

# The 4 Economic Systems





# What is an Economic System?

**Economics** is the study of how people make decisions given the resources that are provided to them

Economics is all about CHOICES, both individual and group choices. We must make choices to provide for our needs and wants. The choices each society or nation selects leads to the creation of their type of economy.



## 3 Basic Questions

Each economic system tries to answer the three basic questions:

What should be produced?

How it should be produced?

For whom should it be produced?

How they answer these questions determines the kind of system they have.



# Four Types of Systems

There are four main types of economic systems.

The **Traditional** Economic System

The **Command** Economic System

The **Market** Economic System

The **Mixed** Economic System

Each system has its strengths and weaknesses.



## Traditional Economy

In a traditional economy, the customs and habits of the past are used to decide what and how goods will be produced, distributed, and consumed. Each member of society knows from early on what their role in the larger group will be. **Jobs are passed down from generation to generation** so there is little change in jobs over the generations. In a traditional economy, people are depended upon to fulfill their jobs. If someone fails to do their part, the system can break down. Farming, hunting, and herding are part of a traditional economy. Traditional economies can be found in different indigenous groups. In addition, traditional economies bartering is used for trade. Bartering is trading without money. For example, if an individual has a good and he trades it with another individual for a different good.



# Traditional Economy Takeaways

**Traditional Economy**-The production of goods and services are based on a particular society's traditional customs or beliefs; people will make what they have always made and will do the same work their parents did; exchange of goods is done through bartering.

- Traditional economies base economic decisions on cultural values and beliefs. This economy relies on farming, hunting, and fishing.
- Several traditional economies have evolved into a mixed type that incorporates elements from capitalism, socialism, or communism.
- Traditional economies can be negatively affected by other economy types that use large amounts of natural resources

# The Command Economy

In a command economy, the government planning groups make the basic economic decisions. The government determines which goods and services are to be produced, the prices and the wage rate. The government, not the people, own farms and businesses. Workers are told what to produce and how much to produce. They are given a quota to fulfill. All workers are given a quota and are expected to fill it. A problem with a command economy is deciding what needs to be produced. A benefit is that prices are controlled and people know what something will cost.





# Command Economy Pros and Cons

**Command Economy-** The central or state government determines the goods produced, prices of goods, services provided and the wages of workers. Typically found in communist governments.

## PROS

- Can manipulate large amounts of resources for large projects without lawsuits or environmental regulatory issues.
- An entire society can be transformed to conform to the government's vision, from nationalizing companies to placing workers in new jobs after a governmental skill assessment.

## CONS

- Rapid change can completely ignore society's needs, forcing the development of a black market and other coping strategies.
- Goods production is not always matched to demand, and poor planning often leads to rationing.
- Innovation is discouraged and leaders are rewarded for following orders rather than taking risks.





# The Market Economy

In a market economy, decisions are guided by changes in prices that occur between buyers and sellers. Market economies are also known as free enterprise, capitalism, and laissez-faire. Businesses and farms are owned by individuals and corporations. Each business or farm decides what it wants to produce. **Supply and demand** determines the price people pay for things. **Supply** is the amount of goods available and **demand** is how many consumers want the goods. A benefit of a market economy is that consumers can find the goods they want and can buy as much as they can afford. A problem is there is no stability in prices and businesses, if mismanaged, can go out of business. If this happens, then workers lose their jobs and income.



# The Market Economy

- A market economy functions under the laws of supply and demand.
- It is characterized by private ownership, freedom of choice, self-interest, optimized buying and selling platforms, competition, and limited government intervention.
- Competition drives the market economy, optimizing efficiency and innovation.
- Market economies marginalize those that are unable to compete, contributing to income inequality.

**Market Economy**--an economic system in which economic decisions are guided by the changes in prices that occur as individual buyers and sellers interact in the marketplace to determine the sale of goods (based on what the people want and what they are willing to pay). Based on free enterprise and competition between manufacturers.



# The Mixed Economy

Mixed economy has characteristics of both pure command and market economies. All modern economies have characteristics of both systems and are often referred to as mixed economies though most economies are closer to one type of economy than another.

- A mixed economy combines market, command, and traditional economies.
- It has both the advantages and disadvantages of other types of economies.
- Most countries have a mixed economy thanks to globalization.



# Advantages of a Mixed Economy

A mixed economy has the advantages of a market economy. First, it distributes goods and services to where they are most needed. It allows prices to measure supply and demand. Second, it rewards the most efficient producers with the highest profit. That means customers get the best value for their dollar. Third, it encourages innovation to meet customer needs more creatively, cheaply or efficiently. Fourth, it automatically allocates capital to the most innovative and efficient producers. They, in turn, can invest the capital in more businesses like them.

A mixed economy also minimizes the disadvantages of a market economy. A market economy could neglect areas like defense, technology, and aerospace. A larger governmental role allows fast mobilization to these priority areas.

The expanded government role also makes sure less competitive members receive care. That overcomes one of the disadvantages of a pure market economy which only rewards those who are most competitive or innovative. Those who can't compete remain at risk.



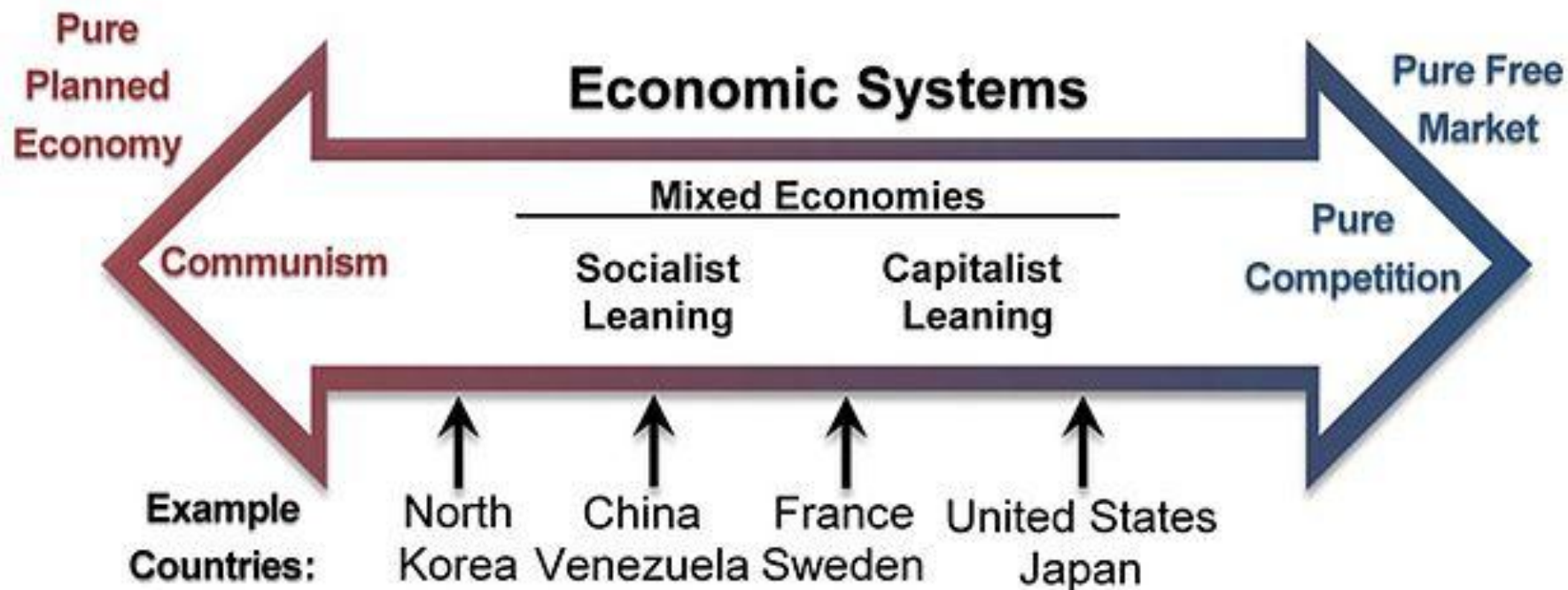
# Disadvantages of a Mixed Economy

A mixed economy can also take on all the disadvantages of the other types of economies. It just depends on which characteristics the mixed economy emphasizes.

For example, if the market has too much freedom, it can leave the less competitive members of society without any government support.

Central planning of government industries also creates problems.<sup>5</sup> The defense industry could become a government-subsidized **monopoly** or **oligarchy system**. That could increase the country's debt, slowing down economic growth in the long run.

Successful businesses can lobby the government for more **subsidies** and tax breaks. The government could protect the free market so much that it doesn't regulate enough. For example, businesses that were too big to fail could be bailed out by the government if they started going bankrupt.





# What do you think?

What kind of economy do you think is best?

Can you think of countries or civilizations from the past that we have studied that fall into these categories?

If your household was a kind of economy, what kind do you think it would be?