Traditional Economy

A **traditional economic system** is shaped by tradition. The work that people do, the goods and services they provide, how they use and exchange resources tend to follow long-established patterns. These economic systems don't change very much. Standards of living stay the same and business is 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* are more important than the individual. Individuals may be expected to combine their efforts and share equally.

Today, traditional economies are rare. Traditional economic systems can be found among Australian aborigines and some isolated tribes in the Amazon. In the past, they could be found everywhere—in the villages of medieval Europe, for example.

A traditional economy is defined by three characteristics:
1. It is based on agriculture, fishing, hunting, gathering or some combination of the above.
2. It is guided by traditions.
3. It may use barter (or trade) instead of money.

For these reasons, people who live in a traditional economy *appear to be* living in poverty, even if their daily needs are being met.

It is generally thought that all other economies got their starts as traditional economies. Likewise, it is generally expected that a traditional economy will *evolve* into either a market, command or mixed economy.

Characteristics of a Traditional Economy

At its most basic level, a traditional economy exists in a hunter/gatherer and nomadic society. These groups live in families or tribes, and cover wide areas to find enough food to support them. They follow the herds of animals that sustain them. They may also move to follow the seasons, whether it's winter/summer or wet/dry season.

Since traditional economies center around a family or tribe, it is easy to use traditions gained from the experience of the elders to guide day-to-day life. Economic decisions are based on these traditions.

Traditional Economy Advantages

Since traditional economies rely on custom and tradition, the distribution of resources is usually established (people know the deal). Everyone knows their role in production, and what they are likely to receive. Traditional economies are usually less destructive to the environment, and are therefore sustainable.

Traditional Economy Disadvantages

Traditional economies are very vulnerable to changes in nature, especially the weather. For this reason, traditional economies limit population growth. When the harvest or hunting is poor, people starve. They are also more vulnerable to market or command economies that have superior resources to wage war or take away needed natural resources. For example, Russian oil development in Siberia has damaged streams and the tundra, reducing traditional fishing and reindeer herding.

Traditional Economy Examples

- Traditional economies prevailed in the U.S. before the immigration of Europeans beginning in 1492. Native Americans economies that relied on hunting and fishing were more healthy than those that relied on farming and therefore massed in large, disease-prone communities. Nevertheless, even the most successful hunting-based economies were devastated by poaching and war from the new settlers. Their market economy gave them weapons and a source of funding that the traditional economies couldn't compete with.

- The American South had somewhat of a traditional economy before the Civil War. It was based largely on farming, and was guided by a strong network of traditions and culture that were largely devastated by the War.

- Two-thirds of Haiti's population relies on subsistence farming for their livelihood. Their reliance on wood as a primary source of fuel has stripped the forests of trees. This makes them vulnerable to natural disasters, such as the earthquake that struck Haiti in 2010.

- Many indigenous tribes in the Arctic region, in North America and eastern Russia, have maintained their traditional economy. They rely on fishing and hunting of caribou for their existence. Others, such as the Saami, manage reindeer herds.

US Aspects: Traditional Economy

The U.S. is moving further away from a traditional economy. However, many economic policies are still guided by tradition. First, a traditional economy is based on agriculture, hunting and fishing. U.S. farm business is still supported by Federal subsidies, even though it is run by a few global corporations.

However, tradition dictates that family farms be supported, even though there are few large family farms left. The fishing industry is also supported by laws and treaties. Although hunting is no longer needed as a primary source of food for America, it's still supported by laws and permits and celebrated in our traditions.

Command Economy

In a **command economic system** the government controls the economy. The state decides how to use and spread out resources. The government regulates prices and wages; it may even determine what sorts of work individuals do.

A command economy is where economic decisions are planned out in detail by a central government authority. The plan is implemented through laws, regulations and directives. Businesses follow production and hiring targets instead of individually and freely responding to the laws of supply and demand.

Socialism is somewhat of a 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.

Command Economy Advantages

Centrally planned economies are great at mobilizing economic resources quickly, effectively and on a large scale. They can execute massive projects, create industrial power and attain imperative social goals. They are able to override individual self-interest, and subjugate the welfare of the general population, to achieve a greater agreed-upon goal for the society at large.

Command economies are also good at wholly transforming societies to conform to the *planner's* vision, as in Stalinist Russia, Maoist China and Castro's Cuba. For example, the command economy in Russia built up an effective military might and quickly rebuilt the economy after World War II. Of course, there are other side effects when people like Mao, Stalin, and Castro are in power.

Command Economy Disadvantages

This rapid mobilization often means command economies must ignore other societal needs. For example, workers are often told what jobs they must fulfill and are even discouraged from moving.

However, people won't ignore their own needs for long. They often develop a shadow economy, or black market, to buy and sell the things the command economy isn't producing. The efforts of leaders to control this market can ultimately weaken support for the central planning authority.

Instead of leading to immense productivity, command economies often produce too much of one thing and not enough of another. That's because it's difficult for the central planners to get up-to-date information about consumers' needs. In addition, prices are set by the central plan, and so can't be used to measure or control demand. Instead, rationing often becomes necessary.

Command economies are not good at stimulating innovation. Businesses are focused on following directives, and are discouraged from making any autonomous decisions.

Centrally planned economies also have trouble producing the right exports at global market prices. It's difficult for the various planning sectors to coordinate with each other, not to mention foreign countries' needs.

Command Economy Examples

- The classic (failed) example of a command economy was the communist Soviet Union. The collapse of the communist bloc in the late 1980s led to the demise of many command economies around the world; Cuba and North Korea continue to hold on to their planned economies even today.

US Aspects: Command Economy

There are several aspects of the U.S. economy that follow the characteristics of a command economy. First, although there is no central economic plan, there is an annual Federal budget that outlines the government's priorities. This usually includes stimulating economic growth.

Second, resources are partially allocated through the use of taxes, which discourage some activities, and subsidies, which encourage other activities.

Third, government spending outlines the priorities for the country. For example, U.S. military spending increased after the 9/11 terrorism attacks.

Fourth, the government owns a monopoly in important national industries. These include NASA, the interstate highway system, and defense.

Fifth, the Federal government also uses laws, regulations and sometimes wage/price controls to support economic priorities.

Market Economies

In **market economies**, economic decisions are made by individuals. The free interaction of individuals and companies in the marketplace determines how resources are used and goods are distributed. Individuals choose how to invest their personal resources (money)—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 has zero involvement.

A market economy is an economy based on the power of division of labor in which the prices of goods and services are determined in a free price system set by supply and demand.

This is often contrasted with a planned economy, in which a central government can distribute services using a fixed price system. Market economies are also contrasted with mixed economy where the price system is not entirely free but under some government control or heavily regulated, which is sometimes combined with state-led economic planning that is not extensive enough to constitute a planned economy.

In the real world, market economies do not exist in pure form, as societies and governments regulate them to varying degrees rather than allow self-regulation by market forces. The term *free-market economy* is sometimes used synonymously with market economy, but, as Ludwig Erhard once pointed out, this does not preclude an economy from having socialist attributes opposed to a laissez-faire system.

Different perspectives exist as to how strong a role the government should have in both guiding the market economy and addressing the inequalities the market produces. For example, there is no universal agreement on issues such as central banking, and welfare.

Market Economy Examples

- The United States in the late nineteenth century was about as close as we've seen to a pure market economy in modern practice.

US Aspects of a Market Economy

The U.S. has the six characteristics of a market economy. First, ownership of private property is protected by law.

Second, everyone is free to live, work, produce, buy, and sell whatever they choose.

Third, the buying and selling of goods and services, including employment, are driven by self-interest. Sellers try to get the highest price, while buyers try to get the best value for their money.

Fourth, competition is protected by law and prices can move on their own.

And finally, the role of government is primarily to make sure that the market is *protected*, and that everyone has free access to it. This includes regulations to make sure no one is unfairly manipulating the market, and free press to ensure everyone has equal access to information.

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 use and distribution of resources.

The United States today, like most developed nations, is a mixed economy.

The United States is a mixed economy because its Constitution protects the requirements of a market economy, including ownership of private property, limitations on government interference, and promoting innovation. However, the Constitution also encourages the government to promote the general welfare. This allows the ability to effect a command economy, where needed.

A mixed economy seeks to have all the advantages of a market, command and traditional economy with little of the disadvantages.

Mixed economies also have a command economy in certain areas. Most allow government to have a command role in areas that safeguard the people and the market itself. This usually includes the military, international trade, and national transportation. Many mixed economies also allow centralized planning and even government ownership of key industries, such as aerospace, energy production and even banking. Some mixed economies encourage the government to centrally manage health care, welfare, and retirement programs.

Mixed Economy Examples:

- Most of the world's major economies are now mixed economies. It would be difficult to avoid, thanks to globalization. A country's people are best served through international trade -- oil from Saudi Arabia, consumer products from China, and food from the U.S. As soon as businesses within a country are allowed or even encouraged to export, the government must give up some control to free market forces.

Advantages of a Mixed Economy

A mixed economy can enjoy the advantages of a market economy. First, it can efficiently allocate goods and services where they are needed, by allowing prices to measure supply and demand. Second, it also rewards the most efficient producers with the highest profit, ensuring that customers are getting the best value for their dollar. Third, it encourages innovation that meets customer needs more creatively, cheaply or efficiently. Fourth, it automatically allocates capital to the most innovative and efficient producers. They, in turn, can invest the capital in more businesses like them.

A mixed economy also minimizes the disadvantages of a market economy. A larger governmental role allows fast mobilization in priority areas, such as defense, technology or aerospace. Since a pure market economy rewards those that are most competitive or innovative, leaving others at risk, the expanded governmental role can make sure these less competitive members are cared for and valued.

Disadvantages of a Mixed Economy

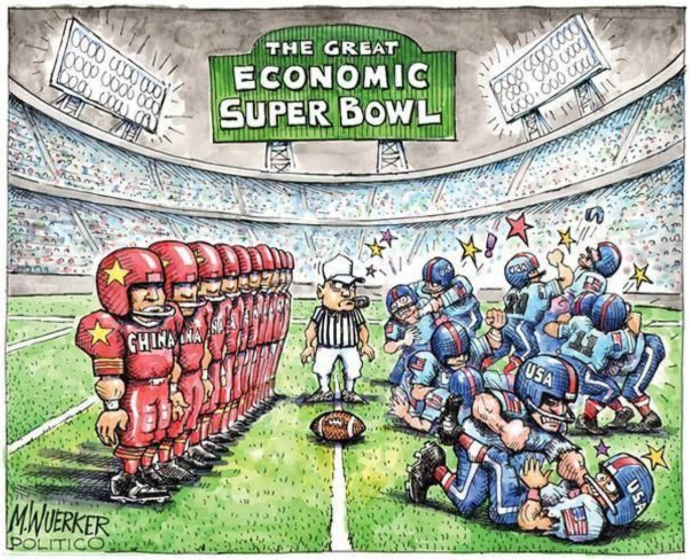
A mixed economy can also take on all the disadvantages of the other types of economies, depending on which characteristics are emphasized. If it has too much free market, it can reward the competitive members of society and leave others without any government support. Central planning might do extremely well in mobilizing forces for defense, creating a government-subsidized monopoly or oligarchy system. This could also put the country into debt, slowing down economic growth in the long run. Businesses that are already successful can lobby the government for more subsidies and tax breaks. The government's role of protecting the operation of the free markets might mean not enough regulation, and ultimately taxpayer-funded bailouts of businesses that took on too much risk.

IN CONCLUSION: Why ALL of this matters today…

Half of the twentieth century went down as a global battle between defenders of free markets (democratic capitalist nations, led by the United States) and believers in command economies (the communist bloc, led by the Soviet Union).

The US and USSR never went to war against each other directly, but dozens of smaller (yet still tragic and significant) wars unfolded around the world as bitter fights over economic systems turned bloody. Korea, Vietnam, Nicaragua, Afghanistan, Angola… millions of people died in the various "hot" theaters of a Cold War fought to decide whether markets or states should control economic affairs.

The great irony was that the Cold War finally ended not on a battlefield, but because the Soviet economy finally self-destructed by the late 1980s. For most of the world, the Soviet collapse proved that command economies were simply inferior to the market-dominated mixed economies of the capitalist world. Of course, China – still ruled politically by an authoritarian Communist Party, even though its economy is now more mixed if not exactly free – is now the biggest creditor nation to the United States.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