

CHAPTER

18

# Comparative Economic Systems

## Economics & You



The freedom to use your own tools and labor in pursuit of profits is one of the primary features of capitalism. In Chapter 18, you will learn that capitalism is more than an ideology. It is the way we live and the way the world is headed. To learn more about the different systems of economics, view the Chapter 25 video lesson:

**Comparative Economic Systems**

**ECONOMICS**  
*Online*



**Chapter Overview** Visit the *Economics: Principles and Practices* Web site at [epp.glencoe.com](http://epp.glencoe.com) and click on *Chapter 18—Chapter Overviews* to preview chapter information.

**CLICK HERE**

This scene of the city of Jaipur in northwest India shows a blend of traditional and modern life.

**CONTENTS**

# The Spectrum of Economic Systems

## Study Guide

### Main Idea

Capitalism, socialism, and communism are historically three popular economic systems.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below by listing six advantages of capitalism and providing an example of each.

Capitalism	
Advantages	Examples

### Key Terms

capitalism, socialism, communism

### Objectives

After studying this section, you will be able to:

1. **Explain** the advantages and disadvantages of capitalism.
2. **Describe** the differences among the doctrines of socialism, capitalism, and communism.
3. **Compare** the features of communism to other types of economic systems.

### Applying Economic Concepts

**Surplus Value** Have you ever felt that the value of your work was much more than your wage? If so, you have something in common with Karl Marx, who founded communism and introduced the concept of surplus value that is extracted from labor.

## Cover Story

### Sweden Pays the Price of High Taxes

STOCKHOLM—Electrolux AB, the big Swedish appliance maker, scoured the globe for a person to set up a new data-processing division last year before finding Stephan Carlquist, a Swede and senior executive at ABB Asea Brown Boveri in the United States.

Persuading him to jump to Electrolux was no problem, but bringing him to Sweden, home of the industrialized world's highest tax rates, was another matter. Instead, Mr. Carlquist set up shop in London, where taxes are lighter. . . .

Over the next year, he plans to build a multinational team of as many as 50 people—few of them Swedes. . . . “It’s very hard to attract skilled, international people to Sweden.” Mr. Carlquist said.

—*International Herald Tribune*, March 16, 1999




Stephan Carlquist

Throughout most of the 1900s, the world’s developed nations fell into three categories of economic systems—communism, socialism, and capitalism. Communist countries were closely associated with command economies, capitalist countries were most similar to market economies, and socialist countries had a combination of both command and market economies. Sweden is an example of a country with a strong socialist tradition, and—as you read in the cover story—the high taxes that go along with it.

The three basic types of economic systems are shown in **Figure 18.1**. At the far left is communism, in which a strong central government influences almost every economic decision. At the far right is capitalism, in which government has a limited role. As one moves from left to right along the spectrum, both the ownership of resources and the degree of government involvement in the operation of the economy change.

No lines separate communism, socialism, and capitalism. They appear on the spectrum as having a greater or lesser degree of government involvement and private ownership of resources.

## Capitalism

 Under **capitalism**, the means of production are privately owned. Supply and demand determine prices, and businesses are free to direct resources into activities that promise the greatest profits.

### Advantages of Capitalism

One of the main advantages is efficiency. If there are many buyers and sellers, if resources are reasonably mobile, and if buyers and sellers are reasonably well informed, then resources will be directed to their most profitable and efficient use.

Another advantage is freedom, which gives consumers the opportunity to purchase the goods and services that best satisfy their preferences. Producers also have the freedom to direct productive resources into activities that consumers demand most. Producers have the incentive to do so because of the profit motive, and because private property rights allow them to keep the fruits of their efforts.

A third advantage is that capitalism is highly decentralized. Consumers and producers jointly answer the WHAT, HOW, and FOR WHOM questions all societies face. This is made possible because of the price system, which sends signals to both producers and consumers. The decentralized nature of decision making leads to the fourth advantage. Specifically, the role of government in the economy is much smaller.

The fifth advantage is the high degree of consumer satisfaction that comes from the variety of products that are produced to satisfy consumer demands. The sixth advantage is the flexibility to accommodate change. When consumer preferences change, or when the price of resources changes, signals are sent through the price system and everyone adjusts accordingly.

The most visible result of these advantages is the enormous amount of wealth that capitalist nations have accumulated. With few exceptions,


the countries that have the highest living standards and per-capita incomes today are ones with market-based capitalist economies.

### Disadvantages of Capitalism

Capitalism has its disadvantages. Although it is efficient in satisfying the demands of consumers, it does not always satisfy everyone's needs. At a collective level, capitalism ignores the production of many public goods such as roads, public schools, a system of justice, and national defense. Instead, the market produces private goods and services—items that can be withheld if people refuse to pay for them.

At an individual level, capitalism produces only for those who have demand, which means the ability and willingness to pay. A system of pure capitalism would ignore poor people, the unemployed, and less productive members of society like the elderly.

## Socialism

 **Socialism** is an economic system in which government owns and runs some of the basic productive resources in order to distribute output in ways deemed to be in the best interest of society. Most socialist societies are democracies in which elected officials direct the allocation of resources in key industries.

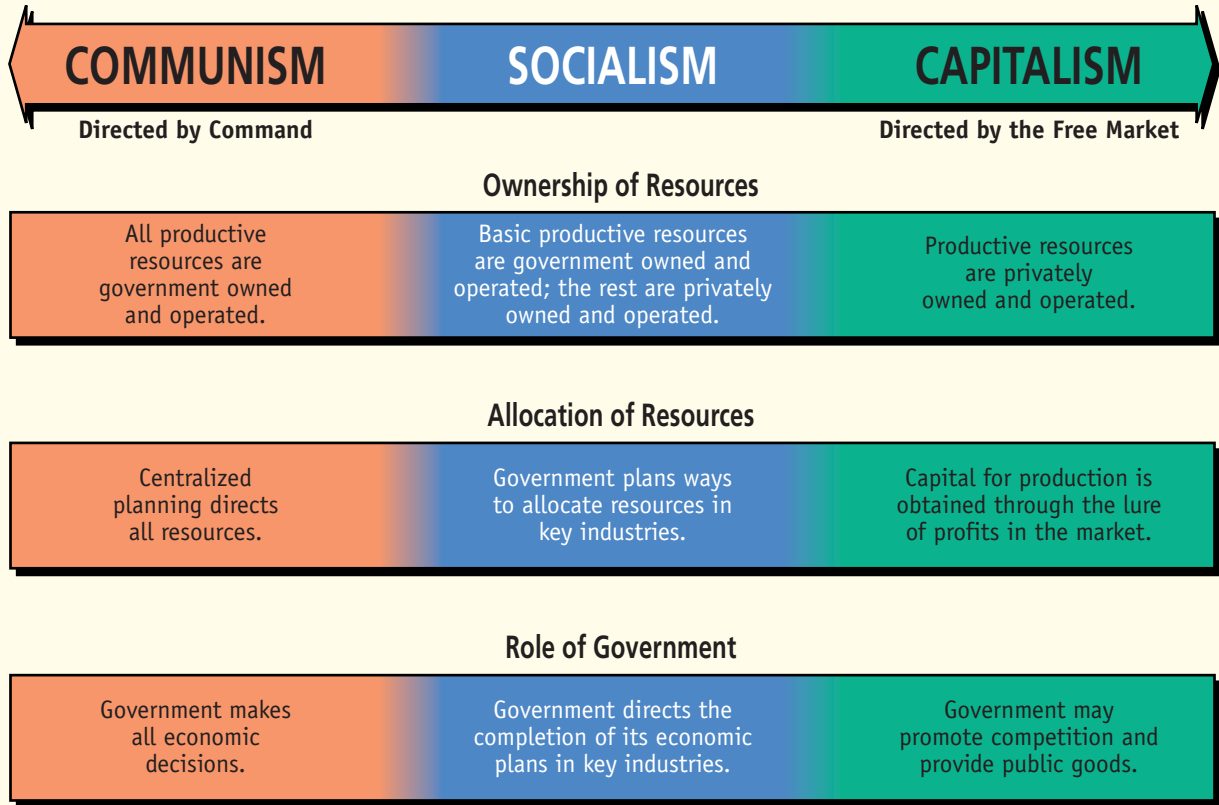
### Advantages of Socialism

Socialism addresses the FOR WHOM question directly. Those who are not fortunate or productive enough to earn a competitive income still share in the benefits of society. Although the government owns the majority of productive resources in a socialist society, people use their electoral power to influence many of the WHAT, HOW, and FOR WHOM questions.

### Disadvantages of Socialism

Socialism is normally less efficient than capitalism. If workers receive government guarantees of jobs, more workers will be hired than are necessary, driving up the cost of production. The

## The Spectrum of Economic Systems



**Using Charts** The distinguishing feature of economic systems is the ownership of the factors of production and the role of government in deciding **WHAT, HOW, and FOR WHOM** to produce. **How is capital for production acquired under capitalism?**

government also has an incentive to keep these workers employed—even if they are not all needed—to show that the government is providing jobs for everyone.

Because the government provides a broader range of services such as health care, education, and welfare, taxes are generally higher in socialist countries. This often causes the type of labor mobility problems discussed in the cover story—where workers may be reluctant to work in countries with such high taxes.

### Communism



In its purest form, **communism** is a political and an economic framework where all property is collectively owned, labor is organized for the common advantage of the community, and everyone consumes according to their needs.

To date, no modern country has achieved the ideal of pure communism. Countries such as Cuba, North Korea, and the former Soviet Union instead developed rigid command-type economies where

the state—usually represented by a single authoritarian party—claims the ideal of pure communism as its eventual goal.

## Advantages of Communism

One of the main advantages of communism, from the typical worker’s point of view, is that of equality. Because everyone is theoretically equal, the wages of workers from the assembly line in the factory to the surgeon in the hospital are nearly identical.

To make up for the lack of purchasing power, the state provides a broad range of public goods such as health care, transportation, education, and a military defense system. These services are normally supplied at little or no cost.

A third advantage is the lack of uncertainty concerning careers and job security. This is because the state directs workers into their jobs, and workers are not fired or dismissed as they could be in other societies.

A fourth advantage is that the centralized control allows the economy to shift directions in a relatively short period of time. In the case of the former Soviet Union, the entire economy changed from a relatively underdeveloped agrarian nation

to an advanced industrial one in the course of a few short decades.

## Disadvantages of Communism

One of the first disadvantages of communism is that individual freedom is lost. People have little or no say in their jobs, and economic planners determine even the choice of occupation.

Communism also lacks effective incentives that encourage people to work hard. Most people receive the same pay regardless of how hard they work.

Communism generally fails to meet the needs and wants of consumers, primarily because the WHAT to produce question is determined by central planners. Most communist states place a high priority on military preparedness, resulting in the neglect of consumer goods that are highly prized in other parts of the world.

One of the biggest drawbacks to communism is the inefficiency of centralized planning. The resources needed to execute the planning, and the overwhelming obstacles to effective execution, are serious problems that countries encounter after reaching a certain size. Finally, communist economies, like most command economies, lack the flexibility to deal with day-to-day changes.

### Section 1 Assessment

#### Checking for Understanding

- 1. Main Idea** Identify the three broad economic systems of the last century.
- 2. Key Terms** Define capitalism, socialism, communism.
- 3. List** the advantages and disadvantages of capitalism.
- 4. Explain** how capitalism, socialism, and communism are different.
- 5. Describe** how communism differs from other types of economic systems.

#### Applying Economic Concepts

- 6. Surplus Value** According to Karl Marx, employers take advantage of their employees

by paying them less than they are worth in order to make a larger profit. Do you think Marx’s opinion is valid in the United States today? Why or why not?

#### Critical Thinking

- 7. Making Comparisons** How does the role of the individual differ under capitalism, socialism, and communism? Explain your reasoning.
- 8. Finding the Main Idea** What people does pure capitalism tend to ignore? Explain why this is the case.



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

# TECHNOLOGY

## Skill

### Using a Database

A computerized database program can help you organize and manage a large amount of information. After entering data in a database table, you can quickly locate the information according to key words.

#### Learning the Skill

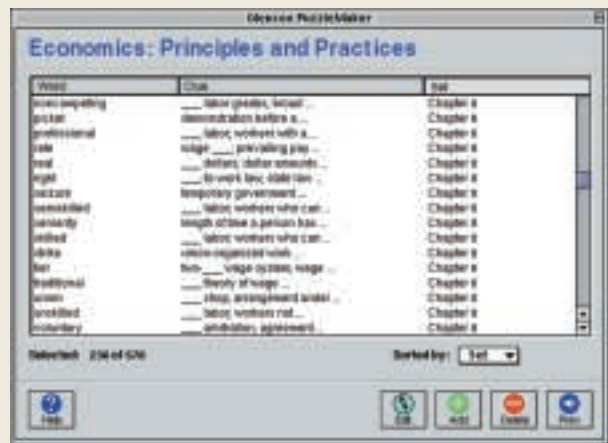
An electronic database is a collection of facts that are stored in a file on the computer. The information is organized into categories called *fields*. For example, one field may be the names of your clients. Another field may be the street addresses of your clients. All the related fields make up a record. Together, all the records make up the database.

A database can be organized and reorganized in any way that is useful to you. By using a database management system (DBMS)—or special software developed for record keeping—you can easily add, delete, change, or update information. When you want to retrieve information, the computer searches the files, finds the information, and displays it on the screen.

#### Practicing the Skill

Follow these steps to build a database on economic reform in China.

1. Determine what facts you want to include in your database and research to collect that information.



Using a database can help organize population statistics, clients' names and addresses, and even baseball card collections.

2. Follow the instructions in the DBMS that you're using to set up fields. Then enter each item of data in its assigned field.
3. Determine how you want to organize the facts in the database—chronologically by the date, alphabetically, or by some other category.
4. Follow the instructions in your computer program to sort the information in order of importance.
5. Verify that all the information in your database is correct. If necessary, add, delete, or change information or fields.

#### Application Activity

Research and build a database that organizes information about U.S. trade with countries in Asia. Explain why the database is organized the way it is and how it might be used in this class.

# The Rise and Fall of Communism

## Study Guide

### Main Idea

Communism is an economic system that has both centralized control of the means of production and of the political system.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below by explaining how the economic system in the former Soviet Union answered the basic economic questions.



### Key Terms

Five-Year Plan, collectivization, Gosplan, state farm, collective farm, piecework, storming, perestroika

### Objectives

After studying this section, you will be able to:

1. **Explain** the rise of the Soviet economy under Lenin and Stalin.
2. **Describe** the complexities of a centrally planned economy.
3. **Understand** the forces that brought about the collapse of communism as an economic system.

### Applying Economic Concepts

**Perestroika** Have you ever thought that some aspects of the economy should be changed from top to bottom? If so, read to find out more about perestroika, which is the Russian term for “restructuring.”

## Cover Story

### Kiev to Pay Russian Debts with Bombers

Russia has agreed to accept bomber aircraft as payment for part of Ukraine's huge debt to Russia for natural gas . . .



Blackjack bomber

Ukraine owes Russia \$1.8bn according to Russian figures and \$1bn according to Ukrainian figures . . . Russia has agreed to take eight Tu-160 Blackjack bombers in payment from Ukraine.

Ukraine typically pays for gas in barter, with nominal prices set at around three times the market price for the goods . . . [but] Ukraine and Russia are constantly at loggerheads over gas debts.

Russia in the past has shut off gas supplies in Ukraine due to non-payment, but Ukraine has then simply stolen Russian gas bound for Europe instead. All of Russia's gas exports to Europe travel through Ukrainian pipelines.

—The Financial Times, August 9, 1999

In the absence of pure communism, the former Soviet Union is the most frequently cited example of a communist economic system. The early Soviet economy showed the main advantage of a command system—that it could mobilize resources and change direction in a short period of time. The sudden disintegration of the Soviet economy in the late 1980s, however, demonstrated the essential flaws of communism.

## The Economy Under Lenin and Stalin

In 1917 a revolutionary named Vladimir Ilyich Ulyanov, or Lenin, overthrew the government of Russia. In its place, he set up a communist government. Lenin was a strong believer in theoretical communism, and he quickly took steps to develop a communist society. Large estates were taken from the rich, and the land was divided up and given to the peasants. Lenin also outlawed private property and turned the country's few factories over to the workers.

The workers, however, did not have the skills to manage the factories. Before long, production fell and the economy began to disintegrate. People lost faith in the money supply, and a system of barter emerged. The government sent armed forces to the farms to confiscate surplus food for the hungry city dwellers and industrial workers. The angry farmers retaliated by reducing their production so there would be no surplus crops.

By 1927, many changes had taken place. Russia had become the Soviet Union, and the country was under Communist Party control. Lenin had died, and Joseph Stalin was the new leader. Stalin wanted to transform the Soviet economy from agriculture to industry.

To accomplish this goal, he introduced the government's first **Five-Year Plan**—a comprehensive, centralized economic plan designed to achieve rapid industrialization.

Under Stalin's leadership, the process of **collectivization**—the forced common ownership of all agricultural, industrial, and trading enterprises—began. Not surprisingly, many people opposed the reforms. Peasants even destroyed their livestock and sabotaged their equipment rather than turn their property over to the collective farms.

Stalin's retaliation was brutal. Millions of people were killed or imprisoned. Ukrainian grain stores were seized in the winter of 1932, causing the starvation of more than five million peasants. The suffering in the cities was nearly as harsh. Workers were forced to work in heavy industry, and the standard of living deteriorated drastically.

Although the first Five-Year Plan did not achieve all of its goals, the government continued with more planning. The plans that followed concentrated heavily on defense industries, heavy manufacturing, and some consumer goods.

## The Soviet Economy After Stalin



Stalin's brutal regime ended in 1953. By then the Soviet economy had successfully completed its transition from a backward agrarian economy to a major industrial power. The Soviet government and its comprehensive system of

planning dominated the Soviet economy, but the real force was the ruling Communist Party.

## Complexities of Central Planning

In the Soviet economy, the **Gosplan** was the central planning authority that devised the Five-Year Plans. As the Soviet economy grew, however, this process became increasingly complex.

Consider the difficulties in a single industry such as shoes. First, the planners have to decide how many shoes should be produced in any given year. This amount would depend on the population and the number of pairs that each person, on average, would need. The planners would then have to decide how many pairs to make of each style, including colors, sizes, and widths.

Next, the various sizes, grades, and amounts of leather, dye, metal eyelets, thread, glue, and other materials needed to produce the shoes had to be estimated. After the central planners developed this data, individual factories were given monthly and annual quotas. Even a factory that produced thread would be told how much thread of every diameter and color to produce for use in shoes.

Similar decisions had to be made for all industries, including clothing, farm implements, stationery, and military goods. The planners detailed everything that would be needed in the economy right down to nails and paper clips. Even these minor items required the planners to make estimates of iron ore, coal, coke, blast furnaces, mining equipment, trains, and ore cars.

To ensure the growth of the economy from one year to the next, all the planners had to do—or so they thought—was to increase the quotas given to the factories. In short, the central planners determined almost everything beforehand.

## Difficulties With Agriculture


The situation was similar in agriculture, where food was raised on state, collective, and peasant farms. The **state farms** were large farms entirely owned and operated by the state. Workers on the state farms were paid for the number of items they produced. All output was turned over to the government at prices fixed by the government.



Peasant families worked **collective farms**, small private farms collected into large units for joint operation. The land, buildings, tools, livestock, and machines belonged to the government, which bought a certain amount of produce per acre. Peasant families were allowed to keep their homes and household goods, and a small plot of land.

Despite its efforts, the government was not able to make agriculture as efficient as that of many capitalist countries. In the mid-1980s, before the collapse of the Soviet Union, nearly 25 percent of the workforce was in agriculture. In the United States at the time, only 3 percent of the workforce was in agriculture.

## The Soviet Economy Collapses

 The Soviet Union made considerable progress with industrialization, but it never caught up to the United States. Despite its larger population and land area, the Soviet Union's GNP never exceeded two-thirds of that of the United States.

To offset low morale in the factories, a number of incentive programs were attempted. One involved the use of **piecework**, meaning that workers are paid for each piece of output they produce rather than for the number of hours they work.

Although this system may seem like a good idea, piecework quotas often were set at unrealistically high levels. This led to **storming**, the practice of rushing production at the end of the month to make up for the slower pace at the beginning of the month. The rush at the end often affected the quality of the products. Because of storming, knowledgeable Soviet shoppers often avoided buying goods made at the end of the month.

Other incentives included patriotic and emotional appeals. Workers who had outstanding records or did something special were awarded hero medals, such as the Order of Lenin and the Hero of Social Labor. Some of these medals brought rewards such as free public housing or vacations.

## Production Quotas

As with incentives, quotas also failed at the factory level. During the 1950s, the Soviet economy had a reputation for producing some of the world's poorest consumer and industrial goods. Shoe factories, for example, were given quotas in terms of millions of pairs of shoes. Because small shoes could be made fastest, more were made than were needed. When the quotas were changed to measure production in the amount of shoe leather consumed, the result was shoes with some of the thickest soles in the world.

## Production of Consumer Goods

Another major problem was the inadequate supply of consumer goods. After World War II, the Soviet people were asked to make sacrifices so their children might have a better life. Many willingly did so. In the 1970s and 1980s, those children were adults. When they were asked to make sacrifices so their children could have a better life, they were not as willing as their parents had been. The new generation had not suffered from the ravages of war and they were aware of the standards of living in other parts of the world. As a result, they were impatient for more consumer goods.

## Careers



### Customs Inspector

Do you like detailed work? Are you able to accept responsibility and deal with people in a firm but friendly manner?

#### The Work

Customs inspectors are part of the Treasury Department. Duties include examining baggage at airports or seaports to ensure that all merchandise is declared and that duties are paid. Commercial and noncommercial cargoes are inspected to determine admissibility and the amount of tax due.

#### Qualifications

Customs inspectors need training in laws governing imports and exports and in inspection procedures. A college degree is preferred. Passage of a civil service exam is required.

## Perestroika

When Mikhail Gorbachev assumed power in 1985, the Soviet economy was weaker than anyone imagined. The main cause was the burden imposed by centralized planning. The economy had become too complex and too large to be managed in the traditional manner.

Plant managers were under increasing pressure to meet or exceed quotas. Glitches in planning, however, were creating shortages and other problems. To facilitate the process, “fixers” called *tolkachi* were employed to resolve shortages or dispose of excess inventories. The *tolkachi* soon became indispensable to producers who wanted to fulfill their quotas. At the same time, they also caused problems for other plants whenever they rerouted a shipment or otherwise interrupted the master plan of the central planners.

To solve these problems, Gorbachev introduced a policy of **perestroika**, the fundamental restructuring of the economy and government. Under the restructuring, Five-Year Plans were retained, but the various ministries of production were to be converted to efficient, state-owned enterprises that would compete in a market economy. Plant managers were given more freedom to

buy and sell in pursuit of profits, and small business was encouraged.

Perestroika represented a halfway point between a market economy and centralized planning. Gorbachev, however, did not remain in power long enough to see his plans realized. Those in industry who opposed Gorbachev’s reforms allowed shortages and other problems to persist, and then used these problems as proof that the reforms were failing. Gorbachev’s successor, Boris Yeltsin, faced similar opposition. Ultimately, the collapse of the economy, the collapse of the political leadership, and the stresses of ethnic diversity and unrest combined to cause the downfall and breakup of the Soviet Union.

### Did you know?

**Frozen Treasures** Siberia covers 75 percent of Russia. It has the largest supply of mineral resources in the country, including gold, diamonds, and coal. Siberia remains mostly undeveloped because of its harsh climate and few transportation routes.

## Section 2 Assessment

### Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 496, describe how the former Soviet Union’s economic system functioned.
- 2. Key Terms** Define Five-Year Plan, collectivization, Gosplan, state farm, collective farm, piecework, storming, perestroika.
- 3. Explain** how the Soviet economy developed under Lenin and Stalin.
- 4. Identify** several complexities of central planning.
- 5. Describe** how central planning contributed to the breakdown of the economy of the Soviet Union.

### Applying Economic Concepts

- 6. Perestroika** Since the mid-1980s, the former Soviet Union has undergone tremendous changes, some of which led to hyperinflation. Why would this hyperinflation hinder the movement toward capitalism?

### Critical Thinking

- 7. Making Predictions** Based upon recent changes, is the former Soviet Union moving toward capitalism or away from capitalism? Give evidence to support your conclusions.
- 8. Summarizing Information** What did Soviet planners think they had to do to ensure economic growth?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

# Profiles IN Economics

## Reshaping the World: Karl Marx

(1818–1883)

Marx was an economic historian and a social scientist. He earned his doctorate in philosophy and history from the University of Berlin, but because of his radical views, he could not get a teaching position.

Throughout the 1840s, he wandered from Cologne to Paris to Brussels. He joined with socialist and radical groups. Persecuted by Prussian and Parisian authorities, Marx fled to London in 1849 where he began a life of exile and, eventually, died in poverty.

### MARX'S WORKS

Marx is best known for *The Communist Manifesto*, published in 1848, and *Das Kapital*, the first volume of which was published in 1867. In these works, Marx argues that “the history of all hitherto existing society is the history of class struggles.” In each era, one class was pitted against another: master against slave, lord against serf, capitalist against worker—the “oppressor and oppressed.”

### HIS IDEAS

Marx argued that the oppressed of his day was the proletariat—people who must work for others

because they have no means of production of their own. Their oppressors? The capitalists or bourgeoisie—people who own the means of production.

Marx argued that labor was exploited in a capitalist society. He gave the name “surplus value” to the difference between the wage paid to the worker and the market value of the worker’s output. He believed this value was unfairly kept by capitalists as profits.

Marx argued that each cycle of prosperity would add to the suffering of the proletariat and the wealth and power of the capitalists. Eventually, he said, oppressed workers would rise up in a violent revolution. “Let the ruling classes tremble at a communist revolution,” he wrote. “The proletarians have nothing to lose but their chains. They have a world to win. Working men of all countries, unite!” During the transition, the

Workers of  
the

World

UNITE!

proletariat would, Marx argued, have to depend on a strong government: a “Dictatorship of the Proletariat.” Thus, authoritarian Communism as practiced in the Soviet Union and other countries was born.

Marx believed that eventually the dictatorship would be replaced by a “classless society,” without government, in which people would produce to the best of their abilities and consume to the extent of their needs.

### Examining the Profile

- 1. Analyzing Information** According to Marx, through what stages must society go before it can reach the ideal state of communism?
- 2. For Further Research** Annotate a world map to show the extent of Marxist economies in the world today.

# The Transition to Capitalism

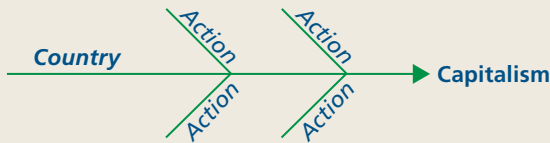
## Study Guide

### Main Idea

Reforms in the former Soviet Union, China, and many Latin American and eastern European nations have moved these economies toward more capitalistic, market-oriented systems.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below by selecting a country and describing how it is making the transition to capitalism.



### Key Terms

privatization, Solidarity, black market, Great Leap Forward

### Objectives

After studying this section, you will be able to:

1. **List** four problems encountered when an economy makes the transition to capitalism.
2. **Recognize** the major countries and regions that are making the transition to capitalism.

### Applying Economic Concepts

**Privatization** Do you value and take care of the things you own? Read to see why private ownership is essential if countries are to make the transition to capitalism.

## Cover Story

### Rubles From the Ruins: A Russian Success

NIZHNY NOVGOROD, Russia—In general, the Russian economy is a mess: Industrial production is half what it was in 1991, the transition to a market economy has gone badly, the ruble has collapsed, and many giant enterprises are in desperate straits, unemployment and poverty are ubiquitous.

And yet, some Russian businesses are actually making money, some are thriving. . . .

Although criminals and corrupt government officials frustrate entrepreneurs all over the country, some manage to evade or ignore them. The experiences of the few who are succeeding provide some powerful lessons in why that hope remains so remote.

Consider the adventures of Andrei Mladentsev. . . .




Russian currency

—*International Herald Tribune*, July 20, 1999

**A**ndrei Mladentsev, the Russian entrepreneur featured in the cover story, now runs one of the largest and most modern pharmaceutical companies in Russia. At age 26 he used the funds he accumulated trading stocks to engineer a takeover of the 75-year-old pharmaceutical factory in Nizhny Novgorod. He is, however, the exception rather than the norm—as the problems of transition are truly daunting.

### Problems of Transition

 Historically, communism and capitalism have been viewed as two opposing political and economic structures. The collapse of communism, however, does not mean that the transition to capitalism will be smooth, or that it will be made at all. An examination of the problems of transition will show why.

### Privatization

A key feature of capitalism is private property—especially capital, which is sometimes referred to as the means of production. Because communist

governments owned the means of production, **privatization**, or the conversion of state-owned factories and property to private ownership, has to be accomplished. Privatization is important because people tend to take better care of the property they actually own. Private property is also important for entrepreneurial activity, especially if the entrepreneurs are allowed to keep the fruits of their labor.

In Poland, Hungary, and the Czech Republic, this transition was accomplished using vouchers. Vouchers were certificates either given to people or sold at very low prices, depending on the country. As the vouchers were distributed, the government drew up a list of companies to be privatized and then organized the companies as corporations. The corporate shares were auctioned, and people would bid for the shares using their vouchers for payment. As people exchanged their vouchers for shares, ownership of the previously state-owned enterprises transferred to private hands.

In other cases, the transition governments simply sold state-owned companies to foreign corporations. The government then used the funds to


pay other bills or make other purchases. These transactions bypassed the citizens and transferred ownership to foreign investors.

### Loss of Political Power

Under communism, the Communist party was the ruling class. The transition to capitalism stripped the Communist party of its political power and transferred it to the new class of entrepreneurs and capitalists.

In countries where the Communists were literally thrown out—as in Poland, Czechoslovakia, and Hungary—the Communist leaders lost their power before industry was privatized. In these countries, the voucher system worked reasonably well.

In other countries, former Communist leaders grabbed a large share of vouchers, and thus a large portion of ownership in many privatized companies. In the most blatant cases, some of which occurred in Russia following the collapse of the Soviet Union, the ownership of companies was simply transferred to politicians who were influential during the transition period. Former political



## THE GLOBAL ECONOMY

Rank	City, Country	Projected Population (in millions)
1	Tokyo, Japan	28.88
2	Bombay (Mumbai), India	26.22
3	Lagos, Nigeria	24.64
4	São Paulo, Brazil	20.32
5	Mexico City, Mexico	19.18
6	Shanghai, China	17.97
7	New York, New York USA	17.60
8	Calcutta, India	17.31
9	Delhi, India	16.86
10	Beijing, China	15.57

### THE WORLD'S LARGEST CITIES BY 2015

Most of the world's population lives in urban areas. Projections show that this trend will continue. Today's five largest cities are more populous than most countries. Cities are rapidly becoming the key economic units of global market analysis.

**Critical Thinking**

1. **Categorizing Information** How many cities are projected to surpass 20 million in population by the year 2015?
2. **Understanding Cause and Effect** What do you think are the economic reasons that the largest cities continue to grow?

Source: *The Shape of Things to Come*, by Richard W. Oliver, McGraw-Hill, 1999



leaders traded their political power for economic power in the form of resource ownership—so that the old ruling group simply became the new ruling group.

## The Discipline of Capitalism

Many countries that desire a capitalist structure have focused on the benefits to be obtained, not the costs. However, the costs can hinder or even discourage a country from making the transition.

The disadvantages of capitalism made apparent during the Great Depression included instability, unemployment, and social unrest. At that time, the United States did not have the fiscal policies, the automatic stabilizers, and the social welfare nets needed to lessen the devastation of the Depression. Now that such assistance exists, most economists agree that another Great Depression will not occur in the United States.

The same cannot be said for the nations in transition. They have not yet developed the automatic stabilizers and the social welfare nets that cushion the instabilities of capitalism. During the transition phase, nations will most likely experience the instabilities of early capitalism—the unemployment, the inflation, and the lost production—long before they experience the benefits.

## Responding to New Incentives

Finally, countries that make the transition to capitalism have to learn to live with a whole new set of incentives. For generations, the government in the former Soviet Union told its people what to do. Under capitalism, people must learn how to make decisions on their own. They must learn how to take the initiative, how to interpret prices, and how to fend for themselves because the government no longer guarantees their jobs, nor does it keep prices artificially low.


These adjustments will be enormous, perhaps even prohibitive, for some people. Many will even long for the past when life was simpler. These people may not want to go through the adjustments and submit to the discipline of capitalism. Impatience for the end result may be a major obstacle to the transition.

## New and Emerging Stock Markets

NUMBER OF LISTED COMPANIES		NUMBER OF LISTED COMPANIES	
Country		Country	
Argentina	138	Morocco	48
Brazil	543	Nigeria	180
Chile	296	Pakistan	778
China	763	Peru	247
Colombia	163	Philippines	222
Egypt	668	Poland	159
Greece	231	Portugal	143
Honduras	111	Russia	222
Hungary	50	South Korea	776
India	5,853	Sri Lanka	240
Indonesia	287	Taiwan	408
Israel	648	Thailand	431
Jamaica	46	Turkey	262
Malaysia	722	Venezuela	91
Mexico	198	Zimbabwe	64

Source: *Emerging Stock Markets Factbook*, 1998

**Using Charts** New and emerging stock markets are now found all over the world, and more are still to come. **Why is the corporate form of organization a necessary component of capitalism?**



Visit [epp.glencoe.com](http://epp.glencoe.com) and click on **Textbook Updates—Chapter 18** for an update of the data.

**CLICK HERE**

## Countries and Regions in Transition



Despite the transitional problems, the rise of capitalism is one of the most remarkable phenomena of the late twentieth century. Today, nations and regions all over the globe are making the transition.

## Russia

Privatization in Russia is well underway, despite the continued resistance of hard-liners. Some privatization took place under Gorbachev, and President Boris Yeltsin accelerated the process when he signed a 1992 decree requiring that state-owned enterprises be converted to privately owned ones.

Many conversions took place when the government printed and distributed vouchers to its people. The people then used the vouchers to purchase shares of stock in the newly converted companies.

Smaller businesses were also being privatized at a rapid rate. Soon more than half of the restaurants and shops in the major cities were in private hands. Eventually Russia opened a stock market so that individuals could buy and sell shares. The widespread ownership of the means of production

by individuals is now a reality in a country that once preached the evils of private ownership.

## Eastern Europe

The nations of eastern Europe, especially those that were unwilling members of the Soviet bloc, are the newest nations to embrace capitalism. The struggle for freedom began in Poland with **Solidarity**, the independent and sometimes illegal union that Lech Walesa established in 1980. Solidarity was influential in securing a number of political freedoms in Poland. Eventually, the Communist party lost power, and interest in capitalism grew. Political reform slowed privatization plans at first, but capitalism finally appeared to be under way again in the face of progress by Poland's neighbors.

Hungary is another country well on the way to capitalism. Hungary was often regarded as the most

# CYBERNOMICS SPOTLIGHT

## An Emerging Latin American Market

*Historically, the economies of most Latin American countries depended on agriculture. Beginning in the mid-nineteenth century, these Latin American economies began to change. Countries exported raw materials, such as oil, so that they could import machinery to build factories for manufacturing goods. As a result of the growth of the manufacturing sector, service industries such as banking and insurance took on new importance. An educated middle class emerged, consisting of lawyers, doctors, entrepreneurs, government employees, and skilled office and factory workers.*

*As Latin America moves into the twenty-first century, economies in the region are changing once again. Technology is affecting how business is done. Many groups in Latin America see e-commerce as a means to becoming more economically efficient and competitive.*

**Internet Users in Latin America** Consumers, businesses, and governments are beginning to see the value of Internet commerce. Online supermarkets and retail



Changes in Latin America's business

shopping are becoming more popular with consumers. Technology is being developed in Brazil to develop an online-only grocery store, where consumers will be able to purchase products such as soap and oatmeal using a catalog and a bar-code scanner. Businesses use the Internet to link their factories with suppliers to cut costs. They can track product shipments and check on the status of an invoice. The government is also beginning to post government contracts online so that public and private companies can bid on them. Companies can get information about competing bids and contest decisions using the Internet.

“western” of the Eastern bloc countries. It also had a flourishing **black market**—a market in which entrepreneurs and merchants sold goods illegally. Hungary’s experience with these markets helped ease the transition to capitalism.

The Czech Republic is another country in transition. By early 1998, more than 60 percent of the economy was in private hands. Progress accelerated after the separation of the Czech and Slovak Republics, a separation based in part on the Slovakian concern about adopting the capitalist ways of the West. The Czechs, who were strongly influenced by the economic success of the former West Germany, are now more able to pursue reforms.

The Baltic states of Estonia, Latvia, and Lithuania are also making great strides toward capitalism. Latvia and Lithuania have their own stock markets to help facilitate the transition. Estonia has made so

much progress that it—along with the Czech Republic, Hungary, and Poland—will be considered for membership in the European Union between 2002 and 2006.

## Latin America

In the past, many Latin American countries followed a path of economic development that combined socialism and isolationism based on the infant industries argument. Mexico accelerated the move to capitalism and open markets in 1989 as it made plans to restructure its economy for the North American Free Trade Agreement (NAFTA). Under President Salinas de Gortari, the government sold thousands of state-owned companies and cut back on the government bureaucracy.

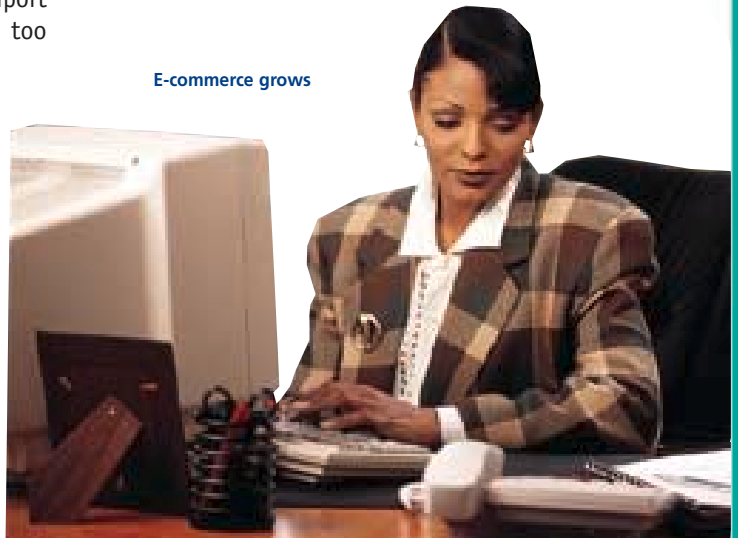
### Did You Know?

**On The Net** Even though fewer people in Latin America have access to the Internet than in the United States, those who use it spend more time online. Latin American Internet users spend about 8.2 hours online a week, compared with 7.1 hours in the United States.

**Getting Online** Several problems are hindering the growth of e-commerce in Latin America. Only one in ten people have a phone line. Because the average gross domestic product per capita is less than \$4,000, the ability to buy a personal computer and get online is out of reach for many people. Few people in Latin America use credit cards; many are reluctant to give out credit card numbers online. Custom regulations and import duties can delay the arrival of goods or make them too expensive to buy.

Industry experts agree that these problems will be less troublesome in the future. It is expected that within a period of five to seven years the number of phone lines will double, to two per 10 people. Personal computer prices are expected to fall as the number of sales increases. Smart cards are becoming more popular, giving consumers a better sense of security for buying online. Internet companies are beginning to inform shoppers at the time of purchase how much they will owe for duties and other taxes, and it is expected that tariffs will be removed as more countries form regional trading blocs.

E-commerce grows





## Economic Change



**Retreat From Socialism** Once state-owned, many companies in Mexico are now under private ownership. *How is Argentina reducing the role of government in the economy?*

Chile has also taken major steps to foster the growth of capitalism. It has privatized airlines, telephone services, and utilities. Chile even used the billions deposited in its pension funds to supply capital to new entrepreneurs. As a result, the country exports copper, lumber, fruit, and even software to the rest of the world. Chile's markets include the United States, which imports millions of popsicle sticks, and Japan, which imports chopsticks.

Argentina has similarly embarked on a crash program to remove government from the everyday business of running the economy. The country has sold oil fields, petrochemical plants, and a number of other formerly state-owned businesses.

## China

The People's Republic of China became a communist economy in 1949. That year, the Chinese Communists, under the leadership of Mao Zedong, gained control of the country. Over the years, China modeled itself after the Soviet Union, adopting a series of Five-Year Plans to manage its growth.

In 1958 the **Great Leap Forward** was instituted. This was the second Five-Year Plan that tried to

institute a system of pure communism along with an industrial and agricultural revolution almost overnight. Industrialization was pushed and, at the same time, collectivization of agriculture was intensified. Farmers were forced off their land and made to live and work on large, state-owned farms.

The Great Leap Forward was a disaster. The agricultural experiment failed, and the economy never came close to achieving the planned degree of industrialization. Even the gains made during the first Five-Year Plan were lost.

Other plans followed but, by the late 1970s, the government decided that the country no longer could follow the models of either the Soviet Union or other command-type economies. China and its population were too big for large-scale centralized planning. Industrializing the cities enough to provide jobs for nearly one-fourth of the world's population would be nearly impossible.

By the early 1980s, the influence of other successful market economies in Asia—Taiwan, South Korea, Hong Kong, and Singapore—was too much for China to ignore. One of China's provinces,

## Privatization



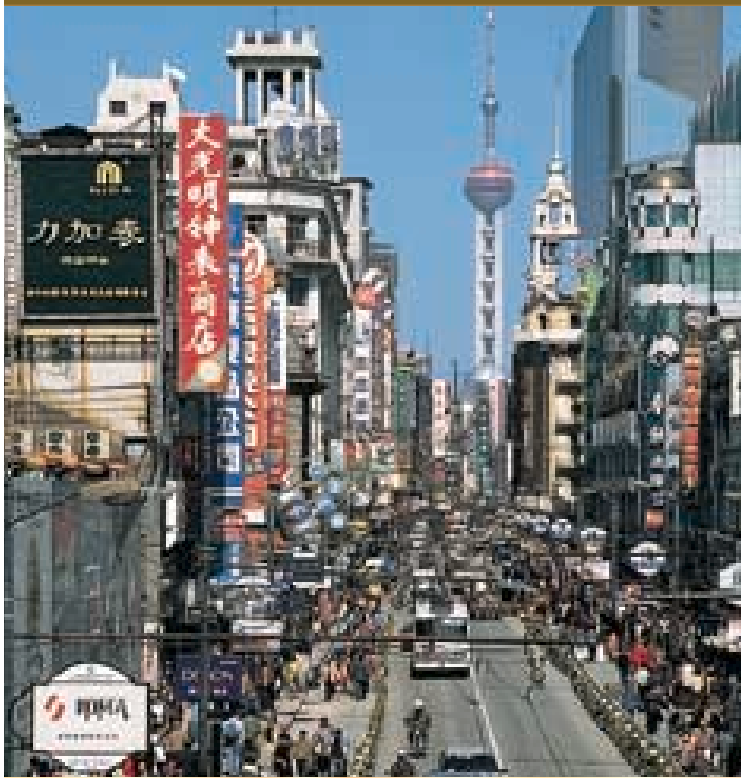
**Changes in Chile** Chile has privatized telephone services and airlines. *What is Chile hoping to accomplish through privatization?*

the Guangdong Province just north of Hong Kong, copied many of the free market practices of the region and was even allowed to officially experiment with capitalism. At one time Guangdong was an embarrassment to the official communist dogma, but it was later touted as an economic role model for the rest of the nation.

China was also influenced by the eventual reunification with Hong Kong, which took place in 1997. The city of Shanghai, in particular, embarked on a program of reforms and expansion in an attempt to become China's "first city" after the reunification.

Today China is no longer experimenting with capitalism. It is instead privatizing industries, introducing market reforms, and otherwise acting in a decidedly capitalistic manner. China still has a long way to go, and the government still directs most major economic activity. Its economy has evolved, however, into what former President Jiang Zemin once called "socialism with Chinese characteristics"—loosely translated as free market capitalism.

## Reform and Expansion



**Shanghai** Reform has resulted in strong economic growth for China. *Why did China stray from centralized planning?*

### Section 3 Assessment

#### Checking for Understanding

1. **Main Idea** What is privatization? Describe two ways in which transition economies handled privatization.
2. **Key Terms** Define privatization, Solidarity, black market, Great Leap Forward.
3. **List** the problems a country is likely to encounter when converting to capitalism.
4. **Identify** two major countries that are making the transition to capitalism.
5. **Trace** the economic policy changes in China.

#### Applying Economic Concepts

6. **Privatization** Explain why capital stock and other property is expected to last longer when it is privatized rather than collectively owned.

#### Critical Thinking

7. **Finding the Main Idea** Suppose you are visiting one nation in eastern Europe adopting a market economy. What questions would you ask local officials to determine whether they are successfully moving toward capitalism?



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# BusinessWeek

AUGUST 2, 1999

Newsclip

*In 1949, communist forces won the civil war in China. The communists then established absolute control over the government and the economy. Today, however, technology is reshaping the communist state.*

## China's Web Masters

Anyone who assumes the Internet is still a novelty in China has been asleep at the mouse. The communist giant's state-owned factories and political system may seem frozen in another era. But when it comes to cyberindustry, China is moving at net speed. Driven by soaring computer sales, rapid expansion of China's telecom networks, and the encouragement of reformist leaders, Internet use is growing explosively. . . .

The impact will be revolutionary, both on China's economy and society. A new class of entrepreneur is emerging because the government is allowing the private sector wide latitude to develop Web business—remarkable for an industry Beijing regards as strategic. The rapid spread of e-commerce could transform China's stodgy retail and banking sectors. It may also boost efficiency of Chinese industry by allowing old-line factories to streamline supply chains. . . .

To encourage development of Chinese content, Beijing makes it surprisingly easy for foreign companies. While they cannot own equity in mainland telecom operators, they can own majority control



of Net companies. And although Beijing guards its monopoly on traditional media, it lets entrepreneurs publish on the Web. . . .

. . . The government limits what Chinese Net users can see by telling them to block portals run by dissident and human-rights groups. Determined surfers can go through offshore services. But because Beijing prohibits imported encryption technology, state snoops can easily eavesdrop on traffic. . . .

The Net's success could breed its own problems. As it grows more lucrative, bureaucrats may not be able to keep their hands off. Beijing is usually happy to accept foreigners' investment dollars at first. Then it often changes the rules to the advantage of state-run rivals once a sector gets hot. The same could happen with the Internet.

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### Examining the Newsclip

- 1. Analyzing Information** How is technology changing China's economy and society?
- 2. Making Predictions** What problems could arise as Internet use increases?

# The Various Faces of Capitalism

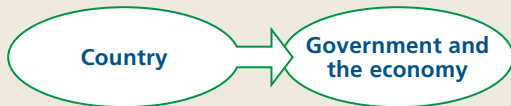
## Study Guide

### Main Idea

Many countries have moved toward capitalism, although its exact form varies from country to country.

### Reading Strategy

**Graphic Organizer** As you read the section, complete a graphic organizer similar to the one below by selecting one of the nations discussed in the section and describing what role the government plays in its economy.



### Key Terms

capital-intensive, keiretsu, infrastructure, collateral, transparency

### Objectives

After studying this section, you will be able to:

1. **Explain** the factors that encouraged economic growth in Japan.
2. **Rank** the “Asian Tigers” according to per capita GNP.
3. **Describe** Sweden’s retreat from socialism.

### Applying Economic Concepts

**Economic Growth** Have you ever looked at the labels inside your clothes? If so, you may have noticed that many of them were made in Korea, Hong Kong, or Taiwan. Read to find out how different economies experienced economic growth.

## Cover Story

### Pressing Need for a Second ‘Restoration’

In the center of Tokyo stands an elegant, wooded shrine to the Emperor Meiji who ruled Japan in the 19th century. It is a monument that now poses a critical challenge to his modern-day political successors.

Slightly over a century ago, Emperor Meiji gave his name to one of the most dramatic reformations that Japan has seen: in a few decades he transformed the country from a closed, feudal, and rigid society into a dynamic, entrepreneurial industrial power. The question now is whether Japan can surprise its critics by performing the same “modernizing” trick again—and implement a second major “restoration” to revive the country’s flagging fortunes.



Meiji shrine in Tokyo

—The Financial Times, July 13, 1999

**C**apitalism is a force sweeping the world. It is also a force that has many different faces. The common element of capitalism is that the factors of production are privately owned and controlled; there are, however, many variations on this theme.

The sharp financial crisis that swept Asia in the fall of 1997 also demonstrates another feature of capitalism—that the welfare of most capitalist economies is increasingly entwined. The interdependence we often see at the local and national level is beginning to become a feature of the global economy. These are some of the forces that are causing capitalism in Japan, as you read in the cover story, to continue to evolve.

## Japan



Japan, like the United States, has a capitalist economy based on markets, prices, and the private ownership of capital. Unlike the United States, however, Japan’s government is very involved in the day-to-day activities of the private sector.

At the end of World War II, Japan was a devastated country. Today, it is the second largest industrial nation in the world, with a GNP about 79 percent of that of the United States. In the 1970s and 1980s, the Japanese economy was one of the fastest growing in the world. However, it stalled in the 1990s. Slower growth, a currency crisis in 1995, and a recession in 1998–99 added to the economy’s woes—factors that convinced the Japanese that further restructuring was necessary.

## Reasons for Success

One of the reasons for Japan’s early success was the workers’ intense loyalty to their employers. Many workers joined large companies for life. In return, the company supplied benefits such as wedding halls, private schools, and even vacation resorts.

Japanese workers traditionally take great pride in the quality of their work. It is not unusual for

a company’s entire workforce to arrive early to take part in group calisthenics and meditation exercises.

Japan’s recent economic crisis has severely tested the historically close employee-employer relationship. Some firms have actually laid off workers, and some no longer guarantee lifetime employment. Whether or not these changes will become widespread depends in large part on the speed and strength of the Japanese recovery.

Another reason for Japan’s success is the ability and willingness of the Japanese to develop new technology. Because of their relatively small population, they have worked to boost productivity by developing methods that are **capital-intensive**—techniques that use a large amount of capital for every person employed. Today, the Japanese are recognized as the world leader in the area of industrial robots. As a result, most factories require only a fraction of the workers that similar factories in other countries need.

Most large Japanese firms also belong to a **keiretsu** (ky • reht • soo). This is a tightly knit group of firms governed by an external board of directors from potential competitors. The role of the governing board is to ensure that competition does not get so fierce that individual firms are threatened. A similar agreement in the United States among competing firms would be illegal under our antitrust laws.

## The Role of Government

Historically, Japan’s public sector was relatively small. Spending on **infrastructure**—the highways, mass transit, communications, power, water, sewerage and other public goods needed to support a large population—was low. The government also had a modest military capability and was not burdened with welfare spending. As a result, taxes were low, which



**Worker Attitudes** Japan’s economic success is due in part to its workers’ loyalty and pride in their products. *What other factors have contributed to Japan’s success?*

CLICK HERE

## ECONOMICS Online



**Student Web Activity** Visit the *Economics: Principles and Practices* Web site at [www.glencoe.com](http://www.glencoe.com) and click on **Chapter 18—Student Web Activities** for an activity on the governments and economies of nations.

allowed people to save their money or spend it on consumer goods.

The Japanese government also worked closely with businesses to limit foreign competition in the domestic market. Even today the Japanese government is more closely allied with businesses than consumers, often aiding efforts to keep foreign goods out of the country in order to protect domestic producers.

Some of this has changed with the recent economic downturn. In order to stimulate economic growth, the government introduced a number of Keynesian-type spending packages in 1998 and 1999 to stimulate the economy. As a result, the government sector now spends more than ever.

### A Closed Economy

Despite Japan's success in international trade, their economy is partially closed to the products of foreign producers. When foreign companies try to sell their goods in Japan, many encounter numerous obstacles ranging from delayed government permission to huge amounts of paperwork.

Until recently, Japan was even reluctant to import rice, a food staple, in order to protect domestic rice producers. As a result, the cost of rice to the Japanese consumer is several times higher than it would be if Japan imported rice from the world markets.

### The High Cost of Living

Protectionism in Japan may help certain segments of the economy such as the rice farmers, but it does not help the consumer. Because foreign competitors supply so few goods, products are generally expensive. Citrus fruits cost four to six times more in Japan than they do in the United States. Clothing costs two to three times as much, and even cameras and electronics cost more in Japan than elsewhere.

For years, the Japanese have been making electronic consumer goods and selling them abroad. Recently, Japanese citizens discovered they could purchase their own goods cheaper in Hawaii than they can in their own country. As a result, Japanese cameras, radios, and other electronic

equipment are among the most popular items Japanese visitors bring back from trips abroad.

### Reliance on Manufacturing and Trade

Japan must actively engage in international trade because it is an island nation with few natural resources. Consequently, it must import most of its oil as well as a number of other critical materials. For the most part, the Japanese paid for their imports with revenues from the sale of cars, cameras, and other consumer products.

Much of Japan's trade success has been attributed to the direction that provides its Ministry of International Trade and Industry (MITI). This is a government ministry that identifies promising export markets, and then subsidizes industries so that they can be competitive in this area.

### Stagnation and Recession

Despite Japan's economic successes, it experienced stagnation and recession for most of the 1990s. Industrial production peaked in 1991 and then declined until 1994. It recovered to its 1991 level in 1997, but then went into its worst recession since World War II.

Part of the reason for the poor economic performance was the banking crisis in the 1990s. When Japan was growing exceptionally fast several years earlier, land values soared. Many borrowers pledged their land as **collateral**—property or other security used to guarantee repayment of a loan—against loans that ultimately went bad. Banks had so many bad loans—estimates ranged as high as one in four—that banks simply stopped lending in 1996 and 1997. To make matters worse, banks had been so secretive about their loans that

## STANDARD & POOR'S INFOBYTE

**International Bonds** An international bond is a bond that is issued in one country on behalf of borrowers that live in another country. An example would be a Japanese-issued corporate bond being offered for sale on the New York bond market.

banking regulators did not even know who received the loans, making default by the borrowers relatively easy.

The banking situation made it difficult for qualified borrowers to get loans, and many industries, including construction, came to a halt. Unemployment rose; the government tried to stimulate the economy with a number of programs, including “employee adjustment grants” designed to subsidize employee wages. In 1999 alone, the government used ¥61.1 billion (\$532 million) to pay two-thirds of the salaries of nearly 2.5 million workers in 300 industries. Despite these subsidies, Japan’s unemployment reached record-high levels in late 1999.

### Restructuring and Reform

Another problem facing Japan is that it can no longer rely exclusively on basic manufacturing because many of its neighbors can now produce the same products at a lower cost. Also, the cozy relationship between government and industry makes it difficult for incremental change to take place—one of the features of capitalism. This inflexibility is made more difficult by the keiretsu, whose purpose is to maintain relationships and to ensure that competition does not become detrimental to its members. Finally, there is the issue of **transparency**, or the need to make business dealings more visible to everyone, especially government regulators. Without more transparency, it will be difficult to prevent another crippling banking crisis.

According to its Ministry of International Trade and Industry, Japan needs to institute supply-side reforms. These reforms would redefine government’s

role in the economy and restructure the way firms produce and compete with one another. This is an ironic turn of events because the world looked to Japan as the very model of growth in the 1980s. Today, Japan looks to the United States for guidance on restructuring so that it can resume its previous growth.

### The Asian Tigers



Three other Asian countries—Singapore, Taiwan, and South Korea—have made striking economic progress during the last 50 years. The British colony of Hong Kong also experienced explosive growth before it was reunified with China. Despite setbacks during the Asian financial crisis of 1997, the four are called the “Asian Tigers.” Each has based its growth on capitalism, but each has taken a slightly different path.

### Hong Kong

When Hong Kong was still a British colony, it was recognized as the most free market economy in the world, one with virtually no government interference. Entrepreneurs in Hong Kong developed a manufacturing-based economy that used technology other countries had already developed. Their major industrial products included textiles, clothing, electronic games, radios, telephones, watches, electronic components, and toys.

At the time of unification in 1997, Hong Kong’s per capita GNP was nearly 90 percent of the United States’s, and nearly 40 times that of China. Other factors, however, were beginning to change. Financial services and tourism had caught up with manufacturing, and the Asian crisis had thrust the economy into a deep recession. Furthermore, China’s promise not to interfere with Hong Kong markets for a period of 50 years seemed to be in jeopardy. In mid-1999, Hong Kong’s chief executive Tung Chee-hwa announced plans to pour billions of dollars into high-tech computer industries, marking a sharp departure from the laissez-faire capitalism that once characterized Hong Kong.

## Singapore

The second Asian Tiger is Singapore, an island nation about 3.5 times larger than Washington, D.C., with a per capita GNP about 80 percent of that of the United States. More than 1,000 multinational firms have been attracted to Singapore with the lure of generous tax breaks, government subsidies, and government-sponsored training of employees. Unlike Hong Kong, Singapore made a determined effort to develop its own technologies through extensive spending on research and development.

The government of Singapore is trying to develop a few select industries, including telecommunications services, software, and biotechnology. The government has spent millions on laboratories, attracting top scientists from all over the world. The biotechnology industry has scored some original successes, one of which is the transfer of firefly genes to orchids to make them glow in the dark.

## Taiwan

The Republic of China, also known as Taiwan, is an island about the size of West Virginia located off the coast of the People's Republic of China. Taiwan's population is about 22 million, and the per capita GNP is almost half that of the United States.

Planning was always a feature of the Taiwanese economy. The most recent plan identified 10 industries to receive government assistance—these include telecommunications, consumer electronics, semiconductors, precision machinery, aerospace, pharmaceuticals, and others.

Taiwan was one of the early economic powers in Asia, but some people wonder if the centralized planning process will hamper future economic growth. Another concern is the looming presence of the People's Republic of China, which regards Taiwan as a “renegade province” and vows eventual unification. Despite its early start, the per capita GNP in Taiwan has fallen far behind those of Hong Kong and Singapore.

## South Korea

South Korea, a country slightly larger than Indiana, has the smallest per capita GNP of the Asian Tigers, at about 45 percent of the United States's. In the past, a group of technocrats governed Korea with the help of the military. The factors of production were privately owned, but a small number of powerful business families dominated the private economy through conglomerates.

South Korea was hit hard by the 1997 Asian financial crisis, but it was also one of the first nations to recover. Many reforms have been undertaken since, but South Korea's future economic growth still depends on whether the private economy can adapt to competition and rely less on its relationship with the political sector.

## Sweden



Sweden is a mature industrial nation, once regarded as the “socialist state that works.” The reputation was apt because Sweden provided a broader range of social welfare programs for its citizens than did any other free-world country. Some

### Changes in Sweden



**Restructuring** Many government-owned businesses in Sweden were privatized in the early 1990s. *What led to the ouster of Sweden's Socialist party?*



of the basic industries were nationalized, but Sweden also had a considerable amount of private enterprise. The country, therefore, was not a model of pure socialism in the traditional sense.

## The Welfare State

Many worker benefits were instituted during the 44-year rule of the Socialist party. During this time, wages were high, jobs were easy to find, and unemployment was in the 1- to 3-percent range. The Swedish economy—with its generous maternity, education, disability, and old-age benefits—was thought to be the model of European socialism.

Because government owned some basic industries, and because many of these industries were not profitable, the government relied on steep taxes to pay for the welfare state benefits. In the mid-1980s, tax receipts were about 50 percent of GNP. In some cases, additional income that Swedish citizens earned was taxed at an 80 percent rate, meaning that a person who earned an additional \$100 would keep only \$20. Some individuals even left the country to avoid high taxes. When tennis star Bjorn Borg was at the peak of his career, he resided outside of Sweden to avoid paying high taxes.

Many others devised ways to avoid paying taxes. Some craft workers resorted to barter. A carpenter

who built some cabinets for an auto mechanic, for example, might be paid with repair work on the family car.

## Restructuring

Eventually, the heavy tax burden and the additional costs of the welfare state began to cut into Sweden's economic growth. Growing inflation added to the problems, as did a massive government deficit. Growing discontent with conditions finally led to the defeat of the Socialist party in 1976.

A free-market government was elected in 1991, and by 1993 the role of the public sector had been reduced, although current revenues by all levels of government exceed 60 percent of GNP. Taxes on individuals and corporations are also lower, although they are still high by U.S. standards. Many government-owned businesses have been privatized, and more are scheduled to be converted.

European nations such as Sweden were relatively unaffected by the Asian crisis, so economic growth was positive in the decade of the 1990s. Real GNP growth rates have been lower than those of the Asian tigers, however, leaving Sweden with a real GNP per capita about two-thirds of that in the United States.

### Section 4 Assessment

#### Checking for Understanding

- 1. Main Idea** Discuss how the approaches to economic growth differ in Taiwan and South Korea.
- 2. Key Terms** Define capital-intensive, keiretsu, infrastructure, collateral, transparency.
- 3. Describe** significant factors that contribute to economic growth and development in Japan.
- 4. Rank** the "Asian Tigers" according to per capita GNP.
- 5. Explain** how Sweden's retreat from socialism affected the nation's tax rates.

#### Applying Economic Concepts

- 6. Economic Growth** How has Sweden's transition from socialism to capitalism helped promote economic growth?

#### Critical Thinking

- 7. Making Predictions** How might continued economic growth in Asia affect industries in the United States?
- 8. Making Comparisons** What type of help is provided to Japanese businesses by their government that the American government does not give to its businesses?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

## Chapter 18 Summary

### Section 1

#### The Spectrum of Economic Systems (pages 491–494)

- The world's three main types of economic systems are capitalism, socialism, and communism.
- Under capitalism, productive resources are privately owned and operated; capital is obtained through profits in the market; supply and demand determine prices; and the role of government is limited to promoting competition and providing public goods.
- Under **socialism**, many of the basic resources are government owned and operated, with prices playing a major role in the allocation of resources.
- Under **communism**, all productive resources are government owned and operated; centralized planning directs all resources; and labor is organized for the common advantage of the community.

### Section 2

#### The Rise and Fall of Communism

(pages 496–499)

- In 1917 revolutionists overthrew the government of Russia and instituted a communist system.
- Utilizing a series of **Five-Year Plans**, Stalin wanted to achieve rapid industrialization. The plans included the **collectivization** of agriculture and the transformation of industry.
- When Stalin's brutal regime ended in 1953, the Soviet Union had successfully completed its transition to a major industrial power.
- The command economy ultimately proved to be a miserable failure. Low productivity and the lack of incentives led Mikhail Gorbachev to attempt **perestroika**, the fundamental restructuring of the economy and the government. The restructuring was not completed, however, and in the early 1990s, the Soviet economic system collapsed.

### Section 3

#### The Transition to Capitalism

(pages 501–507)

- The former communist systems face several challenges—including the **privatization** of capital resources—as they try to move toward capitalism.
- These challenges include privatization, the shift in political power from Communists to elected officials, and the new incentives of a capitalist economy.
- Russia and Eastern Europe have had varying amounts of success in this transition to capitalism.
- Many countries in Latin America and even China are also moving toward a capitalist economy.

### Section 4

#### The Various Faces of Capitalism

(pages 509–514)

- Japan achieved phenomenal economic growth with a combination of worker and corporate loyalty, technology, and low taxes until the early 1990s.
- Despite Japan's economic success, it experienced stagnation and recession during the 1990s.
- The economies of the “Asian Tigers”—Singapore, Taiwan, Hong Kong (before reunification with China), and South Korea—also owe much of their remarkable success to capitalism.
- Sweden, once regarded as the “socialist state that works,” has restructured in an attempt to move away from socialism.



## Chapter 18 Assessment and Activities

### ECONOMICS Online



**Self-Check Quiz** Visit the *Economics: Principles and Practices* Web site at [epp.glencoe.com](http://epp.glencoe.com) and click on **Chapter 18—Self-Check Quizzes** to prepare for the chapter test.

**CLICK HERE**

### Identifying Key Terms

Write the key term that best completes the following sentences.

- |                      |                    |
|----------------------|--------------------|
| a. state farm        | f. Five-Year Plan  |
| b. socialism         | g. collective farm |
| c. black market      | h. communism       |
| d. capital-intensive | i. perestroika     |
| e. privatization     | j. storming        |
1. In most former communist countries, state-owned enterprises are being converted to private ownership, a process known as \_\_\_\_\_.
  2. To direct production, Soviet planners adopted a \_\_\_\_\_.
  3. Under \_\_\_\_\_, the government owns all the means of production.
  4. In the Soviet agricultural system, the state owned and operated each \_\_\_\_\_.
  5. Soviet leader Mikhail Gorbachev introduced a policy of \_\_\_\_\_, the fundamental restructuring of the economy and government.
  6. In the Soviet Union, groups of peasant families, each of which was allowed to keep their home and household goods, a few cattle, and a small plot of land, worked each \_\_\_\_\_.
  7. Most nations of Eastern Europe had a flourishing \_\_\_\_\_, where entrepreneurs and merchants sold goods illegally.
  8. Under \_\_\_\_\_, the government owns many, but not all, of the basic productive resources.

9. In \_\_\_\_\_ industries, a large amount of capital is used for every person employed in manufacturing.
10. Piecework quotas often led to \_\_\_\_\_, where workers worked slowly until the last week of the month and then sped up to meet the unrealistically high quota.

### Reviewing the Facts

#### Section 1 (pages 491–494)

1. **Explain** the role of the government in a capitalist economic system.
2. **Describe** how the people in a socialist economy help allocate the use of resources.
3. **Describe** who answers the basic economic questions in a communist system.

#### Section 2 (pages 496–499)

4. **Describe** Stalin's efforts to implement centralized planning.
5. **Describe** the problems that central planning caused in the Soviet economy.
6. **Explain** the impact that perestroika had on the Soviet economy.

#### Section 3 (pages 501–507)

7. **List** the problems that nations may face as they try to make the transition from communism to capitalism.
8. **Name** the nations that are currently trying to adapt to a market economy and describe the specific problems they are facing in their transition.

#### Section 4 (pages 509–514)

9. **Explain** the role that the government plays in Japan's economy.
10. **Describe** how the approaches to economic growth differ in South Korea and Singapore.

## Thinking Critically

- 1. Evaluating Information** Do you think five-year plans could work in the United States? Why or why not?
- 2. Drawing Conclusions** What safeguards are in place to ensure that the United States will not face an economic downturn as severe as the Great Depression? List the safeguards on a graphic organizer like the one below.



- 3. Sequencing Information** Trace Sweden's transition from socialism to capitalism.
- 4. Drawing Conclusions** The Communists promised people that their system would lead to workers' paradises throughout the world. By the early 1990s, however, communist systems and their command economies in most countries had collapsed. Why do you think communism was such a failure?

## Applying Economic Concepts

- 1. Capitalism** Many nations are attempting to switch from communism or socialism to capitalism. Often, the transition has been quite difficult. What suggestions would you make to the leaders of these nations to help ease the transition to capitalism?
- 2. Economic Growth** The "Asian Tigers" have experienced rapid economic growth and development. Do you think they can sustain this growth rate? Why or why not?
- 3. Economic Change** Why have many countries chosen to change the mix of socialism and capitalism in their economies in recent years?

## Math Practice

Assume that your salary is 500 rubles per month. The government-controlled price of bread is 10 rubles, and you buy five loaves each month. What percentage of your income do you spend on bread? After the government deregulates prices, bread costs 25 rubles. What percentage of your income goes to buy bread? How does the inflation affect your standard of living?

## Thinking Like an Economist

Explain why firms in the former Soviet Union could make low-quality products and continue to exist year after year. What would happen to such a firm in the United States economy?

## Technology Skill

**Using a Computerized Card Catalog** For one week, summarize in your journal news articles you read about events in eastern Europe and other former Soviet bloc nations. Focus on articles that relate to those regions working to convert from a command economy to a market economy.

Using a computerized card catalog, find other sources describing economic events in these areas. Compose a journal article analyzing current developments in either of those regions of the world. Include quotes from the sources you found using the computerized card catalog.

## Building Skills

**Building a Database** Review recent issues of newsmagazines and current newspapers. Using the steps described on page 495, build a database of information about current world developments concerning capitalism and socialism that the newspapers or the news magazines mention. Explain to a partner why the database is organized the way it is and how it might be used in class.



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

# ECONOMICS WORKSHOP IN ACTION

## Simulating Trade in Various Economies

*From the classroom of . . .*

*Danielle Dressler*

*Mifflinburg High School*

*Mifflinburg, Pennsylvania*

*The world contains various types of economic systems. Some countries have market economies, some command economies, some traditional, and still others have mixed economies. Each type of economy poses its own challenges when it comes to international trade. In this workshop, you will organize into groups and attempt to trade your products for goods produced in another country.*

### Setting Up the Workshop

Your teacher will separate you into groups and provide you with your products. Your group will represent a command, market, traditional, or mixed economic system. Read the instructions for your economic system. Then, read the steps of the procedures and begin the activity.

### Procedures

#### STEP 1

Your group has all the “goods” your country produces (for example, the command economy has all the sugar packets). Later, you will use your goods to trade for the staples you need that are produced in the other countries.

#### STEP 2

When your group trades, keep in mind that the trade value of the products are: 100 lbs of sugar = 100 lbs of tea = 50 lbs of cotton = 25 lbs of meat.

#### STEP 3

Begin trading with the other “countries,” paying careful attention to your restrictions on imports and exports. To satisfy the needs of its population, the goal of each country is to trade its product in such a way that it comes as close as possible to achieving the following mix of goods:

- 75 lbs of meat
- 250 lbs of cotton
- 500 lbs of sugar
- 300 lbs of tea



## Command Economy

You are citizens of a country under a command economy. Your country has 1,500 pounds of **sugar** to trade. Your government has placed many regulations on both imports and exports. Three regulations are required during sugar production in order for sugar to be exported. Also, three regulations protecting your citizens need to be met in order for products to come into the country. Before you begin, organize your society (government officials, farmers, etc.) and list your regulations on imports and exports.

## Traditional Economy

You are members of a society that has a traditional economic system. Your country has 800 pounds of **tea** to trade. You must decide in what quantities and with what countries you want to trade your tea, which is in very low supply. Before you begin, describe the characteristics of your society (climate, organization, leaders, etc.) and organize your group so that each member has a part in the economy.

## Mixed Economy

You are members of a country that has a mixed economic system. You have 400 pounds of **cotton** to trade. Your government does not have complete control over the economy, but it places two regulations on the export of the cotton produced in your country and two regulations on imported products. Before you begin, organize your society (government officials, producers, etc.) and list your country's regulations on imports and exports.

## Market Economy

You are a member of a country that has a market economic system. Your main export is **meat**—300 pounds in total. (Every member has an equal share.) You are free to compete in trade against one another. Your task is to export the meat from your country by competing with the other members of your group. Before you begin, describe the characteristics of your society and decide if you want to implement regulations on imports and exports.

## Summary Activity

When the trading has been completed, discuss the following questions.

1. Which “country” came closest to the optimal mix of products? What factors of the economic system made this possible?
2. Which types of economies were least able to achieve a good mix of products? Why do you think this is so?

