

## Introduction

Consider the last time you exchanged money for something—whether it was a good or service—that satisfied a want or need. This exchange of money for a good or service probably seemed quite simple, but beneath this transaction was an economic system. An economic system is the way a government and its people use its resources to satisfy its people’s needs and wants. With all the diversity in the world, it is nice to know that there are only three types of economic systems: the *traditional*, *market*, and *command* economic systems. Sure, there are variations on these three types, but as they say, “That’s All, Folks!”



## The Traditional System: Primitive Humans Find a Way to Co-exist with Nature and Each Other

Primitive people met their needs—food, clothing, and shelter—in very simple ways. They grabbed a weapon and killed animals for food, often using the hides and remains to fashion clothing and cover. They may have staked out suitable caves or tree cover for shelter.

Meeting their basic needs was quite difficult and dangerous for primitive people. *Economics* to primitive humans was about the constant search for food and strategies to avoid ever-present dangers.

Danger abounded for primitive people, so they grouped together in *tribes* for protection against enemies—both human and natural. When humans began to live in groups, they had to consider issues larger than feeding themselves and their families. The tribe developed leaders who made decisions to help the tribe survive. For example, the chief of the tribe probably told the tribespeople that they must share their kills with everyone. Perhaps the chief began to divide important tasks. Some people hunted; others made clubs for hunting, and others cooked the meals.

The tribal system was the first political system that people developed to help them increase their ability to survive. The tribal system is an example of how politics influence and develop primitive economic systems. As time went on, tribes began trading goods, both within their own tribes

and with other tribes. Food may have been traded for clothing. One piece of clothing may have been traded for another. There was no money to buy goods from one another; only *things* had value.

**Barter** is the exchange of goods without using money. Barter first occurred in societies that did not have money. It is the only form of trade in a **traditional economic system**. For two people to barter, both must have property that is desired by the other, and both must be willing to exchange their property for that of the other person. Bartering is still used by individuals and even giant corporations that wish to trade goods or services owned by another individual or corporation. Think of yourself—you probably traded something today.

In traditional economic systems, few goods are produced. Most of the goods produced are those necessary for food, shelter, and clothing. In this economic system, human-made goods are usually produced by hand rather than by machines. The big problem in this system is called *double coincidence of wants*. Simply, this means someone has to want to trade you for your products. Trading in a barter economy is not always easy.

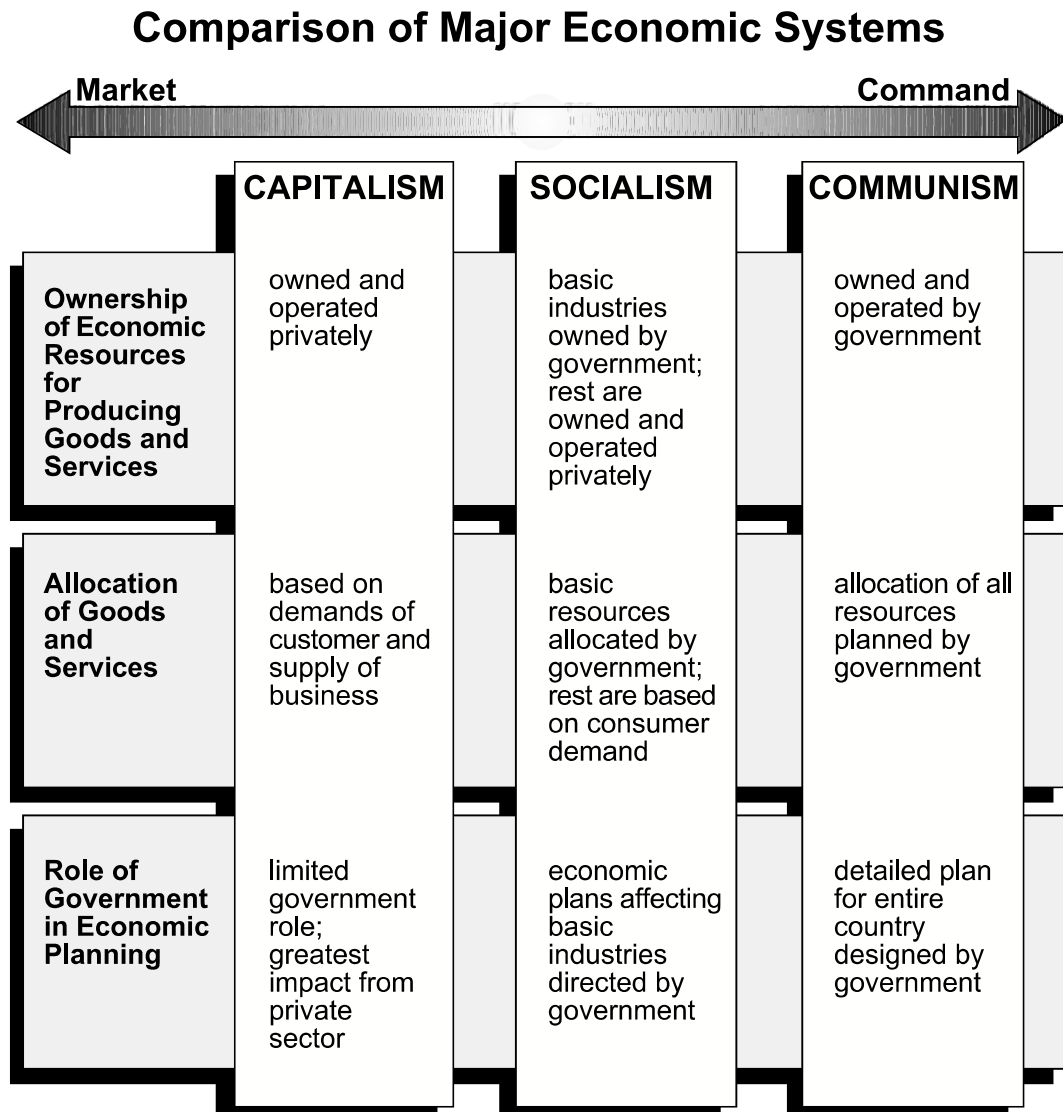
## The Market System: Money Replaces Barter

The **market economic system** developed along with the earliest governments in Greece and Rome. In a market system, goods are exchanged for money. A market system allows people to buy the goods they want and producers to make the goods they feel people will buy. Money allows corporations to accumulate the vast amount of wealth required to build products such as automobiles and aircraft. No corporation could efficiently barter for all the necessary resources to build these goods.

Most societies that have developed market economies are **democracies**. *Democracies* stress the rights of individual citizens to make and buy almost any goods they wish to produce or demand. Democracies fit well with the market economic system. Market economic systems permit wide-ranging political



and economic freedom. By promoting money as a medium of exchange for buying and selling goods, market systems have developed the wealthiest civilizations on Earth. **Capitalism** is the name often given to describe this freedom to buy and sell goods of one's choice and the right to own private property.



## The Command Economic System: Total Government Control

Some civilizations have chosen to control the buying and selling of goods with either very rigid sets of rules or government-owned factories, and in some cases, both. These economic systems are called **command economic systems**. People use money to buy and sell goods just as they would in the market system, but they have less freedom to become wealthy because the government restricts them from starting their own business or investing their incomes.

With the breakup of the Soviet Union and the changes in China today, the last of the command economic systems are converting to market economic systems. Although **economists** agree that the process has begun, they cannot predict how long it will take for these countries to move from government rule and ownership to *free enterprise*.

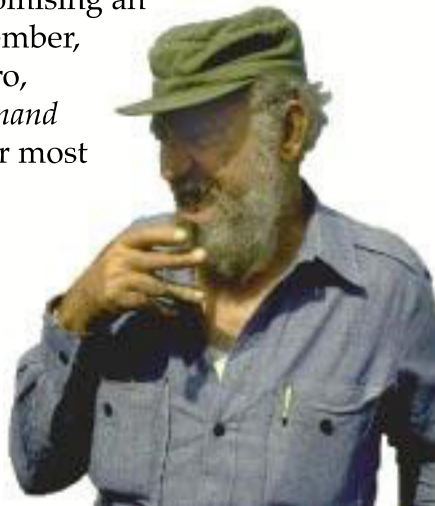
### Case Study: Government Controlled Command Economy

#### Cuba

About 90 miles off the southern Florida coast lies a country known as Cuba. Before Cuba was colonized it had a *traditional economy* with people trading or bartering for survival. Most nations start this way; however, as Cuba grew, so did the need for a more advanced economic system.

A crude market system grew until the late 1950s when current leader Fidel Castro came to power promising an industrialized market economy. Remember, we all have to make choices and Castro, once in power, chose a primarily *command economy* with government control over most everything.

In a command economy, the government makes decisions about what to produce, how much to charge, and how much to pay workers. Cuba's command economy and political differences have severely delayed Cuba's economic growth and international relations with the United States. Throughout



*Fidel Castro came to power promising an industrialized market economy.*

the years, the *market economy* of the United States and the Cuban command economy have clashed over issues with the United States prevailing. Today through the economic choices of its leader, Castro, Cuba has one of the poorest economies in the world.

All nations have to choose some type of economic system. Elements of all three economic systems need to be present in a mixed economic system, or there is a likelihood of delayed economic growth.

### Mixed Economies: Combining Basic Types

No country in the world has a *pure* traditional, market, or command economic system. By using some of the basic **economic elements** of each system, countries have developed their own unique economic systems. That is, all countries take certain basic elements and mix them together to create an economic system that meets their specific needs. In the end, each system evolves into a unique *mixed* economy that is not based on a pre-determined plan.

In the United States, just as in all countries, a *mixed economy* has evolved. Most of the elements used to develop our economic system came from the *market economic system*, but we also have elements from the *command* and

*traditional* systems. The Canadian economic system has a few more **command elements** than ours—their government has more control over their industries and health care. In Switzerland, industries have more economic freedom than do companies in the United States. The countries of the former Soviet Union are just beginning to adopt market elements to transform their command economic system into a mixed economy. Their current system, however, still has more government control, especially over industry, than the American system.



If an economy is entirely free of government rules, it is called a *pure market system*. Such systems do not actually exist. Both producers and consumers need rules to provide for the safety of products, or to insure fair pay and safe working conditions. Mixed economies vary in the amount of government control. In some societies, mixed economies lean very heavily towards government control; others, such as the Swiss, have very few rules that control their economies.

If an economy is not free and the government owns and operates all production, it is called a *pure command economic system*. The four basic economic decisions of what to produce, how to produce, and to a great extent, for whom to produce and how efficiently are in the hands of the government. In a *modified command system*, however, the government allows the people to make some decisions about what, how, for whom to produce, and how efficiently. A modified command system is one type of mixed economy—it contains a *mixture* of different basic economic elements. Presently, all economic systems are mixed.

#### **All Economic Systems Must Answer These Four Questions**

- What goods and services will be produced?
- What methods will be used to produce those goods and services?
- For whom will those goods and services be produced?
- Are we efficient?

Traditional economic systems, or pure barter systems, do not survive once they come into contact with economically *advanced* civilizations. Their economic systems do not become modified—there is no such thing as a modified traditional economic system—rather they eventually disappear and are replaced by more recently developed systems. A good example of such an event occurred when people from the mainland of the United States met the original settlers of the Hawaiian Islands. Mainlanders introduced a new lifestyle to the Hawaiians. The goods and services that were part of this new lifestyle forever changed the Hawaiians' traditional economic system. Money was introduced, and the traditional barter system all but disappeared. Money became the dominant medium in the exchange of goods. The people of the traditional economic system began

supplying raw materials for the economically advanced mainlanders in return for manufactured goods, including weapons, clothes, and jewelry. Soon the traditional economy disappeared, and the native Hawaiians adopted the mainlanders' economic system.

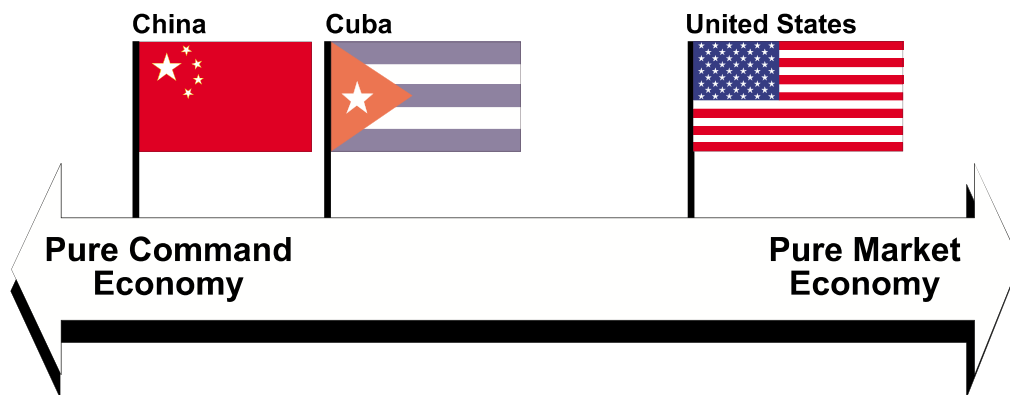
In summation, all nations have a mixed economic system with tendencies toward a market or command system. Traditional systems have all but disappeared, but the barter system still exists in mixed societies. No matter what system nations may choose, they all are answering the same questions and dealing with scarcity.

## The Economic Spectrum: From Pure Command to Pure Market

It is possible to look at economic systems along a spectrum or continuum. The illustration below shows the range between a pure market system that allows total economic freedom and a pure command system that allows no economic freedom.



On a scale, the economy of our country would be placed closer to the right-hand side of the line than the left-hand side. China would be placed much closer to the left-hand side of the scale. Cuba would be placed closer to China than the United States. However, this could change as the future world economy changes.



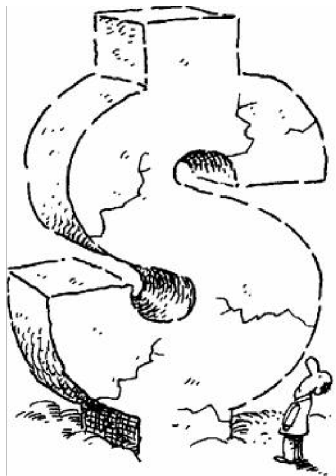
The illustration above indicates that the economy of the United States is not a pure market but instead is a *modified* market system. What is not shown is that besides some market elements in our economy, we also have some elements of a traditional economic system in our economy. Barter, or the exchange of goods without the use of money, still exists to a small extent in our economy. Visit a nearby flea market and watch the exchange or bartering of property. The United States also has some command elements, such as when the government controls the production of some goods (like nuclear weapons) or decides who will get some goods (such as the distribution of food stamps).



In summary, the economy of the United States is a modified market economy. All existing economic systems in the world are either modified market economies or modified command systems. Some economies lean more towards a pure command system; some lean more towards a pure market system. Some traditional elements such as barter still exist, but that is about all that is left of the traditional economic system.

## Changing Terminology: From Command Economy to Command Elements

The former Soviet Union was the largest modified command economic system. The government of the former Soviet Union operated most of the factories in the country. Rules were made in Moscow about what goods to produce, how those goods were to be made, and which citizens could obtain which goods.



With the collapse of the Soviet Union, the 15 former member republics of the Union of Soviet Socialist Republics (USSR) began to change their own economic systems into a modified market economy—a movement to the right along the continuum (see previous page). In addition, countries formerly under domination of the Soviet military have also begun to shift towards modified market economies. Countries such as Poland, East Germany, which is now part of the Federal Republic of Germany, and Hungary have begun the process of allowing their citizens to decide what goods they wish to buy and sell.

The collapse of the Soviet Union has forced economists to come up with new ways to discuss government controls in an economy. The old term *command economic system* no longer accurately describes the situation.

Current usage is now changing from the term *command economic system* to the term *command economic elements*. This new term means that there is still some government control over the economy, but there are no longer large countries, such as the former Soviet Union, that dictate a command system to their people. Some small countries, such as Cuba, still have command economies.

## Measuring Government Control of the Economy: A Closer Look at Government Control of the Economy

The more goods produced under government direction, the more command elements are functioning in that economy. The **gross domestic product (GDP)** of a country is the total value of all final or finished goods and services produced in one year *within a nation's borders*, by whoever produces them. The **gross national product (GNP)** of a country is the total value of all final or finished goods and services produced in one year *by a nation's residents*, no matter where they are located. Beginning in November of 1991, the United States Department of Commerce switched emphasis to gross domestic product from gross national product. The shift reflects that GDP has become more closely related to changes in economic factors, such as employment.

Another way to look at the command elements of an economy is to find out what percentage of the average citizen's salary is spent on taxes. Consider that tax money is spent by the government on goods and services directed by a

country's leaders; what is left after taxes is used by consumers to buy the goods and services they wish to buy. The graph above compares countries' tax rates as a percentage of their gross national product.

Note, for example, that in the United States 30 percent of the nation's GDP is collected by the government in taxes. In other words, the government controls and spends about 30 percent of all the wealth created by Americans. In Sweden the government collects about 55 percent of the country's GDP. The Swedish government controls more of its country's wealth than its citizens do. Thus, Sweden would be considered more of a command economy than the United States. However, remember all economic systems are *mixed*.

