

# Comparative Economic Systems

by Sophia Tutorial



## WHAT'S COVERED

This tutorial will cover comparative economic systems. We will discuss the three questions every economy answers and compare market and command economies, as well as explain why most economies are neither pure market nor pure command economies.

Our discussion breaks down as follows:

1. Three Key Economic Questions
2. Market Economies
3. Command Economies
4. Mixed Economies

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## 1. Three Key Economic Questions

We know that economics as a field of study looks at choices.

Because of scarcity, consumers and firms make choices everyday.

When consumers make choices, they are looking to maximize their utility. When firms make choices, they aim to maximize profit. Every choice made every day involves an opportunity cost.

All of our choices added up equate to societal choices.

Economic systems have developed in order to help our society answer three main questions:

1. What should be produced?
2. How should those things be produced?
3. Once it is produced, who should receive it?

Just as individuals have different values, so do societies. Depending on a society's values, these questions will be answered differently.

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## 2. Market Economies

A **market economy** is a system free to establish the price of goods and services according to supply and demand.

In a pure market economy, there is absolutely no government interference at all.



HINT

You may hear the term "laissez-faire" to describe a market economy--meaning hands off!

The government would not intervene to provide any public goods at all. There would be no safety nets like social security or welfare programs, for example.

This would be a government that is completely relying on supply and demand in the private marketplace to determine the answers to all of those three economic questions.

Individual consumers and firms would decide what gets produced, how it gets produced, and who receives those things.

The values that would rank high in this economy are:

- *Economic efficiency.* We know that the marketplace without government intervention does a good job of efficiently figuring out what needs to get produced and what price is going to be the best price. You've seen equilibrium price and quantity many times, so you know that it is a very efficient way of figuring out those things.
- *Economic freedom.* This would also obviously rank high here, because in a market economy with no government telling you what is going to be produced or controlling prices--or what you have to do for a living, as an extreme--you are completely free in your economic life.
- *Economic growth and innovation.* Both of these values would be highly encouraged in a market economy. There is profit motive alone driving things, so people and businesses tend to do the absolute best they can because it is in their best interest to do so, which encourages economies that are market-based to have a lot of innovation and growth.



TERM TO KNOW

### Market Economy

A system free to establish price of goods and services according to supply and demand

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## 3. Command Economies

A **command economy** is at the opposite end of the spectrum, where goods and services are produced and sold according to government alone, instead of through the free market mechanism of supply and demand.

In a pure command economy, there is no private sector. Nobody would own anything themselves; all goods would be provided by the government.



**EXAMPLE** For instance, there would be no such thing as owning your own home or having any property of your own--the government would own everything.

The government answers all three economic questions: what gets produced, how it gets produced, and how it is allocated.

Clearly, we know the shortcomings of command economies--communism--but we can look at some of the values that would rank high in this system:

- *Stability and predictability.* Knowing exactly what is going to happen is an idea, at least in theory, behind communism or command economies.
- *Economic equity.* Again, in theory, the idea that everyone should have the same amount of money and goods ranks high in command economies (not to be confused with political equity).

These economies have had problems throughout history, partly because there is an absence of profit motive.

In command economies, the government does not have profit motive as firms do, to get people exactly what they want at a price they are willing to pay.

The government also does not have an incentive to keep costs low and constantly innovate and improve processes.

Therefore, command economies lacks efficiency and innovation.



#### TERM TO KNOW

#### Command Economy

Goods and services are produced and sold according to government instead of through free market mechanism, supply and demand

## 4. Mixed Economies

In reality, most economies today in the world are mixed.

They are neither pure free markets or pure command markets.

While there are certainly some countries that have less government than most, it is very difficult to find any examples of pure free markets with no government at all in the world today.

↪ **EXAMPLE** The closest example to a pure free market may be former Somalia, which until recently had literally no government ruling or making any decisions; the country was essentially controlled by gangs.

Pure command economies today are also rare.

↪ **EXAMPLE** North Korea would probably be the closest to a pure command economy where the government is controlling everything.

There are a spectrum of countries in the world today, but most of them are mixed. It simply depends on how much the government is intervening.

#### IN CONTEXT

The United States is market-based, where supply and demand is answering most of the questions and setting prices instead of the government.

However, government does intervene in our country to provide most public goods, protection for some common goods--to take care of that "tragedy of the commons" that can occur--and some safety nets such as welfare programs like unemployment insurance or social security.

Therefore, the U.S. is not a pure market economy.

As mentioned, the level of government varies across country to country, but it also changes over time as conditions in the country change and as values in the society change.



## SUMMARY

Today we learned about the **three key economic questions** that every economy answers regarding what is going to get produced, how it is going to get produced, and who should receive it. We learned about the difference between **market economies** and **command economies**, discussing why most economies today--including the economy in the U.S.--are **mixed economies**.

Source: Adapted from Sophia instructor Kate Eskra.



## TERMS TO KNOW

### **Command Economy**

Goods and services are produced and sold according to government instead of through free market mechanism, supply and demand.

### **Market Economy**

A system free to establish price of goods and services according to supply and demand.