I. INTRODUCTION TO COMPARATIVE ECONOMIC SYSTEMS

- Not long ago, the world was divided into two seemingly monolithic systems - the socialist and the capitalist worlds. We even referred to first (capitalist), second (socialist), and third (developing) worlds. Now, everything has changed.

- What we have left is one of the greatest economic experiments in history. Formerly socialist economies are transitioning into market economies, and we get to observe (and occasionally participate in) the construction of economic systems from the ground up, to learn how economic systems really work.

- What we are learning is that economic principles really matter, that incentive matters and markets work, and that everything is so much more complicated than we had believed. Change is slow and difficult, information is limited, economic institutions and behaviors evolve slowly, and everything in a modern economy is dependent on everything else.

- This field, comparative economic systems, is also evolving. Not long ago it focused on studying the comparative performance of socialism vs. capitalism. But that is becoming less relevant. Now, we are focusing on the diversity of institutions and systems even among the capitalist economies, the process of economic reform and transition, and the emergence of new alternatives.
A. The Classification of Economic Systems

How do you classify economic systems?

1. Ownership (Marx), property, individual rights (Kennett)
   - Private, state, or common ownership
   - Three aspects of property rights:
     - right of control, of transfer, to residual income
   - Private rights are never total; zoning laws, for example, prevent
     many uses of private property, and taxes limit residual income.

2. Coordinating mechanism:
   - Including information (collection and dissemination) system
   - Planned vs. market economy

3. Organization of decision-making:
   - Hierarchy, politics, institutions, firm structure, culture...
   - Are economic decisions centralized or decentralized?

4. Incentive structure is important:
   - Material, coercive, or and/or moral

5. Objectives:
   - Efficiency, fairness or equity, state power
   - Mao's China had revolution as an end in itself
   - Others (Friedman) might argue that free enterprise
     (or consumer sovereignty) is a goal, not just a
     means to an end.

Bornstein's approach is similar, and based on five questions:

1) Who makes the ultimate decisions?
2) What are the goals and objectives?
3) What are the institutions (relatively fundamental arrangements,
   formal and informal)?
4) What are the instruments (e.g., government policies that are
   relatively easy to change)?
5) What is the pattern of resource allocation and distribution?
Potential combinations:
- two possible outcomes: $2^5 = 32$
- three possible outcomes: $3^5 = 243$

If economies are systems, many of these characteristics go together as part of a system.

Difference between political party/system and economic system.

- Marx’s definition of capitalism.
- Kornai’s definition of socialism.
- What is communism? - economic and political systems.
- All economies are mixed, and we have to consider the predominance of a characteristic, not its mere presence.
- How do we classify the U.S., Sweden, the United Kingdom, Nazi Germany, China, Russia, or the Soviet Union?

Institutions and Rules

- Kennett argues that an economy may be characterized by its rules and institutions:
- Rules include the legal system, rules and procedures within organizations, custom, culture, and tradition.
- Institutions include households, government and its agencies, firms and enterprises, labor organizations, and NGOs
- Also includes “markets” themselves

Questions

1. What are the different characteristics by which we might classify economic systems?
2. According to Kennett, what are the major institutions of an economic system?
3. According to Marx, what makes an economy capitalist?
4. According to Kornai, what makes an economy socialist?