Types of Economic Systems

1. Traditional Economy

This is a type of economic system which is based on agriculture, fishing, and hunting. These economies are based on traditional beliefs and ideologies. The goods and services are made based on the occupation of the people. Money is not used in such economy instead barter system is used. Most economists believed that most economies started as traditional economies.

Below are the common characteristics of Traditional Economy:

- This type of economic system mostly centers on a family or a tribe.
- Mostly they have primitive kind of occupation like farming, hunting, fishing etc.
- They are self-sustained.
- This type of economic system does not engage much in trading. They consume whatever they produce and they rely mostly on barter systems.
- When people in traditional economies engage in farming from hunting, they try to settle down and gradually form a society.

Advantages of Traditional Economy

- Less threat to the environment as the people mostly use traditional ways of occupation like farming, fishing, cattle rearing.
- There is no wastage in this type of economic system. They consume whatever they produce.

Disadvantages of Traditional Economy

- As the economy is based on hunting and farming, the economy becomes disrupted in the offseason when the weather changes.
- In such times, people starve as they don't have goods to survive on.

Now we will discuss some examples of the traditional economy to understand it better.
Some of the countries like Bangladesh, Haiti might still use primitive ways of agriculture but they are not traditional economies as they have modern occupations as well. A traditional economy is about self-sustenance. You can refer to the Jarawa tribe of the Andaman Islands. They use primitive ways for survival.

2. Command Economy

This is a type of economic system where the government has a monopoly over the market. It decides which goods will be produced in what quantity. The government also determines the prices of the goods. All the laws and regulations regarding the market are also set by the government. So in this economy, there is no competition as the government decides all the pricing. The government is also in charge of allocating the resources.

Below are the common characteristics of command economy:

- This type of economic system doesn't rely on the laws of demand and supply.
- Only the government decides the economic laws and regulations.
- The government controls the production of goods and services.

Advantages of Command Economy

- It doesn't face inequality problems among the citizens.
- It also has low levels of unemployment
- As the government is in control of production, profit is not only the motive of production of goods.
- The entire society can be transformed according to the government's economic plan as there is no other free force in the market.

Disadvantages of the Command economy

- Such economies lack innovation as it doesn't have any free flow of ideas.

- This is a type of economic system might ignore the needs of the societies as in such situations black market can emerge as it will supply the goods that the economy is not producing.
- Supply of goods may not be as par with demand.
- These economies won't take the risk of bringing something new as the government has its own set of policies and directives in place.

Some of the countries like North Korea, Cuba are examples of the command economy.

3. Market Economy

This is a type of economic system where the government has no control over the market, the citizens and businesses decide which goods will be produced in what quantity. The pricing is decided by the laws of demand and supply. The government can decide the pricing ceiling so that they do not charge the customer as per their free will. So in this economy, there is competition among the business as there is not much government intervention.

Below are the common characteristics of the market economy:
- This is a type of economic system solely relies on the laws of demand and supply.
- The demand and supply laws control the quantity of production of goods and services.

Advantages of Market economy
- Such economies have a lot of innovation as it has a free flow of ideas.
- It has greater efficiency as there is a lot of competition in the market.
- It has a greater chance of wealth.
- It produces the goods according to the demand of the citizens as customers are ready to pay whatever price they charge.

Disadvantages of Market economy
- It faces inequality problems among the citizens.
- As the government is in no control of production, profit is the only the motive of production of goods.
- There might be poor working conditions as there is no government regulation in place.
- Unemployment may rise as there is no government check in the market.

Some examples of the market economy are the United States, Germany, and Canada.

4. Mixed Economy

Mixed economic system, where is combined all the above three economies i.e. traditional, command and market. The government has an intervention over the market as well as free forces exist. It decides which goods will be produced in what quantity. The pricing is decided by the laws of demand and supply but the government decides the pricing ceiling and taxation norms. So in this economy, there is competition as well as the government safeguards the interest of the people. The government is also in charge of creating an economic plan.

Below are the common characteristics of a mixed economy:
- It relies on the laws of demand and supply.
- The government decides the economic laws and regulations.
- The government controls the production of goods and services.

Advantages of Mixed Economy

This is a type of economic system has all the advantages of a market economy like there is the free flow of ideas, it allows laws of demand and supply to determine the pricing policy and there is also a creation of wealth.

Disadvantages of Mixed Economy

Similarly, this is a type of economic system has all the disadvantages of the above-discussed economies. Some of them are like there might be wastage of resources; economic decisions might get delayed in execution in the sector. There also might be poor planning as a large part of the government is not in control of the government. Examples of a mixed economy are India, France.

Criteria for classifying Economies

Economy

An economy is made up of a group of people which are located within a political entity that has particular geographical characteristics and who are producing and consuming goods and services. An economy functions according to certain rules, customs and laws that underpin the institutional framework within which people operate. It is these institutional frameworks and their basic rules, customs and laws that we are most interested in comparing across different economies.

1. Allocation mechanism

It is the basic problem of every economy to answer the questions of "what, how and for whom" goods and services are produced. All economies produce and distribute goods and services among its people. By production, it means that how factors of production are allocated to different goods and services. While by distribution, it means that how produced goods and services are allocated to people and which part of society gets which goods and how much quantity of these goods.

- In traditional economy, allocation decisions are made by customs or traditions. These customs or traditions are coming from past or they are based on some dominant religion. Thus in this system, the labour is allocated based on tradition. One does what his parents did and therefore allocation of goods is also based on this rule.
- In market economy, allocation decisions are made by individuals or firms on the basis of price signals emanating from the interaction of supply and demand. Market forces determine the production, distribution and consumption of goods and services.
- In a command economy, a central authority or government takes decision for allocation of goods and services and factor inputs.

2. Forms of ownership

The main difference between different economic systems is the ownership of resources or means of production. On the basis of ownership we can classify an economic system.
In capitalism, most of the factors of production are owned by private individuals and firms. While in command economy resources are owned by the state. In mixed economy some of the resources are owned by the state while some are owned by individuals.

3. Role of planning

Economic Planning is the making of major economic decisions what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated.
In centrally planned economy, planner's preferences dominate allocative decision making. Planners determine which goods and services are to be produced and how are they produced.
In capitalism, consumer sovereignty determines the production and distribution of goods and services. Every decision regarding production is made on the basis of consumer demand.
In mixed economy, there is indicative planning because it lacks the command element. The government only tries to influence individual decision making by appropriate monetary and fiscal policy.

4. Types of incentives

An incentive is anything that motivates a person to do something. Economic incentives are financial motivations for people to take certain actions.

In capitalism, there is material incentive. People are induced to work for their self interest or profit.

In socialism, moral incentive and slogans play an important role to induce people to work for their country. They are provided gifts and medals etc. for their services.

In mixed economy, there are both material and moral incentives to induce people.

5. Income redistribution and social safety nets

Redistribution of income and wealth is the transfer of income and wealth from some individuals to others through a social mechanism.

In communism, there is not much for income redistribution because it is already fairly distribute.

Under capitalism, there are various policies to redistribute income from rich to poor such as taxation, land reform, monetary policies etc.

So we can say that the system which has more income redistribution policies will be capitalism and the system which has small number of income redistribution policies will be socialism.

Criteria for Evaluation of an Economic System

Morris Bornstein presents nine criteria by which the relative performance of economic systems can be compared.

First is the level of output. This figure should be corrected for population and the price level, giving us real per capita output as the measure that equals real per capita income. According to this criterion, the free market economies have higher level of output and real per capita income as compared to command economies.

Second is the growth rate of output. This figure must also be corrected for population growth.
It is often easier for middle- to low-income countries to grow faster than either the very poorest or the very richest. The very poorest often are caught in **Malthusian low-level equilibrium traps** where little investment can occur because nearly all output is absorbed by consumption in an effort merely to stay alive. The middle- to low-income countries that have escaped from such traps can borrow technology from the most advanced countries and play catch-up according to the **relative backwardness hypothesis**. Such borrowing can bring dramatic productivity improvements in an economy that is more backward than the world's leading economies. The growth of the richest countries is limited by the general advance of technology at the frontier of knowledge.
Therefore, mostly command socialist economies grow rapidly in short run because they fall middle to low income countries, but in long run they suffer from serious stagnation because there is no incentive for profit; no one is ready to invest in research and development and technology.

Third is the composition of output. The most important is the ratio of consumption to investment. Share of military output and public versus private goods.
Generally command socialist economies have higher share going to investment because everyone is paid only according to his needs and a large sums are left for investment.

Fourth is static efficiency. Formally this means Pareto optimality, the idea that no one in society can be made better off without making someone else worse off. In this situation, resources are being fully utilized to their best potential given the existing technology, and as much is being produced as can be produced. Static efficiency implies that the labour force is fully employed and that the composition of goods being produced is what people want.
Although, market economies are more successful in this area, however, market economies tend to have worse unemployment than command economies.

Fifth is inter-temporal or dynamic efficiency, which involves the allocation of resources over time to maximize long-run sustainable growth. Thus it is the improvement of allocative and productive efficiency.
Allocative efficiency means to allocate resources in such a way to get maximum output.
Productive efficiency means to produce something at lowest average cost.
It means dynamic efficiency can be achieved by introducing new and better products, through innovation, learning, investment etc.
The capitalist economies are better in this regard.

Sixth is macroeconomic stability, the lack of large oscillations of output, employment, or the overall price level. It is usually argued that strict command economies achieve greater short-run macroeconomic stability as compared to market economies which often face short run fluctuations.

Seventh is economic security of the individual in terms of income, employment, and related matters such as health care. This criterion is partially related to the previous one, but it also depends on the broader social safety nets of an economy.

Eighth is the degree of equity of the income and wealth distributions. Generally the socialist and social market economies have more equal distributions than the strictly market capitalist economies.

Ninth is the degree of freedom available to the individual in terms of work, consumption, property, investment, and more broadly in the civil and political realms. This last variable is difficult to quantify, but market economies are well ahead of command economies in this area.