

Axe04: Economic system

The way scarce resources get distributed within an economy determines the type of economic system. There are four different types of Economic Systems; a traditional economy, a market economy, a command economy, and a mixed economy. Each type of economy has its own strengths and weaknesses.

The Four Types of Economic Systems

1. Traditional Economic System.

The traditional economic system is the most traditional and ancient types of economies in the world. Vast portions of the world still function under a traditional economic system. These areas tend to be rural, second- or third-world, and closely tied to the land, usually through farming.

In general, in a traditional economic system, a [surplus](#) would be rare. Each member of a traditional economy has a more specific and pronounced role, and these societies tend to be very close-knit and socially satisfied. However, they do lack access to technology and advanced medicine.

2. Command Economic System.

In a [command economic system](#), a large part of the economic system is controlled by a centralized power. For example, in the USSR most decisions were made by the central government. This type of economy was the core of the communist philosophy.

Since the government is such a central feature of the economy, it is often involved in everything from planning to redistributing resources. A command economy is capable of creating a healthy supply of its resources, and it rewards its people with affordable prices. This capability also means that the government usually owns all the critical industries like utilities, aviation, and railroad.

In a command economy, it is theoretically possible for the government to create enough jobs and provide goods and services at an affordable rate. However, in reality, most command economies tend to focus on the most valuable resources like oil. China or D.P.R.K. (North Korea) is examples of command economies.

●Advantages of Command Economic Systems:

- If executed correctly, the government can mobilize resources on a massive scale. This mobility can provide jobs for almost all of the citizens.
- The government can focus on the good of society rather than an individual. This focus could lead to more efficient use of resources.

●Disadvantages of Command Economic Systems:

- It is hard for central planners to provide for everyone's needs. This challenge forces the government to ration because it cannot calculate demand since it sets prices.
- There is a lack of innovation since there is no need to take any risk. Workers are also forced to pursue jobs the government deems fit.

3. Market Economic System

In a free-market economy, firms and households act in self-interest to determine how resources get allocated, what goods get produced and who buys the goods. This is opposite to how a command economy works, where the central government gets to keep the profits.

There is no government intervention in a pure market economy ("laissez-faire"). However, no truly free market economy exists in the world. For example, while America is a capitalist nation, our government still regulates (or attempts to control) fair trade, government programs, honest business, monopolies, etc.

In this type of economy, there is a separation between the government and the market. This separation prevents the government from becoming too powerful and keeps their interests aligned with that of the markets.

Historically, Hong Kong is considered an example of a free market society.

●Advantages of a Free Market Economy

- Consumers pay the highest price they want to, and businesses only produce profitable goods and services. There is a lot of incentive for entrepreneurship.
- This competition for resources leads to the most efficient use of the factors of production since businesses are very competitive.

- Businesses invest heavily in research and development. There is an incentive for constant innovation as companies compete to provide better products for consumers.

- Disadvantages of a Free Market Economy:

- Due to the fiercely competitive nature of a free market, businesses will not care for the disadvantaged like the elderly or disabled. This lack of focus on societal benefit leads to higher income inequality.

- Since the market is driven solely by self-interest, economic needs have a priority over social and human needs like providing healthcare for the poor. Consumers can also be exploited by monopolies.

4. Mixed Economic System.

A mixed economy is a combination of different types of economic systems. This economic system is a cross between a market economy and command economy. In the most common types of mixed economies, the market is more or less free of government ownership except for a few key areas like transportation or sensitive industries like defense and railroad.

However, the government is also usually involved in the regulation of private businesses. The idea behind a mixed economy was to use the best of both worlds – incorporate policies that are socialist and capitalist.

To a certain extent, most countries have a mixed economic system. For example, India and France are mixed economies.

- Advantages of Mixed Economies:

- There is less government intervention than a command economy. This results in private businesses that can run more efficiently and cut costs down than a government entity might.

- The government can intervene to correct [market failures](#). For example, most governments will come in and break up large companies if they abuse monopoly power. Another example could be the taxation of harmful products like cigarettes to reduce a [negative externality of consumption](#).

- Governments can create safety net programs like healthcare or social security.
- In a mixed economy, governments can use taxation policies to [redistribute income](#) and reduce inequality.

• Disadvantages of Mixed Economies.

- There are criticisms from both sides arguing that sometimes there is too much government intervention, and sometimes there isn't enough.
- A common problem is that the state run industries are often [subsidized](#) by the government and run into large debts because they are uncompetitive.