

## 7.8: Economic Systems

### Learning Objectives

- Distinguish between market, planned, and mixed economies

Legoland, Billund, Denmark: Picture of a Planned Economy?

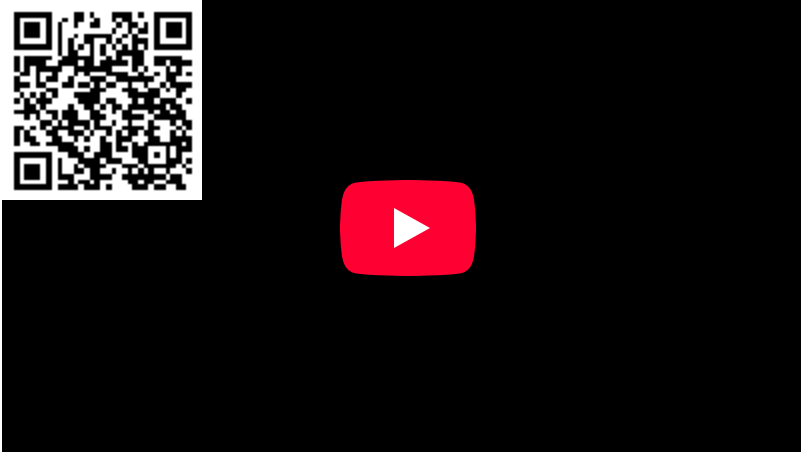


Figure 7.8.1: Legoland, Billund, Denmark: Picture of a Planned Economy?

Consider how complex a modern economy is. It includes all production of goods and services, all buying and selling, all employment. The economic life of every individual is interrelated, at least to a small extent, with the economic lives of thousands or even millions of other individuals.

Who organizes and coordinates this system? Who ensures that, for example, the number of televisions a society produces is the same as the amount it needs and wants? Who ensures that the right number of employees works in the electronics industry? Who makes sure that televisions are produced in the best way possible? How does it all get done? The answer to these important questions depends on the kind of economic system a society uses.

The following Crash Course video provides additional information about the broad economic choices that countries make when they decide between planned and market economies.



You can [view the transcript for “Economic Systems and Macroeconomics: Crash Course Economics #3”](#) (opens in new window).

In the modern world today, there is a range of economic systems, from market economies to planned (or command) economies.

### Market Economies

A **market** is any situation that brings together buyers and sellers of goods or services. Buyers and sellers can be either individuals or businesses. In a market economy, economic decision-making happens through markets. Market economies are based on private enterprise: the means of production (resources and businesses) are owned and operated by private individuals or groups of private individuals. Businesses supply goods and services based on demand. Which goods and services are supplied depends on what products businesses think will bring them the most profit. The more a product is demanded by consumers or other businesses, the higher the price businesses can charge, and so the more of the product will be supplied. Consumer demand depends on peoples’

incomes. A person's income is based on his or her ownership of resources (especially labor). The more society values the person's output, the higher the income they will earn (think Lady Gaga or LeBron James).

Examples of free-market economies include Hong Kong, Singapore, and to a large extent, New Zealand, and the United States.

## Free Markets

In a **market economy**, decisions about what products are available and at what prices are determined through the interaction of supply and demand. A **competitive market** is one in which there is a large number of buyers and sellers, so that no one can control the market price. A **free market** is one in which the government does not intervene in any way. A free and competitive market economy is the ideal type of market economy, because what is supplied is exactly what consumers demand.

Price controls are an example of a market that is not free. When government intervenes, the market outcomes will be different from those that would occur in a free and competitive market model. When markets are less than perfectly competitive (e.g., monopolistic), the market outcomes will also differ.

### ? Practice Questions

<https://assessments.lumenlearning.co...essments/14268>

<https://assessments.lumenlearning.co...essments/14269>

## Planned (or Command) Economies



Figure 7.8.1: Sphinx.

Command economies operate very differently. In a **command economy**, economic effort is devoted to goals passed down from a ruler or ruling class. Ancient Egypt was a good example: A large part of economic life was devoted to building pyramids (like the one at the left), for the pharaohs. Medieval manor life is another example: The lord provided the land for growing crops and protection in the event of war. In return, vassals provided labor and soldiers to do the lord's bidding. In the last century, communism emphasized command economies.

In a command economy, resources and businesses are owned by the government. The government decides what goods and services will be produced and what prices will be charged for them. The government decides what methods of production will be used and how much workers will be paid. Some necessities like health care and education are provided for free, as long as the state determines that you need them. Currently, North Korea and Cuba have command economies.

The primary distinction between a free and command economy is the degree to which the government determines what can be produced and what prices will be charged. In a free market, these determinations are made by the collective decisions of the market itself (which is comprised of producers and consumers). Producers and consumers make rational decisions about what will satisfy their self-interest and maximize profits, and the market responds accordingly. In a planned economy, the government makes most decisions about what will be produced and what the prices will be, and the market must follow that plan.

Most economies in the real world are mixed; they combine elements of command and market systems. The U.S. economy is positioned toward the market-oriented end of the spectrum. Many countries in Europe and Latin America, while primarily market-oriented, have a greater degree of government involvement in economic decisions than in the U.S. economy. China and Russia, while they are closer now to having a market-oriented system than several decades ago, remain closer to the command-economy end of the spectrum.

### ? Practice Question

<https://assessments.lumenlearning.co...essments/14270>

<https://assessments.lumenlearning.co...essments/14271>

To recap, economic systems determine the following:

- What to produce?
- How to produce it?
- Who gets it?

In a planned economy, government controls the factors of production:

- In a true communist economy, there is no private property—everyone owns the factors of production. This type of planned economy is called a *command economy*.
- In a socialist economy, there is some private property and some private control of industry.

In a free-market (capitalist) economy, individuals own the factors of production:

- Privately owned businesses produce products.
- Consumers choose the products they prefer which causes the companies that produce them to make more profit.

Even in generally free market economies, governments will

- Maintain the rule of law
- Create public goods and services such as roads and education
- Step in when the market gets things wrong (e.g., setting minimum wage, establishing environmental standards)

In reality, economies are neither completely free-market nor completely planned. Neither exists in “pure” form, since all societies and governments regulate their economies to varying degrees. Throughout this course we will consider a number of ways in which the U.S. government influences and controls the economy.

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