

INTRODUCTION TO ECONOMICS:

INTRO TO MARKET AND COMMAND ECONOMIC SYSTEMS, EVALUATION & RELATED CONCEPTS

UNIT [1.11] RAPID REVISION

ECON-HUB

THEORY RE-CAP



Theory Recap Questions [TRQs]
Practice Questions [PQs]

Essentials

'LETS MASTER ECONOMIC SYSTEMS

Economic Systems & Applications Unit 1.11 [REV]
ECON-HUB

VERBS SPECIFIC TO A/LS

RE-CAP

- ✓ Define, Distinguish, Explain, Meant by, Describe and Exposition (Brief Explanation): **Paragraph based answer**
- ✓ State, List and Name: **Point form answer (One line points)**
- ✓ Outline, Briefly explain or In what situations: **Point form answer (Points as a brief paragraph)**
- ✓ Differentiate, Compare (Similarities) and Contrast (Differences): **Side – by – Side Comparison**
- ✓ Components and Composition: **Flow Chart, Table, List or Pie Chart**
- ✓ Graphically Illustrate: **Diagrams and Graphs**
- ✓ Consequences, Economic Implications: **Point form answer, including both positive and negative consequences (each point briefly discussed)**

ABE 'PEN ON PAPER' PROGRESS

ABE [1.2]:

ESSENTIALS [4] 11 SEQs

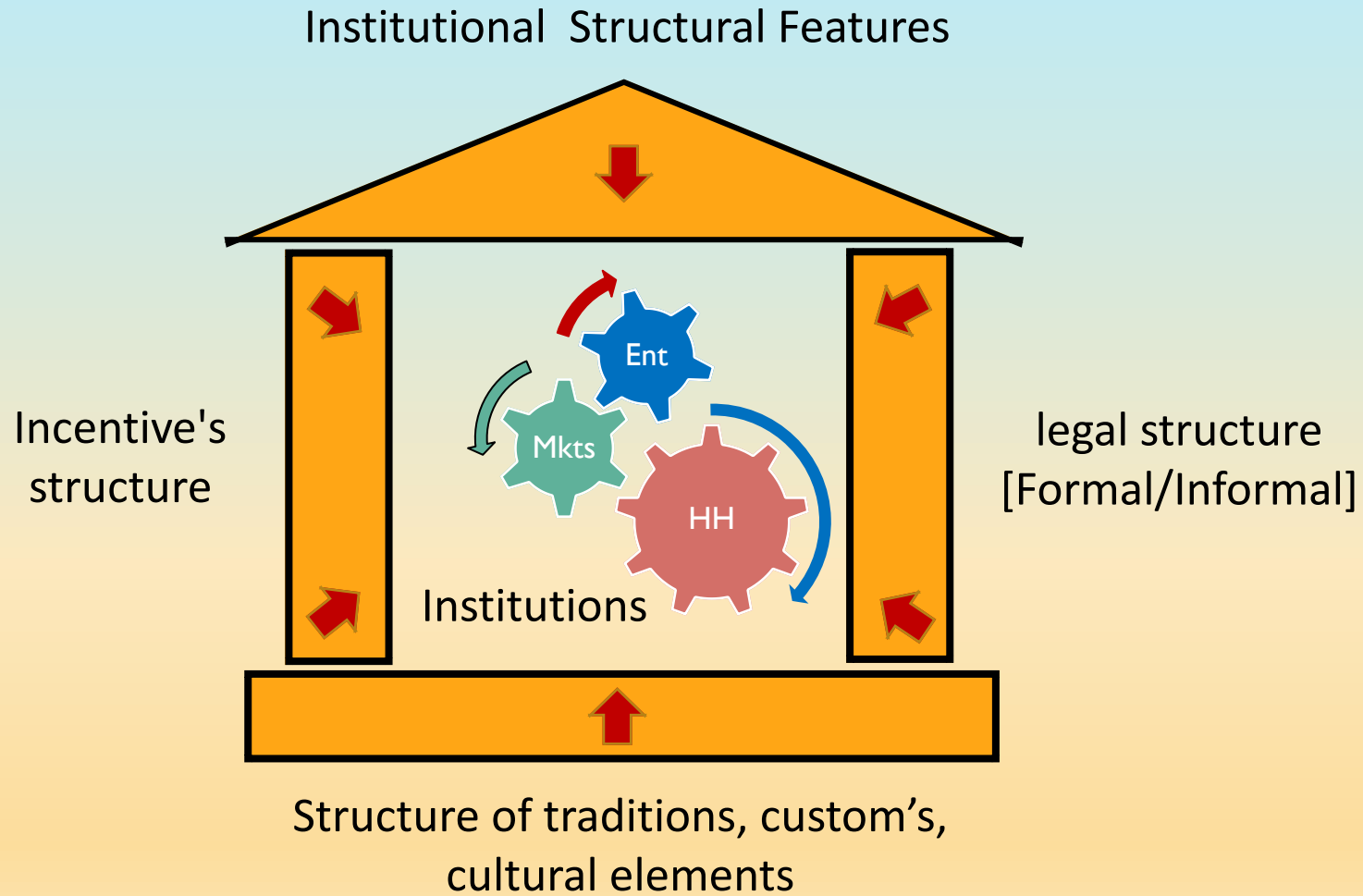
ESSENTIALS [5] 5 SEQs

SELF PRACTICE QUESTIONS [SPQS] 1 SEQs

SHOW YOUR 'GRIT'

'INSTITUTIONAL' STRUCTURE

RE-CAP



REASONS FOR THE VARIETY OF ECONOMIC SYSTEMS

[1] Ownership of (Property) Resources

- **Capitalist/Liberal** economic systems
- **Socialist/ Communist** economic systems

• **Mixed Mechanism**

- Socialist Market Economic System
- Social Market Economic System
- Indicative Planning System

[2] Mechanism of Resource Allocation

- **Traditional systems**
- **Price Mechanism**
 - Market Economic System
- **Planning Mechanism**
 - Command (Central Planning) Economic System
 - Indicative Planning System

RE-CAP

[3] Incentive System

- **Material Incentives**
 - Market Economic System
- **Coercive Incentives**
 - Command Economic System
- **Moral Incentives**

TRM [1.3] Page: 6

[PQ: 37] State the characteristics of a Market Economic System [04 marks]

ESSENTIAL READING

“READERS ARE LEADERS, SUCCESS IS FOR THE PROACTIVE, NOT THE REACTIVE”

- ❑ Special illustration on Economic Systems [TRM Pages: 19 - 24]
- ❑ Special Clarifying Note [TRM Page: 7]
 - [1] Private Property Rights & Market Economy
 - [2] Functions of the Government within a Market Economy
 - [3] Basic intro to Price Mechanism

MARKET ECONOMY & PRIVATE PROPERTY RIGHTS

- A market economic system is alternatively termed as a capitalist or free enterprise economic system. **'Private Property, Ownership and Rights'** are considered as the **foundation** of a **market economic system**.
- **Property rights** refers to the special right or privilege held by a person or institution to use the property resources owned by them as per their own free will. A market economy cannot operate unless private property ownership and rights are well established and protected.
- Defining, establishing and protecting such private property ownership and rights is **inevitability** a responsibility of the government, even within a pure market economy.

PRICE MECHANISM

Price mechanism is a decentralized system by which limited resources are allocated within a market economic system to provide solutions to the basic economic problems. Decentralized decisions within the price mechanisms are made by factor owners, consumers and producers fundamentally based on the functions of relative price, performed within product and factor markets, motivated by self-interest-based incentives.

Functions of Relative Price [or Price Mechanism]:

- **Information (Signaling) Function**
- **Incentive Function**
- **Rationing Function**

FUNCTIONS OF THE GOVERNMENT

[GOVERNMENT ROLE WITHIN AN MKT ECONOMY]

- **Allocative** function

[Correcting: lack of public goods, overproduction of demerit goods, under production of merit goods]

- **Stabilization** function

[Internal stability: low and stable inflation, low unemployment, GDP stability; external stability: BOP stability, FOREX rate stability]

- **Redistribution** function

[Fair distribution of income, i.e., with minimum disparities income and wealth distribution]

- **Regulatory** function

[Defining and protecting property rights promoting competition, , environmental protection]

Furthermore, a government operating in a free-market economy tends to perform some of the following functions in addition to these broader, core functions.

- Providing economic and social infrastructure facilities
- Human resource development
- Promoting economic growth
- Sustainable and balanced social economic development
- Promoting fair competition and market opportunities

CONSUMER SOVEREIGNTY

Consumer sovereignty refers to a situation where consumers function as the ultimate authority within a market economy. The consumer reserves the complete power to make and control decisions such as what goods to produce, which firms should produce and in what quality and quantity such goods should be produced, simply by changing their demand for different goods.

Essential conditions to ensure consumer sovereignty

- Competitive markets
- Perfect information
- Eliminating barriers to competition

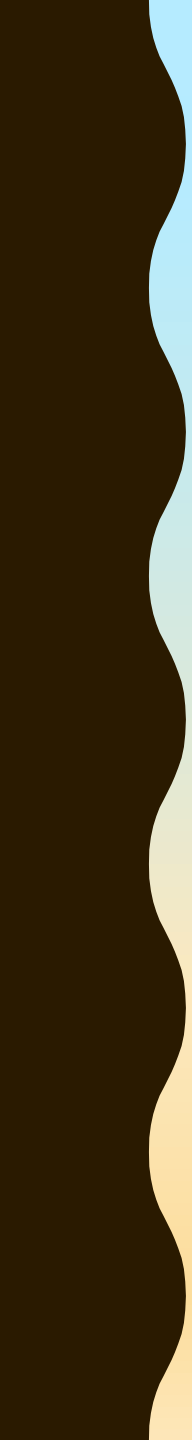
TRM [1.3] Page: 8

[PQ: 38] State the salient characteristics of a Centrally Planned (or Command) Economic System

[04 marks]

COMMAND VS. MARKET

Command Economy	Market Economy
The centralization of decision taking	The decentralization of decision taking
Central planning	Price mechanism
State ownership of property	Private ownership of property
State enterprise	Private enterprise
State monopoly	Freedom of enterprise and competition
Decision making based on social welfare	Decision making based on self-interest
State domination of economy	Limited role of government (laissez-faire)
Corrective incentives	Material incentives (profits)



EVALUATING A MARKET ECONOMIC SYSTEM & COMMAND ECONOMIC SYSTEM

COMPARATIVE ANALYSIS

Answer Input [TRQ: 27]

EVALUATING A MARKET ECONOMIC SYSTEM

Principal Disadvantages [Reasons for Market Failure]

Principal Advantages (Benefits of a Market System)

- The 'Price Mechanism' is **relative efficient** as a resource allocation mechanism
[Subject to sustained macroeconomic stability, minimized externalities and availability of perfect information]
- The ability make consumption and production decisions in decentralized manner based on '**Self Interest**'

Alternative: Freedom to make consumption decisions (freedom of choice) and free enterprise in terms of production decision making

- The efficiency of the economy is further improved due to the **highly effective** and **powerful** self-interest-based material **incentive of 'Profits'**
- The market system in principle is able create a more **conductive environment** to achieve relatively high rates of economic growth

Answer Input [TRQ: 28]

EVALUATING A COMMAND ECONOMIC SYSTEM

Advantages

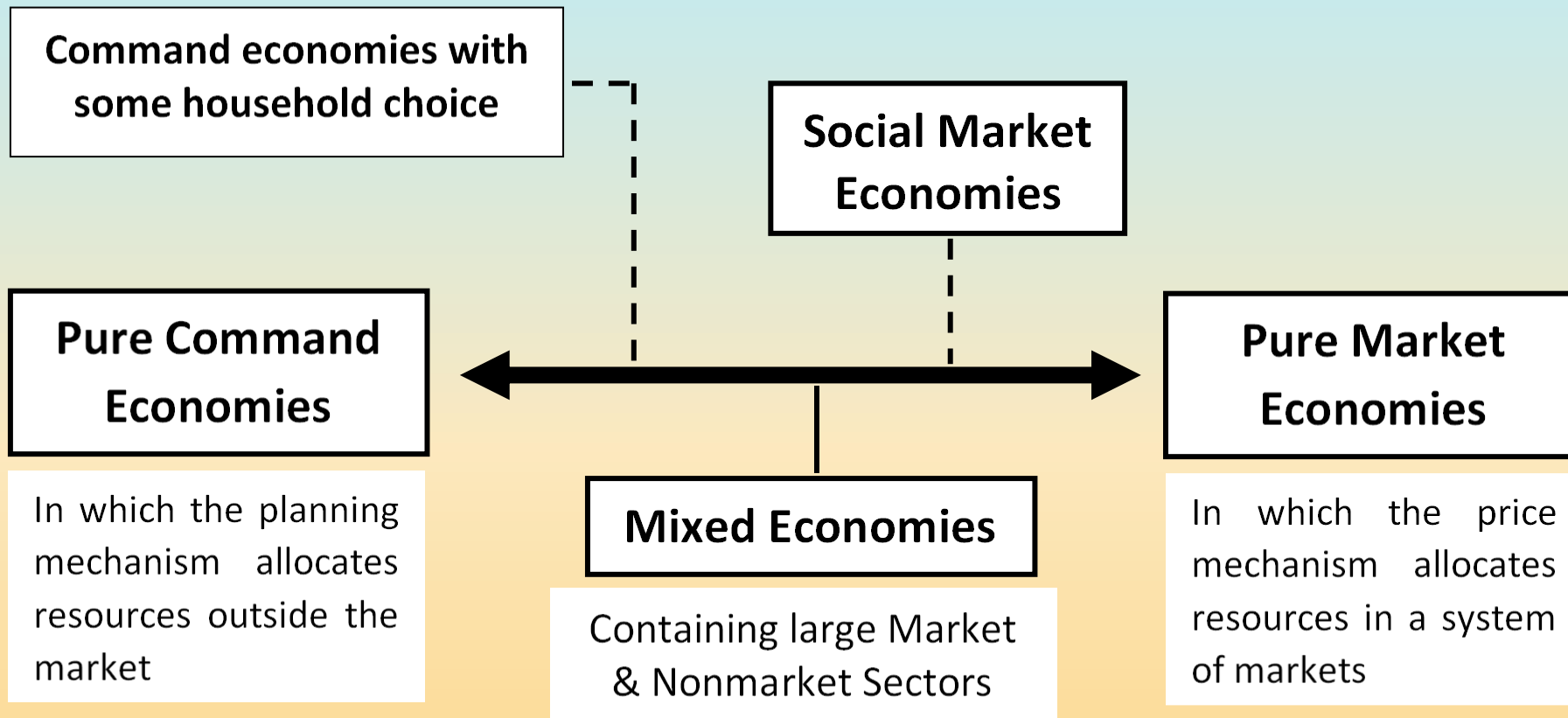
Disadvantages

- Major difficulties and resulting inefficiencies in the process of coordinating complicated economic plans prepared by the planning authority
- Qualitative aspects of output is given inadequate consideration (relative low quality of life)
- The lack of a powerful and efficient incentive to promote rapid economic growth
- Limited choice and freedom enjoyed by consumers, especially in situations where output is distributed based on direct government intervention such as rationing systems

Special Illustration: P22

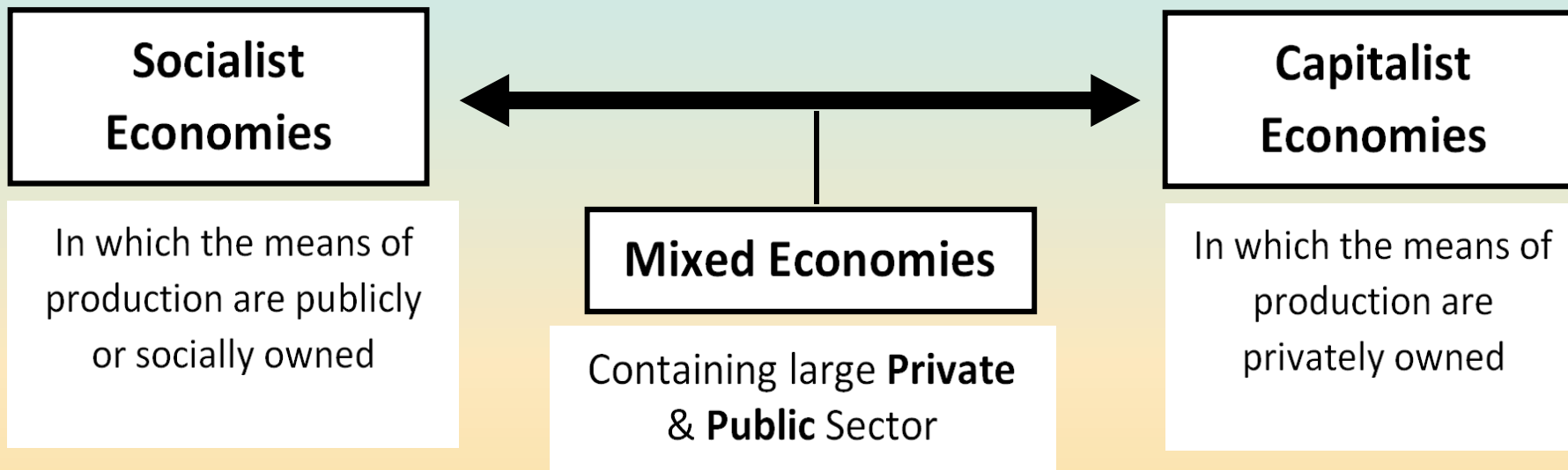
DIMENSIONS OF MIXED MECHANISM

Mixed Economy: Resource Allocation Mechanism



Special Illustration: P22

Mixed Economy: Ownership of Property Resources



[Source: Powell, R. (1996) **A Level Economics**, P33]

Special Illustration: P23

Additional Multidimensional [Cross] Classification Matrix Economic Systems

		Ownership Form	
		Public	Private
Allocation Mechanism	Planning	Socialist Planned Economy	Dirigisme / "Command Capitalism"
	Market	Market Socialism	Market Capitalism

TYPES OF MIXED ECONOMIES

SOCIAL MARKET ECONOMY

In such an economy, the basic human rights of each citizen is protected and ensured, by the government providing comprehensive (major or complete) social protection or safety network (social welfare or benefit program).

Examples: Germany, Denmark, Norway, Switzerland

Answer Input [PQ: 41]

TYPES OF MIXED ECONOMIES
SOCIALIST MARKET ECONOMY

Example: China, Russia

ECONOMIC SYSTEMS & SOLVING BASIC ECONOMIC PROBLEMS



FUNCTIONS OF AN ECONOMIC SYSTEM **'BASIC ECONOMIC PROBLEMS'**

Problem(s)

What to produce, in what quantity
[AKA: Allocation Problem]

How to produce
[AKA: Production Problem]

Whom to produce
[AKA: Distribution Problem]

Decision(s)





RECAP

[3.3] THE PROBLEM OF CHOICE...

All economic systems in the world are designed to make choices (trade-off-based decisions) and find solutions to three basic problems

- 1) **What** to produce? in what quantity? [Allocation Problem]
- 2) **How** to produce? [Production Problem]
- 3) **Whom** to produce? [Distribution Problem]

'What'



'How'



'Whom'



