Comparing Economic Systems

Inquire: Communism, Capitalism, Socialism: What Separates the -isms?

Overview

In the United States, there is a tendency to equate economic systems with government — capitalism is good, socialism and communism are bad. But, what is capitalism, what is communism, and what is socialism? And can socialism really be evil if all of our democratic allies — Canada, Great Britain, France, Belgium, Sweden — have fairly deep socialist systems?

In this lesson, the goal is to give you a fairly simplistic and easy to understand comparison of the “isms,” and how their differences impact the citizens in their countries. Economic systems are all designed to accomplish the same goals. They just travel different roads to get there — and make different sacrifices for different parts of the population. Hopefully, after this lesson, you will be able to have a clear, if somewhat simplistic, understanding of the economic “isms.”

Big Question: What makes communism and socialism so scary in America?

Watch: The -ism that Forgot Personal Achievement

Very simply — an economist will surely find it too simplistic — communism is and was an attempt to bring equality to the masses in their economic lives, just as democracy continued to progress and bring equality to the people in their political and social lives. It was meant to highlight the idea that Jefferson so eloquently expressed: “We hold these truths to be self evident, that all men are created equal.” All men—each man, woman, and child—is intrinsically valuable, just as valuable as every other person.

Political equality continued to progress in the 1800s into the 1900s. Voting rights expanded to white men without property, then to all men, then to all women. Not to minimize the struggles, but political equality was a tidal wave that could not be stopped. But, economically, people were still trapped in a near caste system, and it was almost impossible to become more than the situation you were born into. Especially in Europe, growth was stagnant.

Karl Marx and Friedrich Engels had what they believed was a better idea. What if, instead of all the land, money, and property belonging to the few wealthy, it belonged to nobody, and each person worked in his area for the good of the society. Everyone would be valued equally. The government made sure that each person was valued for his work just as highly as every other person. The trash collector and the surgeon both perform necessary duties for the state—so, why should one make more than the other? A society where everyone is compensated equally: does it really sound so bad?
Nobody feasts like a king, but everyone is fed; nobody has fancy clothes, but everyone has good, functional clothes; no one lives in a mansion, but everyone has decent living quarters. The problem is, there is no reward for exceptional work. You are the best worker on your crew, so you get promoted to supervisor... with no raise because everyone is equal. If in school, the teacher told the class, “Everyone will make a 70 and pass, no matter how hard you work, or don’t work. I promise everyone a 70.” How hard would the students work? Not very.

There is no reward for hard work, so why do it? Communism forgot the power of reward for achievement—for excellence—and so there would be no achievement and no excellence, not on the grand, wide scale.

Communism is the -ism that forgot personal achievement. And that is one of the reasons it has always failed.

Read: Comparing Economic Systems

Think about what a complex system a modern economy is. It includes all production of goods and services, all buying and selling, and all employment. The economic life of every individual is interrelated, at least to a small extent, with the economic lives of thousands or even millions of other individuals. Who organizes and coordinates this system? Who ensures that, for example, the number of televisions a society provides is the same as the amount it needs and wants? Who ensures that the right number of employees work in the electronics industry? Who ensures that televisions are produced in the best way possible? How does it all get done?

There are at least three ways societies have found to organize an economy. The first is the traditional economy, which is the oldest economic system and can be found in parts of Asia, Africa, and South America. Traditional economies organize their economic affairs the way they have always done (i.e., tradition). Occupations stay in the family. Most families are farmers who grow the crops they have always grown using traditional methods. What you produce is what you get to consume. Because things are driven by tradition, there is little economic progress or development.

Command economies are very different. In a command economy, economic effort is devoted to goals passed down from a ruler or ruling class. Ancient Egypt was a good example; a large part of economic life was devoted to building pyramids for the pharaohs. Medieval manor life is another example; the lord provided the land for growing crops and protection in the event of war. In return, vassals provided labor and soldiers to do the lord’s bidding. In the 20th century, communism emphasized command economies.

In a command economy, the government decides what goods and services will be produced and what prices will be charged for them. The government decides what methods of production will be used and how much workers will be paid. Many necessities like healthcare and education are provided for free. Currently, Cuba and North Korea have command economies.

Although command economies have a very centralized structure for economic decisions, market economies have a very decentralized structure. A market is an institution that brings together buyers and sellers of goods or services, who may be either individuals or businesses. The New York Stock Exchange is a prime example of a market in which buyers and sellers are brought together. In a market economy, decision-making is decentralized. Market economies are based on private enterprise; the means of production (resources and businesses) are owned and operated by private individuals or groups of private individuals. Businesses supply goods and services based on demand. (In a command economy, by
contrast, resources and businesses are owned by the government.) What goods and services are supplied depends on what is demanded. A person’s income is based on his or her ability to convert resources (especially labor) into something that society values.

The more society values the person’s output, the higher the income (think Lady Gaga or LeBron James). In this scenario, economic decisions are determined by market forces, not governments.

Most economies in the real world are mixed; they combine elements of command and market (and even traditional) systems. The U.S. economy is positioned toward the market-oriented end of the spectrum. Many countries in Europe and Latin America, while primarily market-oriented, have a greater degree of government involvement in economic decisions than does the U.S. economy. China and Russia, while they are closer to having a market-oriented system now than several decades ago, remain closer to the command economy end of the spectrum.

Regulations: The Rules of the Game

Markets and government regulations are always entangled. There is no such thing as an absolutely free market. Regulations always define the “rules of the game” in the economy. Economies that are primarily market-oriented have fewer regulations — ideally just enough to maintain an even playing field for participants. At a minimum, these laws govern matters like safeguarding private property against theft, protecting people from violence, enforcing legal contracts, preventing fraud, and collecting taxes. Conversely, even the most command-oriented economies operate using markets. How else would buying and selling occur? But, the decisions of what will be produced and what prices will be charged are heavily regulated. Heavily regulated economies often have underground economies, which are markets where the buyers and sellers make transactions without the government’s approval.

The question of how to organize economic institutions is typically not a black-or-white choice between all market or all government, but instead involves a balancing act over the appropriate combination of market freedom and government rules.

Reflect Poll: Would You Rather...

Socialism—the government takes a significant amount of your money, but things are subsidized and cheaper, like health care, and you are not given any choices on the doctors you see. Capitalism—you keep more of your money, you can choose your own doctor, and there are many more choices than in the socialist state, but it is going to cost more.

So, where do you want to live?
- A socialist country
- A capitalist country

Expand: Capitalism, Communism, and Socialism

Karl Marx and Friedrich Engels turned the world upside down.

Until the publication of their 1848 Communist Manifesto, much of the western world followed a course where individuals owned private property, business enterprises, and the profits that resulted from wise investments. Marx and Engels pointed out the uneven distribution of wealth in the capitalist world and predicted a worldwide popular uprising to distribute wealth evenly. Ever since, nations have wrestled with which direction to turn their economies.
Capitalism

Capitalism is based on private ownership of the means of production and on individual economic freedom. Most of the means of production, such as factories and businesses, are owned by private individuals and not by the government. Private owners make decisions about what and when to produce and how much products should cost. Other characteristics of capitalism include the following:

- **Free competition.** The basic rule of capitalism is that people should compete freely without interference from government or any other outside force. Capitalism assumes that the most deserving person will usually win. In theory, prices will be kept as low as possible because consumers will seek the best product for the least amount of money.

- **Supply and demand.** In a capitalist system prices are determined by how many products there are and how many people want them. When supplies increase, prices tend to drop. If prices drop, demand usually increases until supplies run out. Then prices will rise once more, but only as long as demand is high. These laws of supply and demand work in a cycle to control prices and keep them from getting too high or too low.

Communism

Karl Marx, the 19th-century father of communism, was outraged by the growing gap between rich and poor. He saw capitalism as an outmoded economic system that exploited workers, who would eventually rise against the rich because the poor were so unfairly treated. Marx thought that the economic system of communism would replace capitalism. Communism is based on principles meant to correct the problems caused by capitalism.

The most important principle of communism is that no private ownership of property should be allowed. Marx believed that private ownership encouraged greed and motivated people to knock out the competition, no matter what the consequences. Property should be shared, and the people should ultimately control the economy. The government should exercise the control in the name of the people, at least in the transition between capitalism and communism. The goals are to eliminate the gap between the rich and poor and bring about economic equality.

Socialism

Socialism, like communism, calls for putting the major means of production in the hands of the people, either directly or through the government. Socialism also believes that wealth and income should be shared more equally among people. Socialists differ from communists in that they do not believe that the workers will overthrow capitalists suddenly and violently. Nor do they believe that all private property should be eliminated. Their main goal is to narrow, not totally eliminate, the gap between the rich and the poor. The government, they say, has a responsibility to redistribute wealth to make society more fair and just.

There is no purely capitalist or communist economy in the world today. The capitalist United States has a Social Security system and a government-owned postal service. Communist China now allows its citizens to keep some of the profits they earn. These categories are models designed to shed greater light on differing economic systems.
Lesson Toolbox

Additional Resources and Readings
A Crash Course video about capitalism and socialism
  ● Link to resource: https://www.youtube.com/watch?v=B3u4EFTwprM

A video giving an overview of communism
  ● Link to resource: https://www.youtube.com/watch?v=qElx_EyTTKA

A video discussing the differences between communism and socialism
  ● Link to resource: https://www.youtube.com/watch?v=FrtDZ-LOXFw

Lesson Glossary

underground economies: markets where the buyers and sellers make transactions without the government's approval

market: an institution that brings together buyers and sellers of goods or services, who may be either individuals or businesses

Check Your Knowledge

1. Traditional economies are the oldest economic system and are typically found in Asia, Africa, and South America.
   a. True
   b. False

2. Socialism believes that wealth and income should not be shared more equally among people.
   a. True
   b. False

3. Countries like China and Russia are closer to the command economy end of the spectrum.
   a. True
   b. False

Answer Key:
1. A  2. B  3. A

Citations

Lesson Content:
Authored and curated by Jay Reynolds, J.D. for The TEL Library. CC BY NC SA 4.0

Adapted Content: