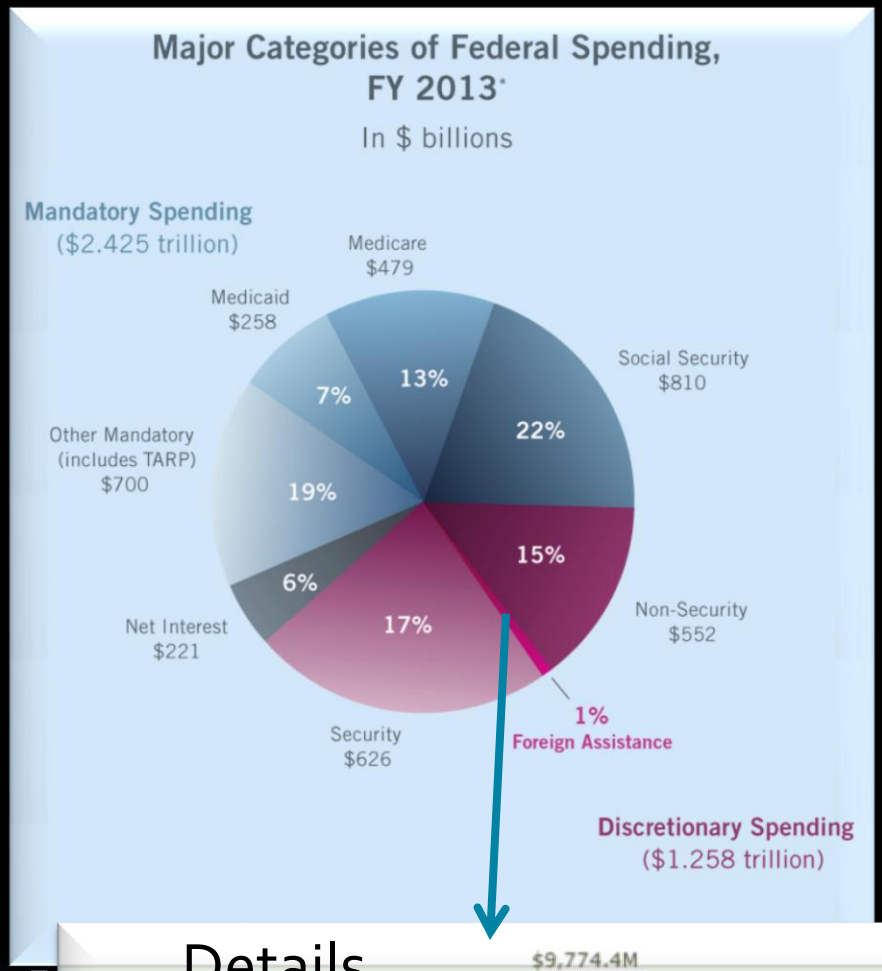
Foreign aid is the transfer of money or resources from one government to another for which no repayment is required.

Contrary to popular belief, less than 1% of the US budget goes toward foreign aid. (If you count military assistance as foreign aid, it increases to 1.4%.)

How Does Foreign Aid Work?

Foreign Aid Around the World

Graphic: US Foreign Assistance by Sector, 2013



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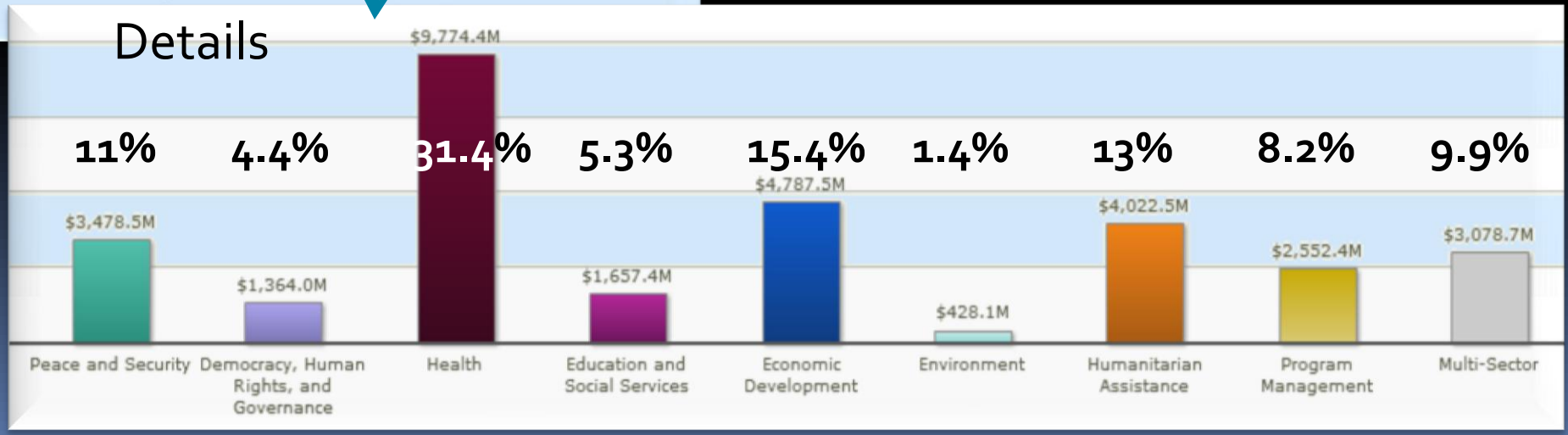
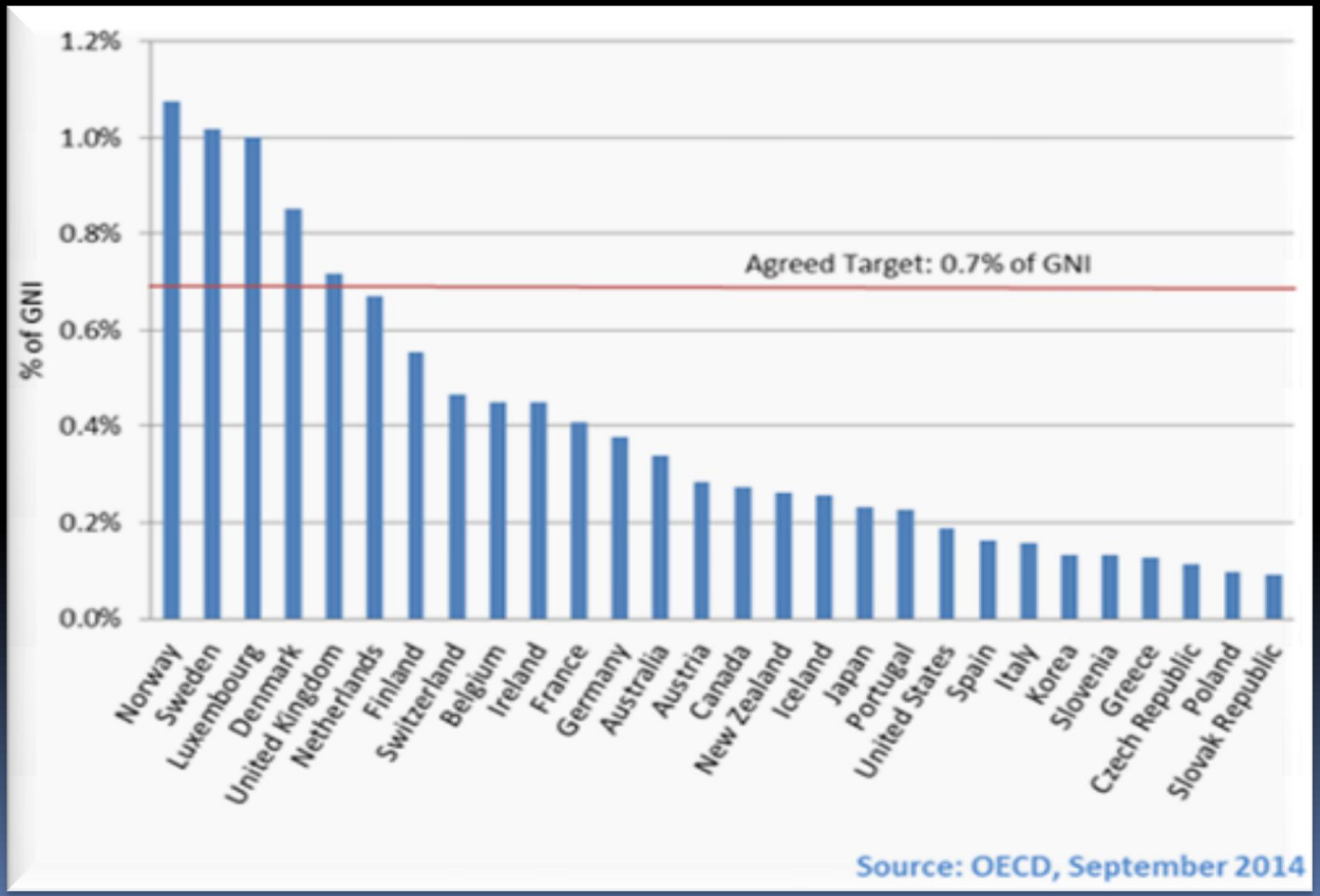


Chart: Foreign Aid as a Percent of GNI by Country, 2013



Who are some of the international actors in the area of foreign aid and development?

International Actors in the Area of Foreign Aid and Development

- The Agency for International Development (AID) is the agency of the US State Department that is in charge of US aid to foreign countries.
- The World Bank is the lending agency that makes long-term low-interest loans and provides technical assistance to less-developed countries.
- The International Monetary Fund (IMF) is the lending agency that makes short-term conditional low-interest loans to developing countries.

continued

- The New International Economic Order (NIEO) is a series of proposals made by LDCs calling for changes that would accelerate the economic growth and development of the LDCs.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