

## 3.8: Economic Systems

### Learning Objectives

- Describe characteristics of market economies, including free and competitive markets
- Describe characteristics of a planned, or command, economy



**Figure 1.** Perhaps a picture of a planned economy?

### Types of Economies

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.

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<https://assessments.lumenlearning.co...sessments/7102>

## Planned (or Command) Economies



**Figure 2.** Ancient Egypt's command economy forced people to work on the building the pyramids.

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, communist countries have employed 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. With the collapse of the former Soviet Union in the 1990s, command economies fell out of favor as an economic system. Currently, only 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 consumers react passively to 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.

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### Watch It

The following Crash Course video provides additional information about the broad economic choices that countries make when they decide between planned and market economies. The narrators talk fast, so you'll need to listen closely and possibly watch the video a second time!

A link to an interactive elements can be found at the bottom of this page.

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:

- Businesses produce products.
- Consumers choose the products they prefer leading the companies that produce them to make more profit.

Even in free markets, governments should

- 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)

### Learning Objectives

[glossary-page][glossary-term]command economy: [/glossary-term]

[glossary-definition]an economy where economic decisions are passed down from government authority and where resources are owned by the government[/glossary-definition][glossary-term]competitive market: [/glossary-term][glossary-definition]is one in which there is a large number of buyers and sellers, so that no one can control the market price[/glossary-definition]

[glossary-term]free market:[/glossary-term][glossary-definition] a market in which the government does not intervene in any way[/glossary-definition][glossary-term]market economy:[/glossary-term][glossary-definition] an economy where economic decisions are decentralized, resources are owned by private individuals, and businesses supply goods and services based on demand[/glossary-definition][glossary-page]

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