

Types of economic systems

Free market economy

In a free market economy, market forces (supply and demand) decide what is produced, how it is produced, and who receives goods and services. The government plays a minimal role, but it may still enforce laws, property rights, and contracts so markets can function.

No economy is purely a free market in reality. Countries with relatively low intervention include the US, Singapore, and Switzerland, though they are still often classed as mixed overall.

Key idea: prices act as signals and incentives, coordinating decisions without central planning.

Mixed economy

In a mixed economy, both the government and the market make decisions. The government steps in where markets do not deliver good outcomes, while private firms still produce and supply most goods and services.

Most European economies are mixed, including the UK, France, and Germany. In the UK, healthcare is mainly funded through the NHS, but private healthcare and private firms operate across many markets.

Key idea: mixed economies aim to balance efficiency from markets with equity and stability from government intervention.

Command economy

In a command economy, the government plans production and distribution. Officials decide what to produce, how to produce it, and how output will be allocated across the population.

A common example is North Korea. In this system, central planning replaces the price mechanism.

Key idea: the state replaces market signals with planned targets and allocation decisions.

Economists and free markets

Adam Smith

Smith argued that markets can produce beneficial outcomes even when individuals act in their own self-interest. This is captured by the idea of the “invisible hand,” where private incentives can support the public interest.

He supported free markets but still saw a role for government, such as enforcing contracts and providing core infrastructure. He also linked division of labour to higher productivity and rising living standards.

Friedrich Hayek

Hayek strongly supported free markets because prices reflect information and preferences spread across millions of individuals. He argued that markets are effective at coordinating this information without central planners.

He saw the state's main roles as maintaining law and order and providing support for people unable to work. For Hayek, competition and profit incentives drive innovation and entrepreneurship.

Karl Marx

Marx criticised free markets and capitalism, arguing that profit incentives can lead to worker exploitation. Firms may increase productivity and output, but the rewards can be captured mainly by owners, managers, and shareholders.

In this view, workers may face low wages and worsening conditions even as profits rise. This links inequality and power to how production is organised in a market system.

Advantages and disadvantages of free market and command economies

Why governments might prefer command-style control

Free markets can lead to outcomes that are not socially best. Governments may use intervention or more direct control to correct market failures and improve welfare.

- Merit goods may be under-consumed because benefits to society are not fully priced in (e.g. education, healthcare). The state can increase consumption through subsidies or free provision, but it may not know the true optimal level.
- Demerit goods may be over-consumed because harms to others and long-term harms are not fully considered (e.g. smoking, alcohol). Governments can reduce consumption through taxes or regulation, though this can be seen as limiting personal choice.
- Markets can create high inequality because wages depend on supply and demand and wealth can persist across generations. This may cause social problems, but income differences can also motivate skill-building and work.
- Markets may lead to monopoly power through economies of scale and barriers to entry. Monopolies can raise prices and restrict output, although high profits can

sometimes fund investment and innovation.

Why free markets can outperform command economies

Command systems rely on planning rather than prices, which can be slow and inaccurate. Free markets often respond faster because prices adjust automatically to changes in demand and supply.

- Prices help reduce shortages and surpluses by clearing markets. This can improve allocative efficiency when there are no market failures.
- Profit and competition give firms incentives to innovate, cut costs, and improve product quality. This is weaker if profits are not reinvested.
- Competition increases consumer choice and can lower prices or raise quality. However, choice and competition can fall if monopolies form over time.

Role of the state in a mixed economy

In a mixed economy, governments intervene to correct market failures and improve outcomes. This often involves supporting socially beneficial consumption while limiting socially harmful consumption.

Common interventions include:

- Subsidising merit goods to increase consumption
- Taxing or regulating demerit goods to reduce consumption
- Providing public goods and sometimes key merit goods
- Using regulation, information campaigns, minimum/maximum prices, and tradable permits
- Redistributing income through welfare benefits and progressive taxation