

Types of Economic Systems



THE FOUR FACTORS OF PRODUCTION



Factor 1:
Labor

Factor 2:
Land



Factor 3:
Capital

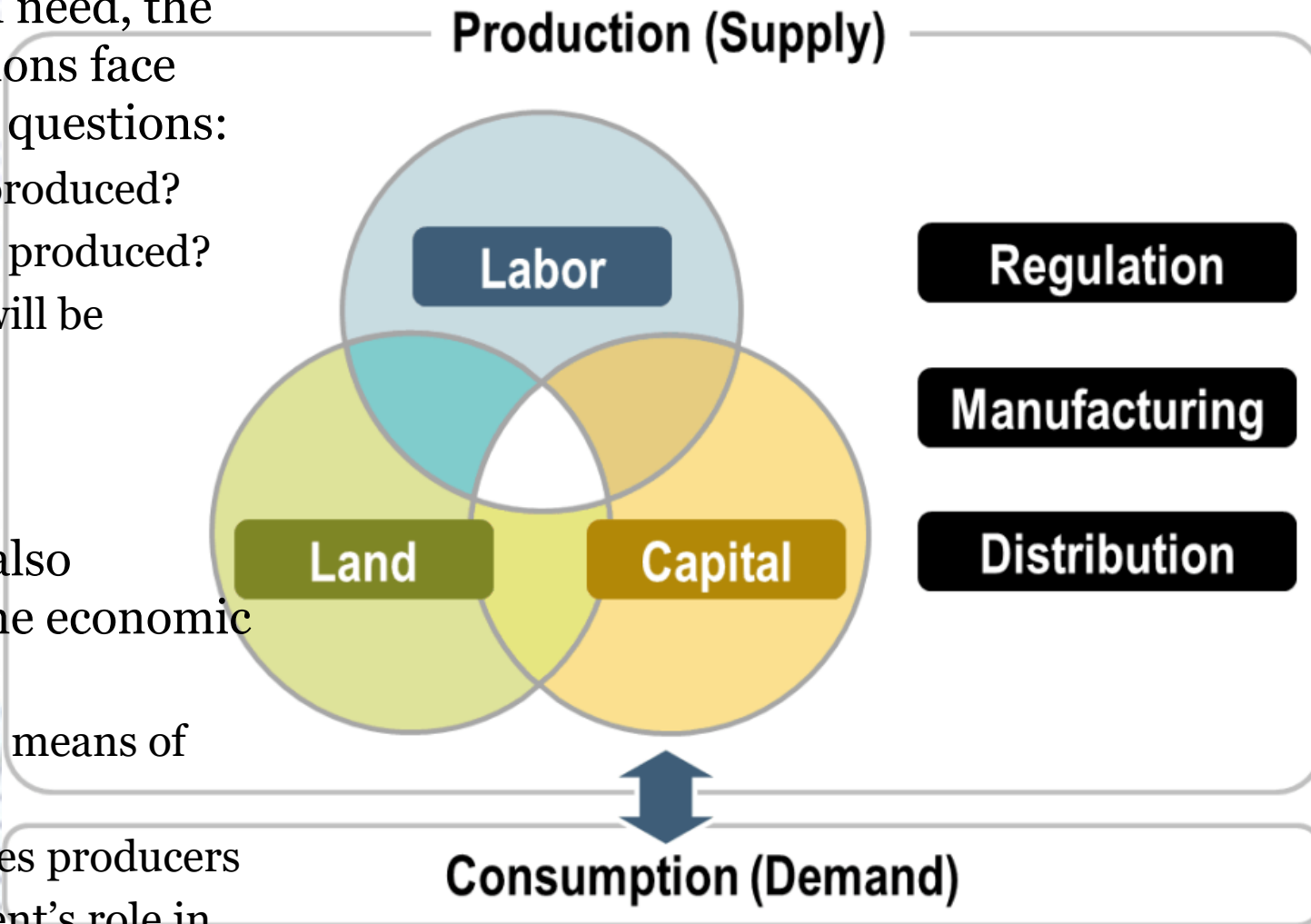
Factor 4:
Entrepreneurship

Because a country cannot produce everything that its residents want and need, the U.S. and other nations face three fundamental questions:

1. What will be produced?
2. How will it be produced?
3. For whom it will be produced?

In addition, these also influence and define economic systems:

1. Who owns the means of production?
2. What motivates producers
3. The government's role in the market



Traditional Economy

System in which people produce most of the goods and services they use (primarily because those are the things they need, in agriculture, this is known as subsistence farming)

-Many things are done because of tradition, custom, or culture and ownership of goods is shared within the community

(e.g., your grandparents fished for a living, you will fish for a living)

-If there is an upper-class, often they control the factors of production

-There typically is not a lot of social mobility for those in traditional economies

✓ Advantages

- Little or no friction between members.
- Everyone understands their role and contribution.
- More sustainable than a technology-based economy.

✗ Disadvantages

- Exposed to changes in nature and weather patterns.
- Vulnerable to market or command economies that use up their natural resources.

- More often the system of societies with less use or access to technology
- Goods may or may not have prices; bartering may take place (goods or services are directly exchanged for other goods or services without using a medium of exchange) (aka money)
- Developing countries usually have a traditional economy
- Not common today because they usually grow unstable once citizens become aware of other kinds of economic systems;

5 TRAITS OF A TRADITIONAL ECONOMY



CENTER AROUND
FAMILY OR TRIBE



EXISTS IN A
HUNTER-GATHERER
AND NOMADIC
SOCIETY



TRADE RELIES
HEAVILY ON
BARTER



PRODUCE ONLY
WHAT YOU NEED
(SURPLUS OR
LEFTOVERS ARE
RARE)

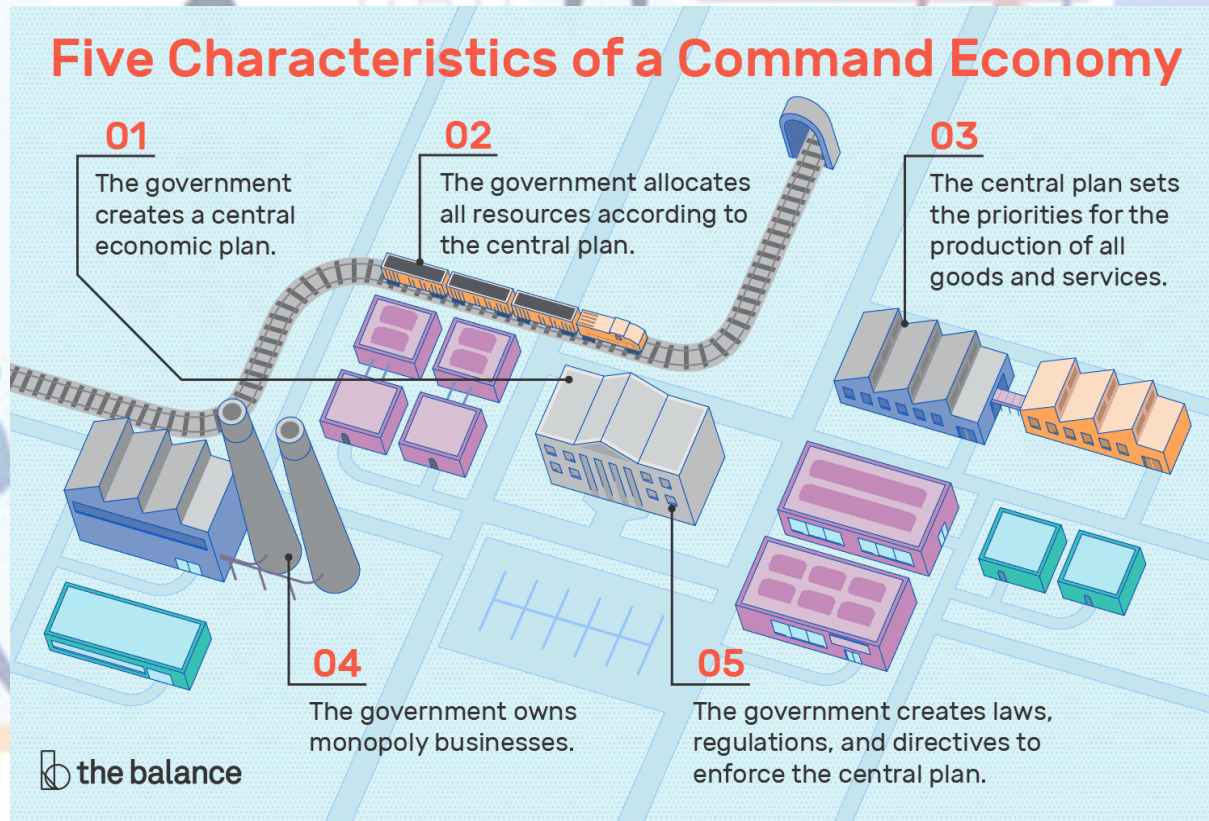


THEY EVENTUALLY
EVOLVE TO FORM
SOME FORM OF
CURRENCY FOR
TRADE

Command Economy

Economic system where the government controls the four factors of production

- Land and resources needed for production are owned by the government and their planners decide which goods and services are produced, and how they are distributed
- The government also sets prices rather than supply and demand
- Government makes all decisions or “command” what is made; tend to have communist or socialist governments
- The distribution of wants and needs are often based on “equity”



- Although laborers tend to remain employed, they may or may not have a say in what kind of job they hold or under what conditions they work
- The incentives to produce are expected to be a sense of duty to the country and/or a sense of personal pride
- Historically, they are less efficient than market economies

Pros and Cons of a Command Economy

✔ Pros

- Speed
- Unity

✘ Cons

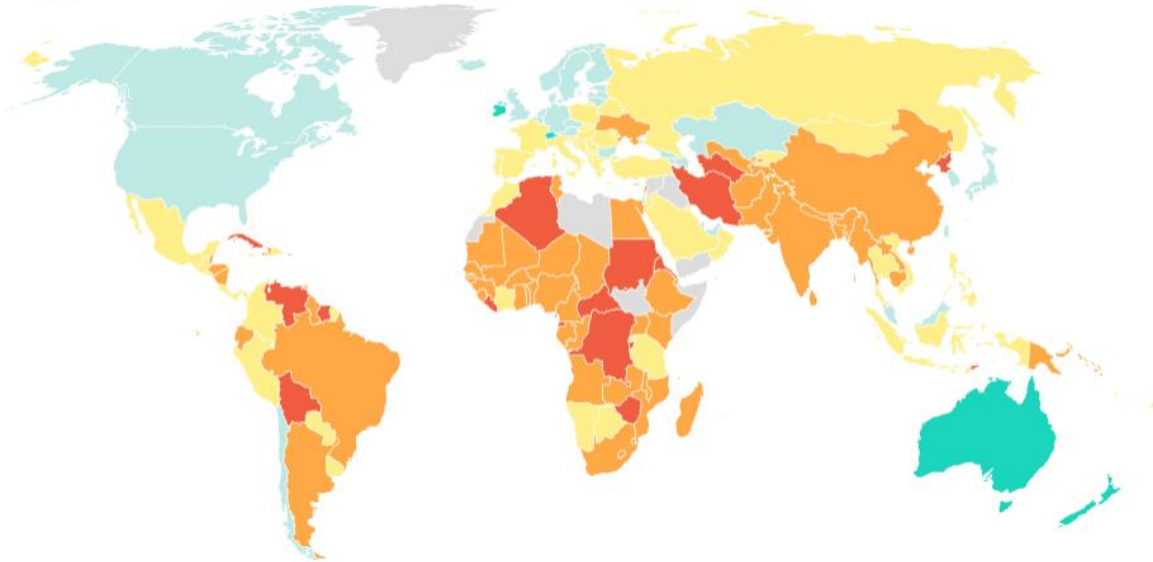
- Ignores consumer preferences
- Inefficiencies
- Innovation is discouraged

- Initially attract poorer individuals because of their emphasis on economic equality; in reality, are susceptible to corruption and greed
- National loyalty and personal pride fail to provide as much motivation for productivity as the promise of financial profit and personal advancement
- Because they are centralized, they are slow to react to changes in demand → often produce too much of something that is not desired and too little of something for which there is a market (e.g., toilet paper)

World Economic Freedom Index

Hover over each country to see its 2021 Index of Economic Freedom score. The Index of Economic Freedom considers a scale of 0 to 100 for each country, based on four indicators—rule of law, limited government, regulatory efficiency and open markets.

Repressed Mostly unfree Moderately free Mostly free Free



Source: [The Heritage Foundation](#)
Get the data • Add this chart to your site

Market Economy

The private sector makes economic decisions according to supply and demand with no intervention from the government

-Also referred to as free market, free enterprise, or capitalist

-Laissez-faire government regulation, meaning the government leaves businesses alone

-Competition, supply, and demand determine prices of goods and quality



- Many of these countries have high per capita GDPs (gross domestic product)
- People have the freedom to choose from a variety of goods and services
- Production of goods is based on what consumers demand
- The primary role of government is to make sure that everyone has free access to a free market

✓ Pros

- Supply and demand driven by consumers and businesses
- Competition encourages efficiency
- Innovation is rewarded with profits
- Successful businesses invest in each other

✗ Cons

- Competition leaves out the disadvantaged
- Caretakers of the disadvantaged tend to be left behind
- Not everyone can realize their full potential
- Self-interest tends to rule over concern for the whole



Audi



DODGE



Cadillac



SATURN



-If there are multiple producers of a type of good or service, consumers can choose between them to decide the products they will buy

-Producers have an incentive to produce what consumers want by being competitive in price, quantity, and quality - because to do so will make them money (this is known as profit motive)

Mixed Economy

- Almost every economic system is some type of mixed economy; what depends is the combination of how much of which system
- The U.S. is a mixed economy in that it offers great freedom to economic actors (producers and consumers) while at the same time implementing enough government control to hopefully avoid economic catastrophes (e.g., economic depression, massive inflation, crucial shortages of needed goods, etc.)



Mixed Economy

A mixture of market and command systems where prices are mostly determined by the consumer (based on supply and demand)

-Individuals have economic freedoms, but the government retains some control for the benefit of citizens

