Economic Systems FAQ

Are all economic systems the same?

No, economists usually identify four basic types of economic systems—traditional, command, market, and mixed.

What is a traditional economy?

A traditional economic system is shaped by tradition. The sort of work that people do, the sorts of goods and services they provide, how they use and exchange resources are all shaped by tradition. These sorts of economic systems are not very dynamic—things don't change very much. Standards of living are static; individuals don't enjoy much financial or occupational mobility. But economic behaviors and relationships are predictable. You know what you are supposed to do, who you trade with, and what to expect from others.

In many traditional economies, community interests take precedence over individual. Individuals may be expected to combine their efforts and share equally in the proceeds of their labor. In other traditional economies, some sort of private property is respected, but it is restrained by a strong set of obligations that individuals owe their community.

What is a command economy?

In a command economic system or planned economy, the government controls the economy. The government decides how to use and distribute resources. The government regulates prices and wages; it may even determine what sorts of work individuals do. Socialism is a type of command economic system. Historically, the government has assumed varying degrees of control over the economy in socialist countries. In some, only major industries have been subjected to government management; in others, the government has exercised far more extensive control over the economy.

What is a market economy?

In market economies, economic decisions are made by individuals. The unfettered interaction of individuals and companies in the marketplace determines how resources are allocated and goods are distributed. Individuals choose how to invest their personal resources—what training to pursue, what jobs to take, what goods or services to produce. And individuals decide what to consume. Within a pure market economy the government is entirely absent from the economy.

What is a mixed economy?

A mixed economic system combines elements of the market and command economy. Many economic decisions are made in the market by individuals. But the government also plays a role in the allocation and distribution of resources.

What type of economist system does the United States have?

The United States has a mixed economy.

Has America always had a mixed economy?

No. When the nation was founded America's economy was far closer to a pure market economy. But from the start, many Americans also identified a role for government in the economy. Alexander Hamilton, for example, the first Secretary of the Treasury, outlined an ambitious plan for government support of the economy in 1791. He argued that the federal government should advance economic growth by a program of internal improvements—roads, bridges, ferries, and harbors. It should stabilize the nation's currency through the creation of a national bank. And most dramatically, the government should collect and funnel capital toward certain sectors of the economy through the careful management of the national debt.

Was the evolution of the American economy toward a mixed economy gradual and steady?

Not really. During certain periods, such as the Progressive Era (1900-1920), the Great Depression (1929-1940), and the 1960s, the federal government assumed a much greater role within the economy.

How did the government's role increase during the Progressive Era?

During the Progressive Era, policymakers like President Theodore Roosevelt argued that the economic playing field had been distorted by the growth of large corporations. He was not opposed to these new large industries, but he believed that their behavior needed to be supervised by an institution of equal size—the federal government. Following his lead, Congress passed the Pure Food and Drug Act and the Meat Inspection Act to protect consumers. To protect workers, the federal and state government passed a series of workplace safety and minimum wage laws. Congress attempted to restrain the power of corporations with the Clayton Antitrust Act and to expand its oversight of business through the creation of the Federal Trade Commission. And to ensure a more careful use of natural resources, Congress passed a series of conservation measures and created the National Forest Service.

How did the government's role increase during the Great Depression?

During the Great Depression, President Franklin Roosevelt introduced a set of government programs labeled the New Deal. Premised on the belief that economic conditions demanded far more aggressive government action, the New Deal moved the government beyond regulation and oversight into the role of job creator and income insurer. The government provided direct relief to the needy under the Federal Emergency Relief Act. It created jobs for the unemployed under the Public Works Administration, Works Progress Administration, and Civilian Conservation Corps. Agricultural prices were manipulated through the Agricultural Adjustment Act. Workers rights to organize into unions were protected under the Wagner Act. Through the Tennessee Valley Authority, the federal government set about re-constructing the economy of an entire region.

How did the government's role increase during the 1960s?

During the 1960s, President Lyndon Johnson introduced advanced even broader economic responsibilities for the federal government in a program labeled the Great Society. Under the Great Society, Johnson pledged to produce "abundance and liberty for all. . . . an end to poverty and racial injustice." America's safety net of social services was expanded through the introduction of food stamps and low-income rent subsidies. The Office of Economic Opportunity was created to assist in training and placing the unemployed. Increased federal aid to education was complemented by the creation of a program for high school dropouts—the Job Corps.

Have all Americans always supported this evolution toward increased government involvement in the economy?

No. In fact, Eras of government expansion were usually followed by periods of counter-reform in which government's role was reduced. During the 1920s, Congress and the Supreme Court struck down many of the Progressive Era measures. During the 1950s, the liberal principles of the New Deal were stifled by the anti-communist anxieties of McCarthyism. And during the 1980s, President Ronald Reagan worked to reverse the century's trend towards increased government involvement in the economy.

How did President Reagan attempt to reduce government's role in the economy?

Under a set of objective often labeled the Reagan revolution, he Reagan pledged to reduce the size of government and eliminate many of the regulations that he believed stifled entrepreneurial initiative and inhibited economic growth.

Was President Reagan successful in shrinking government and reducing its role in the economy?

To a certain extent. He slashed individual tax rates by 25% over three years. And he reduced business taxes further by improving depreciation allowances and research and development credits. He demanded an agency-by-agency review of government regulations. And these efforts led to increased competition and innovation in, most notably, the telecommunications and oil industries.

But he failed to curb spending and as a result budget deficits soared to an average of $175 billion annually during his presidency.