

Advantages and Disadvantages of the Three Economic Systems

The survival of any society depends on its ability to provide food, clothing, and shelter for its people. Because these societies face scarcity, decisions concerning WHAT, HOW, AND FOR WHOM to produce must be made.

All societies have something else in common. They have an economy, or economic system – an organized way of providing for the wants and needs of their people. The way in which these provisions are made determines the type of economic system they have. Three major kinds of economic systems exist – traditional, command, and market. Most countries in the world can be identified with one of these systems.



Traditional Economies

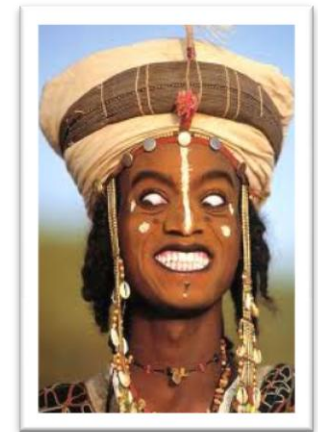
Many of our actions spring from habit and custom. Why, for example, do so many Americans eat turkey on Thanksgiving? Why does the bride toss the bouquet at a wedding? Why do most people shake hands when they meet, or leave tips in restaurants? These practices have generally been handed down from one generation to the next and have become tradition – they are a part of American culture.

In a society with a traditional economy, the allocation of scarce resources, and nearly all other economic activity, stems from ritual, habit, or custom. Habit and custom also dictate most social behavior. Individuals are not free to make decisions based on what they want or would like to have. Instead, their roles are defined by the customs of their elders and ancestors.

Examples

Many societies – such as the central African Mbuti, the Australian Aborigines, and other indigenous peoples around the world – are examples of traditional economies. The Inuits of northern Canada in the 1800s provide an especially interesting case of a traditional economy.

For generations, Inuit parents taught their children how to survive in a harsh climate, make tools, fish, and hunt. Their children, in turn, taught these skills to the next generation. The Inuit hunted, and it was traditional to share the spoils of the hunt with other families. If a walrus or bear was taken, hunters divided the kill evenly into as many portions as there were heads of families in the hunting party. The hunter most responsible for the kill had first choice, the second hunter to help with the kill chose next, and so on.



Later, members of the hunting party shared their portions with other families, because the Inuit shared freely and generously with one another. The hunter had the honor of the kill and the respect of the village, rather than a physical claim to the entire kill. Because of this tradition of sharing, as long as skilled hunters lived in the community, a village could survive the long harsh winters. This custom was partially responsible for the Inuit's survival for thousands of years.

Advantages

The main strength of a traditional economy is that everyone knows which role to play. Little uncertainty exists over WHAT to produce. If you are born into a family of hunters, you hunt. If you are born into a family of farmers, you farm. Likewise, little uncertainty exists over HOW to produce, because you do everything the same way your parents did. Finally, the FOR WHOM question is determined by the customs and traditions of the society. Tradition dictates how people live their lives.

Disadvantages

The main drawback of the traditional economy is that it tends to discourage new ideas and new ways of doing things. The strict roles in a traditional society have the effect of punishing people who act differently or break rules. The lack of progress leads to a lower standard of living than in other types of economic societies.

Command Economies

Other societies have a command economy, one in which a central authority makes most of the WHAT, HOW, and FOR WHOM decisions. Economic decisions are made by the government: the people have little, if any, influence over how the basic economic questions are answered.

Examples

There are few command economies in the world today, but they still can be found in North Korea and Cuba. Until recently, the People's Republic of China, the communist countries of Eastern Europe, and the former Soviet Union also had command economies.



In the former Soviet Union, for example, the government made the major economic decisions. The State Planning Commission directed nearly every aspect of the Soviet economy. It determined needs, decided goals, and set production quotas for major industries. If the State Planning Commission wanted growth in the heavy manufacturing, it shifted resources from consumer goods to that sector. If it wanted to strengthen national defense, it directed resources to the production of military equipment and supplies.

Advantages

The main strength of a command system is that it can change direction drastically in a relatively short time. The former Soviet Union went from a rural (or primitive) agricultural society to a leading industrial nation in just a few decades. It did so by emphasizing heavy industry and industrial growth rather than the production of consumer goods.



During this period, the central planning agency shifted resources around on a massive scale. Consumer goods were virtually ignored, and when the country faced a shortage of male workers on construction projects, the government put women to work with picks and shovels.

Another advantage of command economies, especially those represented by the former Soviet Union and modern-day Cuba, is that many health and public services are available to everyone at little or not cost, regardless of income. While the quality of these services varies widely, it can

be argued that access to some services is better than none.

Disadvantages

One disadvantage of a command system is that it is not designed to meet the wants of consumers, even though many basic needs are provided. In the case of Soviet industrial development, generations were forced to do without such consumer goods as cars, home appliances, and adequate housing. People often were told to sacrifice for the good of the state and the benefit of future generations.

A second disadvantage is that the system does not give people the incentive to work hard. In most command economies, workers with different skills and responsibilities receive similar wages. In addition, people seldom lose their jobs, regardless of the quality of work. As a result, many people work just hard enough to fill the production quotas set by the planners.

This can have unexpected results. At one time in the former Soviet Union, central planners set production quotas for electrical motors to be measured in the tons of output per year. Workers soon discovered the easiest way to

fill the quota was to add weight to the motors. As a result, Soviet workers made some of the heaviest electrical motors in the world. They also produced some of the heaviest chandeliers in the world for the same reason. Some were so heavy that they fell from ceilings.

A third weakness is that the command economy requires a large decision-making bureaucracy. Many clerks, planners, and other administrators are needed to operate the system. Most decisions cannot be made until after consulting a number of people and processing a large amount of paper-work. These procedures slow decision making and raise the costs of production.

Yet a fourth weakness of a command economy is that it does not have the flexibility to deal with minor, day-to-day problems. Even when some change is needed, the sheer size of the bureaucracy discourages even the smallest adjustments. As a result, command economies tend to lurch from one crisis to the next – or collapse completely as in the case of the former Soviet Union.

Finally, people with new or unique ideas find it difficult to get ahead in a command economy. Rewards for individual initiative are rare. Each person is expected to perform a job in a factory, in the bureaucracy, or on a farm, according to the economic decisions made by the central planners.

Market Economies

In a market economy people and firms act in their own best interests to answer the WHAT, HOW, and FOR WHOM questions. In economic terms, a market is an arrangement that allows buyers and sellers to come together in order to exchange goods and services. A market might be in a specific location, such as a farmers' market or a flea market. A list of phone numbers for lawn-mowing services posted on a local bulletin board also acts a market. As long as a mechanism exists for buyers and sellers to get together, a market can exist.

In a market economy, people's decisions act as votes. When consumers buy a particular product, they are casting their "dollar votes" for that product. After the "votes" are counted, producers know what people want. Because producers are always looking for goods and services that consumers will buy, the consumer plays a key role in determining WHAT to produce.



Examples

Many of the largest and most prosperous economies in the world, such as the United States, Canada, Japan, South Korea, Singapore, Germany, France, Great Britain, and other parts of Western Europe, are based on the concept of a market economy. While there are also many significant differences among these countries, the common thread of the market binds them together.

Advantages

One advantage of a market economy is that over time, it can adjust to change. During the gasoline shortage of the 1970s, for example, consumers reduced their demand for large, gas-guzzling automobiles and increased their demands for smaller, fuel-efficient ones. Because auto makers still wanted to sell cars, they moved resources from the production of large cars to small ones.

When gas prices finally declined in the mid-1980s, the trend slowly began to reverse. Consumers wanted to buy large cars again, so auto makers began making large, although more fuel-efficient, vehicles again. Changes in a market economy, then, tend to be gradual. Unlike the traditional economy, change is neither prohibited nor discouraged. Unlike the command economy, change is neither delayed because of bureaucracy, nor suddenly forced on people by others.

A second major strength of the market economy is its high degree of individual freedom. Producers may make whatever they think will sell. They also decide the HOW question by producing their products in the most efficient

manner. Consumers, on the other hand, spend their money on the goods and services they prefer. Meanwhile, individuals are free to choose where and when they want to work, and if they should invest further in their own education and training.

A third strength is the relatively small degree of government interference. Except for certain important concerns, such as national defense and environmental protection, the government tries to stay out of the way so that buyers and sellers can go about their business. As long as competition exists, the market economy tends to take care of itself.

A fourth advantage is that decision making is decentralized, or not concentrated in the hands of a few. Literally billions – if not trillions – of individual economic decisions are made daily. Collectively, these decisions direct scarce resources into uses that consumers favor. Because individuals make these decisions, everyone has a voice in the way the economy runs.

A fifth strength of the market economy is the incredible variety of goods and services available to consumers. Almost any product can and will be produced if a buyer for it exists. Recent products include everything from Internet bookstores to 24-hour cable television cartoon and comedy networks to ultrasound devices that keep the neighbor's dog out of your yard. In short, if a product can be imagined, it can be produced in hopes that people are willing to buy it.

A sixth strength is the high degree of consumer satisfaction. In a market economy, almost everyone can satisfy his or her wants because the choice one group makes does not mean that another group cannot have what it wants. To illustrate, if 51 percent of the people want blue shirts, and 49 percent want white ones, people in both groups can still get what they want. Unlike an election, the minority does not have to live with the choices the majority makes

Disadvantages

One of the disadvantages of the market economy is that it does not provide for the basic needs of everyone in the society – some members of the society may be too young, too old, or too sick to care for themselves. These people would have difficulty surviving in a pure market economy without assistance from government or private groups.

Another disadvantage of a market economy is that it does not provide enough of the services that people value highly. For example, private markets cannot adequately supply a system of justice, national defense, universal education, or comprehensive health care. This because private producers concentrate on providing products they can sell. Therefore, government must provide these services, paid for with tax dollars.

A third disadvantage of a market economy is the relatively high degree of uncertainty that workers and businesses face as a result of change. Workers, for example, worry that their company will move to another city or country in order to lower the cost of production. Employers worry that another company will produce a better and less expensive product, thereby taking their customers.

Finally, market economies can fail if three conditions are not met. First, markets must be reasonably competitive, allowing producers to compete with one another to offer the best value for the price. When markets fail, some businesses become too powerful and some individuals receive incomes much larger than that justified by their productivity. Second, resources must be reasonably free to move from one activity to another. Workers, for example, need the freedom to change jobs if they have a better opportunity somewhere else. Producers need the freedom to produce goods and services in the best way they know how. Third, consumers need access to adequate information so that they can weigh the alternatives and make wise choices.

