

Economic Systems



Are all economic systems the same? Does the government play the same role in all countries? Do all citizens have the same opportunity to make choices about what to buy and where to work?

As we saw when we looked at the business cycle, economics isn't an exact science. We can't guarantee that the economy will grow if we just follow certain steps. In fact, economists often disagree with each other about what the problems are and what must be done to fix them. Even economic *systems* can vary greatly from country to country.

Let's look at some of the various economic systems that you might find throughout the world and see how these differ.

Four Economic Systems

- What to produce
- How to produce
- For whom to produce

Economic Systems :
- Traditional
- Command
- Market
- Mixed



Economists generally classify countries into one of four economic systems based on how its government and citizens determine:

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

These questions are addressed by each nation's leaders and, in some cases, its citizens. Countries with the same economic systems tend to answer the questions the same way based on how they produce and consume goods and services.

These economic systems fall into one of four categories:

- Traditional
- Command
- Market
- Mixed

Let's take a look at each to see how they differ.

Traditional Economies

What to produce?

How to produce?

For whom to produce?



What to produce? For whom to produce? How to produce?

In a traditional economy, the response for all these questions is “what has typically been done in the past.” Traditional economies organize production and consumption around the family and the community using techniques and technologies that have been around for generations. People living in such systems usually farm or hunt for their food and do not produce goods for people living outside their communities, although they may trade with surrounding people. They also don’t tend to produce much more than they need.

Characteristics

- Traditions, customs, and beliefs are integrated with the economy.
- Centered around family and community.



What are some characteristics of a traditional economy? Traditions, customs, and beliefs determine what people do and are integrated with the economy. Men and women assume different economic roles and duties. Economic activities are centered around the family and the community.

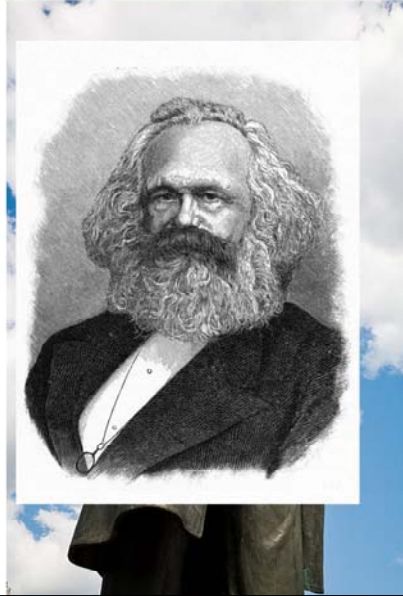
An example of a traditional economy is an Inuit population living near the polar region that depends almost entirely upon itself to produce all of its goods: food, clothing and housing.

Though this type of economy may seem outdated, it still exists in some regions of the world, mainly remote regions of nonindustrial countries. Some parts of Asia, Africa, and South America still have traditional economies that operate within more modern economies.

[Picture source: S.J. Bailey / Library and Archives Canada / PA-175729.]

Command Economies

Karl Marx Government decides what will be produced, how it will be produced, and who will receive the products.
Capitalist economy promotes many inequalities. His writings formed the theoretical basis for many command economies.



A command economy is pretty much what it sounds like. It is centrally controlled by the government which makes all the economic decisions. Government officials have the power to determine what will be produced, how it will be produced, and who will receive the products. Individuals in this type of economy have little or no say in these economic decisions.

Many of the countries that have a command economy, or that had one in the past, based their system on the writings of Karl Marx, who believed that capitalist, or market economy promoted many inequalities. He thought that capitalist economies divided society into two classes: the workers who sell their labor, and the factory owners who make money off of the workers labor. If all property were owned in common, he believed that everyone would share in the profits and be better off.

Marx's theory promoted equality and a strong central government to provide for the common good of all people. Marx's writings were the theoretical basis for many command economies, but many of his beliefs, especially the equality of the people and the government, were never realized.

Characteristics

- Minimal individual economic freedom
- No competition
- No business is created to receive a profit
- Consumers have very few choices
- Government sets prices
- Government dictates your job
- No private ownership
- Everything is owned by the government



North Korea

In a command economy, all decisions are centralized, so the government can quickly change what is produced and how to produce it. Most decisions, however, are not based on individual choice, and people have minimal individual economic freedom. Since the government is the only producer, there is no competition, and no one is in business to make a profit. As a result, consumers have very few choices in the marketplace, and government sets the prices of goods and services. People don't choose their job, since this is determined by the government as well, and people can't go into business for themselves since there is no private ownership. Everything including land, public services, and factories is owned by the government.

Examples of a command economy:

Some current examples of a command economy are Korea and Cuba. Russia, formerly known as the Soviet Union, and most of Eastern Europe also used to be command economies, as was China before 1978.

Market Economy

What to produce? How to produce? For whom to produce?

These questions are answered by individuals



Can you pick what kind of job you want to do and work for any company you like? Can you apply at any college you would like to attend?

The opposite of a command economy is the market economy. In this economic system, the three basic economic questions are answered by individuals. As a consumer, you choose what you want to buy and when you want to buy it. As a producer or business, you decide what you want to produce and when you produce it. The government does not determine how the economy works. People can produce, buy, and sell anything as long as it's not illegal, or regulated by the government for national security purposes.

Does this sound familiar? If so, you have probably been living in the United States or another country that is a market economy where consumers determine what is produced.



Characteristics

- Private ownership of resources, which provides incentives for the owners of resources to weigh the value of present uses against the value of conserving the resources for future use
- Competition among businesses, which tends to lower prices and raise quality
- Prices determined in the marketplace through the interaction of supply and demand
- Consumer sovereignty, the concept that consumers' "dollar votes" tell businesses what to produce
- Profit motive, an incentive for businesses to produce what consumers demand and to produce those goods and service efficiently – keeping costs down – in hopes of earning greater profit
- Limited government that acts as a referee – protecting consumers, workers, the environment, and competition in the marketplace

Market economies are also known as free enterprise, capitalist, and laissez-faire (leave it alone). No country has a pure market economy or free market system since the government does have some control over certain things, though countries such as the United States are considered to be a market economy.

Can you think of other countries that fall into this category? England is one.

Adam Smith

- Early economist
- *Wealth of Nations*
- Market economy is best way to organize economy
- “Invisible hand of the market”



Adam Smith was an early economist philosopher who promoted the market economy as the best way to organize the economy. In 1776, Smith published a book called *The Wealth of the Nations* which described how market economies were the best means of determining how to produce and distribute goods. The book also covered economics concepts such as self-interest and economic freedom. He believed nations would succeed by allowing people to develop and pursue their own self-interests. In the process, individuals and businesses would maximize their profits by producing goods and services that consumers wanted to buy. Economic freedom would result in a variety of goods being sold which in turn would make the nation wealthy. Smith also supported a *laissez-faire* economy; one in which the government should not interfere with trade between individuals.

Have you ever heard the expression “the invisible hand of the market?” This expression is predominantly associated with Adam Smith. He believed that in a free market the government didn’t need to regulate the economy because the “invisible hand” of self-interest would guide businesses and individuals to trade in a way that would benefit everyone. Businesses would have to compete to trade or sell goods or services. Competition would be the “invisible hand” that would regulate the marketplace without government intervention.

He also believed that competition does not need to be regulated. For example, let’s say there is one grocery store in your city and they charge high prices for food. This store cannot do this as long as there is another individual willing to open another grocery store with more reasonable prices. Of course, you as a consumer, acting in your own self-interest would go to the store that charges less for the same food. The store with the higher prices would either have to lower its prices, or lose customers. In this example, competition is the invisible hand that keeps prices down.

For his writings, Smith is widely considered to be the father of modern economics.

Mixed Economy

**Some
Government
Regulation** + **Free
Markets** = **Mixed
Economy**

Today, most economies are considered to be mixed economies. They combine free markets with varying degrees of government control to reduce the downsides of the market economy, while harvesting the power of competition.

Pure forms of market economies or command economies rarely exist. Both individuals and the government share in making decisions. However, the amount of government involvement varies from country to country. Many people consider this the most effective economy for providing goods and services.

Characteristics

- Government and individuals have a stake in the decision making process
- Market economy protects consumers and employees from unjust policies



Examples

- Canada
- United States



Though the United States exhibits many of the characteristics of a market economy, the government does regulate the market to some degree. What are some ways it does this?

The government:

- Sets public utility rates
- Regulates environmental issues
- Regulates advertising in order for businesses to remain ethical
- Constructs highways

Why would the government do this? Usually to protect consumers from unfair business practices, monopolies (markets without competition), to build things for the good of businesses and citizens, and to protect the long term interests of the country.

The United States, its immediate neighbors and most industrial countries can be classified as mixed economies, although some encourage more competition than others, and some governments regulate the markets more.

Economic Systems



Question 1 of 6 Point Value: 10

What type of economy is described below?

Economic production is organized around the family and the community.

- Mixed
- Command
- Market
- Traditional

PROPERTIES

On passing, 'Finish' button: On failing, 'Finish' button: Allow user to leave quiz: User may view slides after quiz: User may attempt quiz:	Goes to Next Slide Goes to Next Slide After user has completed quiz At any time Unlimited times	 Properties...	 Edit in Quizmaker
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