

Econ-Hub **Rapid Revision Classes**

Economic Systems & Solving Basic Economics Problems

BOOK [4]

Theory Recap Material [TRM]

2027 A/L Edition





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Theory Recap Material [TRM]

[Input for Practice Questions: PQs]

Essentials

06

An Economic System

A social and institutional mechanism (or organization) created for the purpose of allocating the scarce resources of a society and solve the society's basic economic problems.

Any economic system has three basic economic questions to resolve: What and how much to produce, how to produce, and for whom to produce. Essentially an economic system is a network of organizations created by people to resolve their basic economic problems.

Each economic system functions within a unique framework consisting of a legal structure, incentives structure, structure of traditions, custom's, cultural elements.

Also, Relevant [11]:

[A] Basic Economic Problems

	Problem(s)	Decision(s)
01	What to produce in which quantity [AKA: Allocation Problem]	Production Decision
02	How to produce [AKA: Production Problem]	Choice of Techniques Decision
03	For Whom to produce [AKA: Distribution Problem]	Income Distribution Problem

AKA: Also Known As

[B] *'An economic system is a set of institutional arrangements whose function is to employ most efficiently scarce resources to meet the ends of society'*

[Alternative Definition: Source - The United Nations Dictionary of the Social Science]

[C] 'Institutional Structure', 'Components' and 'Features'

Institutions [Components]	(1) Households
	(2) Enterprises (Pvt and SOEs)
	(3) Government or Public Sector (Political & Civil Admin.)
	(4) Markets (Factor, Product, Financial & FOREX)
	(5) Labour Organizations
	(6) Non-Government Organizations (NGOs)
Other Institutional Structures	The aforementioned institutions function within a context of a Legal Structure [Formal and informal], Incentives Structure, Structure of Traditions, custom's, cultural elements , unique to each system.
[1] Nature of Institutional Structural Features	Nature of Resource Ownership and Property Rights
	Nature of Resource Allocation Mechanism OR Decision Coordination Mechanism OR Method of Solving Basic Economic Problems
	Nature of Incentives Structure
	Nature of Income Redistribution and Social Safety (Production) Networks
	Nature of Politics and Ideology

- [1]** It is noteworthy; economics systems' tend to **vary** or **differ** from one to the other depending on the **nature** or functional setup of these **institutional structural features**.

[D] Evolutionary Process of Economic Systems [Key Stages]

- Primitive Communal System (primitive communism)
- Slave Social System (humans as a property resource: Slaves and Masters)
- Feudal Social System (land as the main production resource, monarchies)
- Capital (Capitalism) Social System
- Social (Socialism) System

Basis of Classification of Economic Systems		
Ownership of Resources [1]	Mechanism of Resource Allocation [2]	Nature of Incentive Structure [3]
Capitalist (Liberal) System Dominant private sector property ownership	Traditional System	Liberal Market System Dominant Material Incentives
	Liberal Market System [Price Mechanism]	
Socialist (Communist) System Dominant public sector property ownership	Command (Centrally Planned) System [Planning Mechanism]	Command System Dominant Coercive Incentives
Mixed Mechanism: ▪ Social Market Economics System ▪ Socialist Market Economic System ▪ Indicative Planned Economic System		Market and Command System Moral Incentives

‘A Traditional Economy’

- Production factors specially land is maintained as common resources by a certain group or tribe of individuals
- Trade is based on the exchange of goods (generally the use of a barter system)
- Economic and production decisions are solely made by the leader of the tribe or by a high council comprising the senior members of the ethnic group or tribe.

Kings, queens, traditional tribal leaders, religious leaders act as members of this decision making unit and provide leadership

- The existence traditions such as ensuring a fair price and fare wages
- The younger generations follow in the same professions and vocations of the elder generations and ancestors
- The values, decisions and other traditional believe with in such an economic system represent a high degree of inflexibility.

‘A New Traditional Economy’

A new traditional economy refers to economic systems which **primarily** make **resource allocation** and other **economic decisions** based on a **cultural framework** driven by **religious** and **traditional values**.

On the other hand, contrary to typical traditional economy, these countries are **highly driven** by **modern technology** and show a **preference** to be **global citizens**. Most such economies seem to be governed by religious law [e.g. Iran, Pakistan]

Characteristics of a Market Economic System

- Private property ownership
- The existence of Private Enterprises
- The decision-making process is Decentralized, free enterprise and freedom of choice
- Resource allocation is based on Price Mechanism
- Decisions are made based on the incentive of Self-interest.
- Consumer sovereignty
- High degree of competition, among producers to maximize profits.
- Limited or Laissez Faire government involvement in the process of resource allocation

Special Clarifying Note:

[1] Private Property Rights & Market Economy

- A market economic system is alternatively termed as a capitalist or free enterprise economic system. **‘Private Property, Ownership and Rights’** are consider 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.

[2] Functions of the Government within a Market 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

[3] 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

Characteristics of a Centrally Planned (or Command) Economic System

- **Public –sector (state) property ownership**
- **The existence of Public Enterprises**
- **The decision-making process is Centralized.**
- **Resource allocation is based on Planning Mechanism**
- **Decisions are made based on the incentive of Social Welfare (Common Benefit or Social Equity)**
- **Limited or no: competition (state monopolies), freedom of choice, freedom of enterprise among producers to maximize profits.**
- **Limited role of private sector (private sector activities are based on government commands)**

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 Economic Systems:

Market Economic System (or Free Enterprise/Liberal Market System/ **Price Mechanism**) as a **mechanism of resource allocation**

Principal Disadvantages/Demerits (Reasons for Market Failure):

- 1) Inefficiency of not allocating resources to produce public goods.
- 2) Under provision or allocation of resources to produce Merit goods
- 3) Over allocation of resources to produce De-merit goods
- 4) Barriers to competition and efficient resource allocation, such as formation of Monopoly markets, imperfectness of information and consumer exploitation (producer sovereignty overriding consumer sovereignty)
- 5) Disparities in income and wealth distribution
- 6) The creation of macroeconomic instability leading to market failure

Principal Advantages/Merits (Benefits of a Market System):

- The 'Price Mechanism' is relative efficiency as a resource allocation mechanism (Subject to sustained macroeconomic stability, minimized externalities and perfect information).
- The ability make consumption and production decisions in decentralized manner based on 'Self Interest'.
Alt. Freedom to make consumption decisions (or 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 to create a more conducive environment to achieve relatively high rates of economic growth

Evaluate the Command Economic System (or Centrally Planned Economic System) as a mechanism of resource allocation.

Advantages/Merits/Pros

- High degree of certainty within the resource allocation process, due economic plans prepared based on a comprehensive input-output analysis.
- Allocating resources towards the production of public goods, while a high degree of consideration on merit goods is ensured.
- The ability to eliminate certain inefficiencies caused due to intense or deficit levels of competition within certain markets, through government market intervention.
- Making resource allocation decisions motivated by the incentive of 'Common Benefit or Social equity' rather than self-interest.
- Implementing measures to minimize disparities in income and wealth distribution.

Disadvantages/Demerits/Cons

- 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

Characteristics of a Mixed Economic Systems

- The economy comprises of **four** main **economic operators**:
 - Consumers
 - Producers
 - Factor owners
 - Government
- Consumers, producers, and resource owners represent the **private sector** and are motivated by the **incentive** of **self-interest**.
- The **public sector** receives **motivation** through the incentive of **social wellbeing** or benefit.
- The **private sector** and the **public sector** shall **independently own** production **resources**.
- Economic activities of the **private sector** are directed by the **price mechanism** within **competitive markets**.
- The **public sector** makes resource allocation decisions by way of a **planning mechanism**.
- There is a **high degree of freedom** received by **consumers** with regards to goods and services produced by the **private sector**, while there will be critical and decisive **government market intervention**, as required by the public and if the government decides its appropriate.

Social Market Economy

A market economy with a high degree of emphasis (focus) on making sure social equity (justice) and social wellbeing (welfare), while controlling and limiting private freedom (purely private sector self-interest /profit-based decisions making) to some degree is known as a 'Social Market Economy'.

In such an economy, the basic human rights of each citizen are 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

Salient Chrematistics:

- 1) Combines the principles of a free market with social concerns (values)
- 2) Strong focus on free and fair competition with social adjustments
- 3) Ensures social justice (equity) and social welfare (wellbeing or protection) to all.
- 4) Individuals, society, and the state have their own responsibilities.
- 5) Placing a high value on people's dignity (human dignity and respect)
- 6) Essentially a coordinated market economy
- 7) Protects and reinforces five main human rights systems (Civil, Political, economic, social, and cultural)

'Liberal Market Economy' Vs. 'Social Market Economy'

	Liberal Market Economy	Social Market Economy
01	Guided by markets	Guided by politics
02	Non coordinated market economy	Coordinated market economy
03	Life freedom	Global (Universal) freedom
04	Maximum freedom to individuals	Equal freedom for all
05	Laissez-faire policies by government	Balances productivity with social objectives
06	Focused on productivity	Strong welfare state
07	Special attention to civil and pollical rights	Civil, political, economic, social, and cultural rights are protected

[Source: P.Perera, p105; 2020]

Socialist Market Economy

An economy which mainly makes resource allocation decisions (i.e., solving basic economic problems) and directing (guiding) their economy based on the 'planning mechanism' and the principles of 'socialism', at the same time permitting (allowing) market forces (i.e., price mechanism) also to make resource allocation decisions to some degree, is known as a 'Socialist Market Economy'.

Example: China, Russia

Special Note:

GOVERNMENT'S ROLE IN A SOCIAL MARKET ECONOMIC SYSTEM

- Establish and sustain social justice
- Ensure full employment
- Maintaining economic stability
- Ensure labour rights, union rights, social partnerships and co-determination
- Market guidance:
 - Deter monopolies
 - Consumer rights and protection
 - Environmental protection
 - Provision of public goods and essential merit goods
- Establish and maintain an effective social security or safety network (e.g., compulsory insurance for all citizens, income security, building capabilities)
- Define and protect five main dimensions of human rights systems: civil, political, economic, social and cultural.



**Theory Recap Material [TRM]
Input for Practice Questions [PQs]**

Essentials

07

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'



What to produce'?

(Or Production Decision and Allocation Problem)

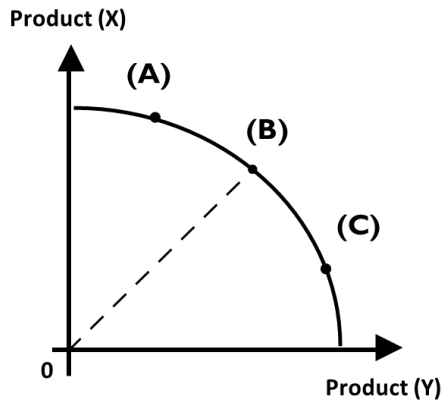
The basic problem of what to produce refers to the process of deciding what goods to produce and what are the needs and wants which should be satisfied, by allocating or using limited economic resources with alternative uses.

Due to the scarce nature of economic resources all possible or available alternative goods or services cannot be produced, therefore an economy is forced to make a choice with regards to what goods to produce in what quantities.

In the process of providing a solution this problem an economy will also make a decision as to how much resource to be 'allocated' for current consumption and future consumption. This problem emphasizes two main factors.

- What good to produce including the decision of what quantity to produce.
- This becomes a basic economic problem since all societies face a problem of scarcity and choice.

ILLUSTRATION: WHAT TO PRODUCE IN WHAT QUANTITY



Alternative Decisions/Solutions

Combination (A):

Producing more product (X) and Less of product (Y).

Combination (B):

Producing equal amounts of product (X) and product (Y).

Combination (C):

Producing more product (Y) and less of product (X).

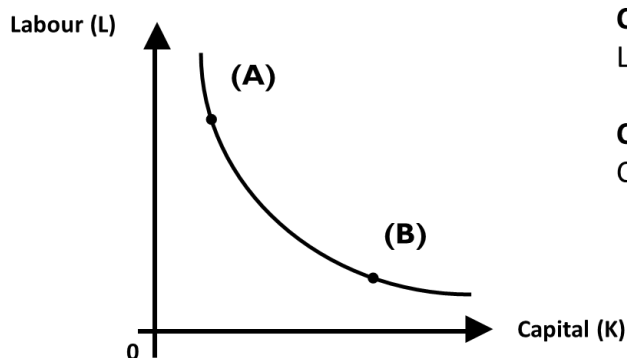
How to produce?

(Or Choice of techniques decision and Production Problem)

The problem of how to produce refers to the process of deciding what alternative production method or resource combination to use in producing goods and services. In simple terms this is a problem relating to the intensity of production factors, i.e. deciding how much each production factor to be used within the production process. The production method or technique will depend of this intensity or combination of production factors.

The production problem of how to produce is provided with a solution by an economy after considering certain important **social, economic, political, and cultural factors**. There are two main methods of production that can be used by countries, which can be given as follows.

ILLUSTRATION: HOW TO PRODUCE



Alternative Decisions/Solutions

Combination (A):

Labour intensive production ($L > K$)

Combination (B):

Capital intensive production ($L < K$)

Whom to produce?

(Or Distribution decisions or problem)

The problem of whom to produce refers to the process of deciding, how the overall output of an economy or national product should be distributed among the households of the economy. This is a problem connected with the distribution of income or wealth.

The distribution of income among households depends on the amount of factor based services owned by the households and prices of such resources etc. Generally factor owners and laborers with high income receive high purchasing power and are able to obtain more goods and services.

Economic Systems & Solving Basic Economic Problems:

Problem/Decision	Market Economy	Command Economy	Mixed Economy
What to produce, in which quantity [Allocation problem, production decision]	- Price mechanism - Product mkt price signals [patterns of demand ← patterns of income distribution] - Most profitable goods	- Planning mechanism - Input-out analysis, list of priorities - Goods which create greatest social welfare/common benefit	- In principle the market economy/price mechanism approach - Decisive government market intervention
Problem/Decision	Market Economy	Command Economy	Mixed Economy
How to produce [Production problem, choice of techniques decision]	- Price mechanism - Factor mkt price signals - Most cost effective (i.e., profitable) production method (Labour or capital intensive)	- Planning mechanism - Input-out analysis, balancing inputs, and output - Production method which creates greatest social welfare (Labour or capital intensive)	- In principle the market economy/price mechanism approach - Decisive government market intervention

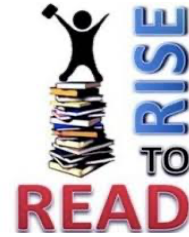
Problem/Decision	Market Economy	Command Economy	Mixed Economy
Whom to produce [Distribution problem and decisions]	- Price mechanism - Both product and factor mkt price signals [patterns of income distribution → patterns of demand] - Distributed to parties with purchasing power	- Planning mechanism - Ensuring fair distribution of income and reasonable pricing of essential goods - Wage rates based on skills, education level and experience...	- In principle the market economy/price mechanism approach - Decisive government market intervention to ensure fairness

Criteria to Evaluate the Performance of an Economic System

- Status of Full employment
- Status of Economic efficiency
- Trends in Economic growth
- Price Stability
- Fair Distribution of income
- External stability
- Qualitative and conducive environment
- Level of Economic freedom

Special Illustrations:

Simplified reading for further learning



[A] Economic Systems

An economic system refers to a **social** and **institutional mechanism** which is created to solve the **basic economic problems** of a society, by allocating their scarce resources. In this process an economic system performs **three main activities** or functions.

- ✓ Making a production decision of what to produce; in what quantities.
- ✓ Making a choice of techniques decision with regards to how to produce.
- ✓ Making a distribution decision with regards to whom to produce.

Alternative Definition:

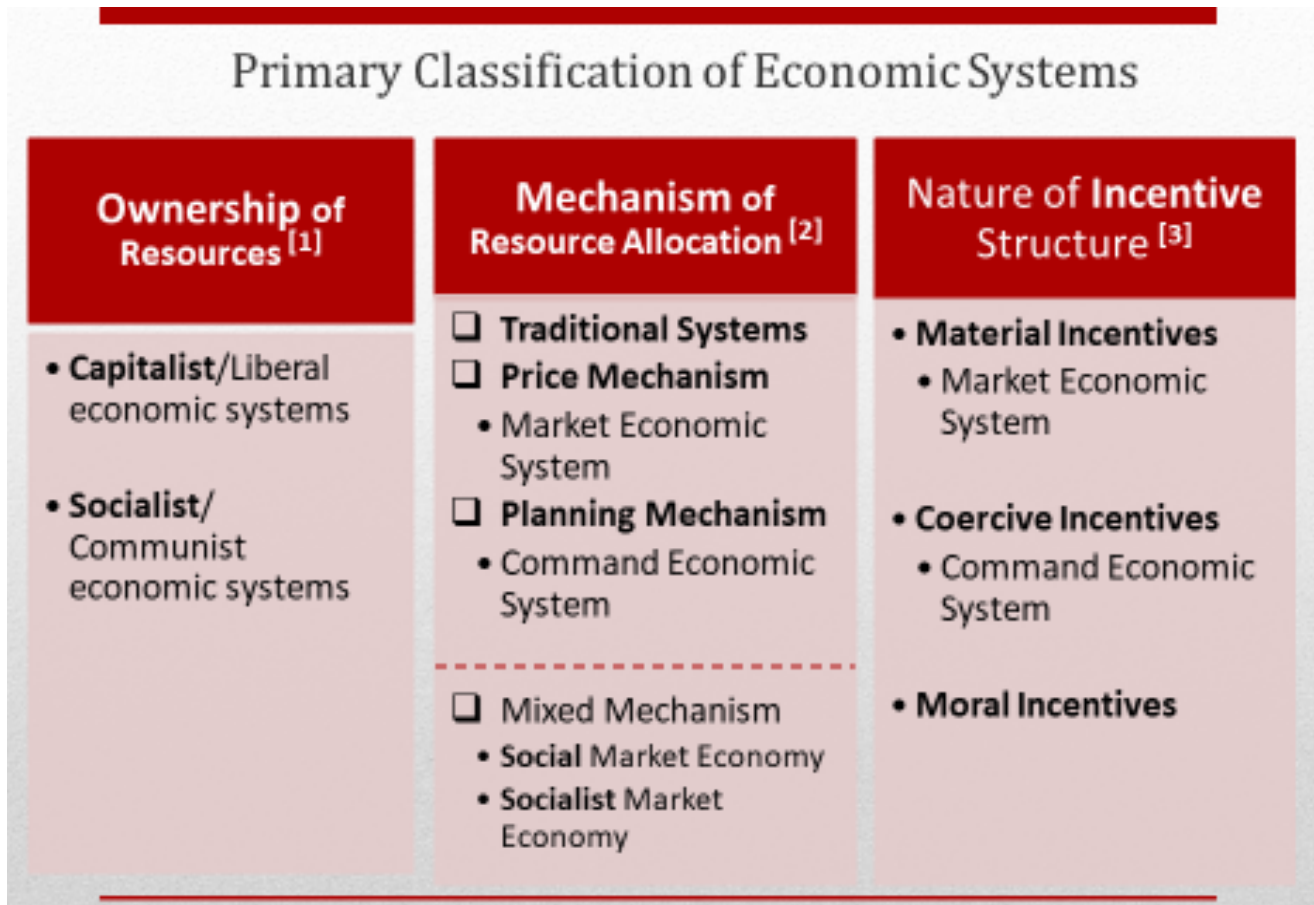
'An economic system is a set of institutional arrangements whose function is to employ most efficiently scarce resources to meet the ends of society'

[Source: The United Nations Dictionary of the Social Science]

These basic economic problems are **unavoidably** and **indiscriminately** faced by all societies since **relative scarcity** and **alternative uses of resources**, which are the primary causes of such problems, are **universal** and **central in nature**.

Although the problem of **scarcity is fundamental** and **common** to all forms of human society from traditional societies to modern market economies such as USA, different societies have created different **institutional frameworks (structures)** and **methods** for **allocation of scarce resources** among **competing uses**. Accordingly, an economic system is the set of institutions within which a community decides what, how and for whom to produce.

All economics systems consists of an institutional structure with a **specific institutional arrangement, legal structure** and a combination of **unique traditions, custom's** and **cultural elements**, while economics system tend to **vary** or **differ** from one to the other depending on the **nature** or **functional setup** of such **institutional structural features**: nature of property ownership, mechanism of resource allocation, nature of incentives, politics, ideologies etc.

[B] Variety of Economic Systems**[1] Nature of ownership, rights and entrepreneurship pertaining to property resources**

The degree of freedom to own private property (essentially land and capital) and conduct private enterprise, freedom of resource mobility, freedom of choice with regards to selecting a profession or employment.



The primary focus is on which party out of the private sector and public (government) sector owns and controls a dominant segment of the country's property resources. In a capitalist or liberal economy such dominance is held by the private sector and in a socialist or communist economy the public sector.

[2] The mechanism that coordinates decisions and allocates limited resources

Based on market mechanism (price mechanism), planning mechanism, customs and traditions. Three alternative economic systems are generally classified based on resource allocation mechanism.

In countries classified as pure market economic systems, price (price mechanism) through as decentralized self-interest based decision making process allocates resources among competing ends. In a pure command economies the basic economic problems are solved by allocating resource based on economic plans prepared and implemented in a centralized manner by the government (or by a government authority/body) , driven by common or social welfare.

Dimensions of Planning Systems

- **Central Planning (Command Planning)**

Dominant government, within a fundamentally command economic system. E.g. North Korea, Cuba, to certain extent China

- **Indicative Planning**

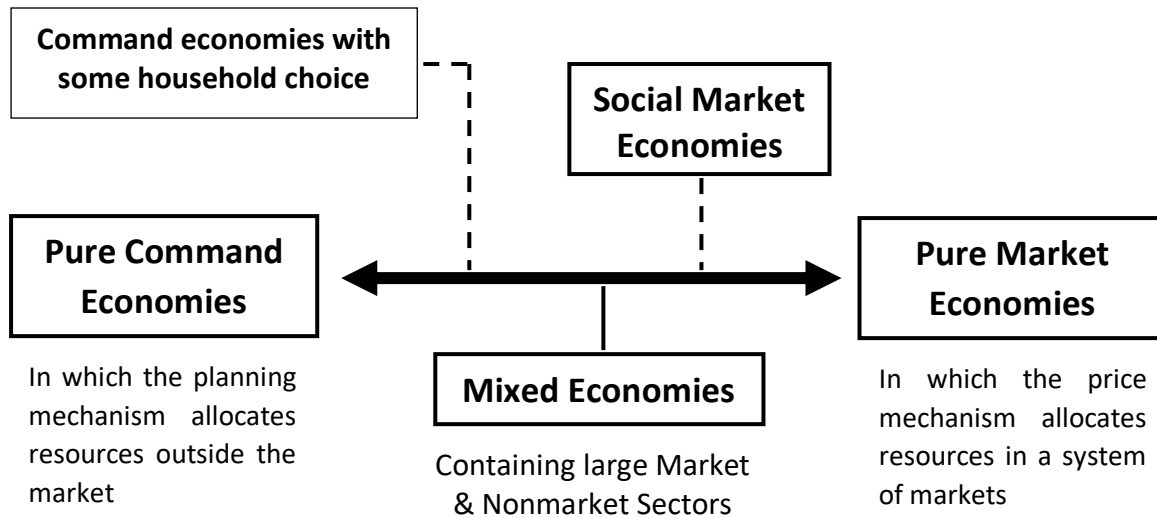
- This is a form of applying the planning mechanism, adopted by the governments of countries which are fundamentally mixed and market economies.
- Indicative planning is used to correct inefficiencies and improve the process of resources allocation and economic activities by way of government intervention, when such problems arise within the market (price) mechanism, caused due to imperfectness of market information.
- Indicative planning is frequently used by countries such as: France, Germany, Japan and South Korea

Traditional economic systems make decisions and solve basic economic problems by allocating their scarce resources, solely based on traditional values, age old and ancestral custom's.

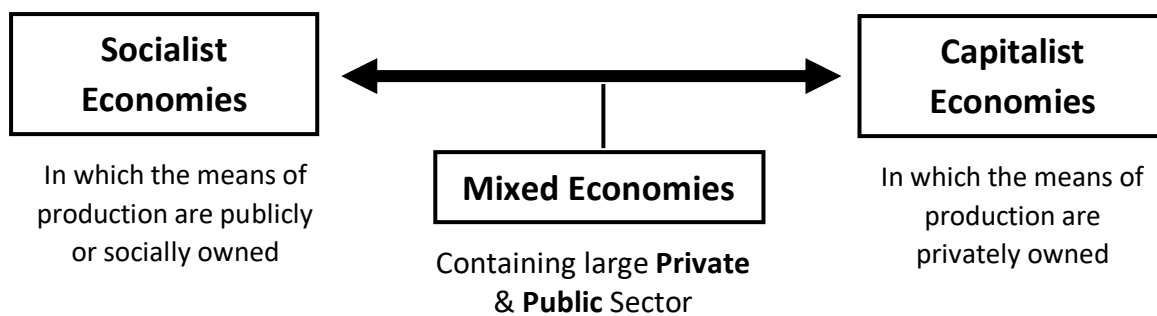
Mixed Mechanism: Mixed Economic Systems

Many economies, especially those of developed or advanced economies such as UK and other Western European countries are termed as mixed economies. A mixed economy is essentially a mixture of different types of economic systems. There are two generally accepted methods of defining a mixed economy: in terms of the mechanism for allocating resources, and in terms of resource ownership.

Mixed Economy: Resource Allocation Mechanism



Mixed Economy: Ownership of Property Resources



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

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

[3] Nature of the Incentives Structure

Individual responses and decisions shall depend on incentives. **Such incentives shall encourage behavior favorable to the society and shall act as a factor discouraging behavior which is unfavorable to the society.** There are three main types of incentives which could be identified with in different economic systems: material, coercive and moral or ethical.



In a market economic system the main source of incentive tends to be profits, while in a command economic system incentives function through authoritative power, in terms of achieving common and equal benefit (welfare). In certain other economic systems incentives function through considerations such as patriotic beliefs, ethical commitments and cultural values etc.

Material Incentives

This is a feature that could be identified within market economic systems. As an example when there is a shortage of a certain good within the market, relative price shall increase and producers are motivated to increase supply.

On the other hand consumers shall decrease consumption in response to the increase in relative price. This is because profits function as a powerful incentive within a market economic system.

Coercive Incentives

This is a feature that is commonly identified within command economic systems. The existence of forced labour even in modern times tends to explain this form of incentive. On the other hand not only in command economic systems, but even in liberal market economic systems such coercive incentives tend to be present since there is a certain degree of government intervention within such economies, (eg: charging taxes, implementing agreements, reducing corruption, bribery and illegal activities)

Moral Incentives

These are incentives which are created based on fractures such as patriotism, national pride, dignity, love, kindness, affection, etc. as an example at times of war, natural disasters, government failure, people represent rational behavior and responsible decision making motivated by such moral incentives. As another example factory employees in Japan receive a high degree of moral incentives and motivation by singing the company song before the day's work.

[C] 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

[D] PRICE MECHANISM

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

Parties operating in free market economy shall receive a high degree of consumer and producer freedom, along with a high level of private property rights. Individuals and firms make decisions based on self-interest.

The price mechanism in operation within a market economic system is a completely independent and 'Decentralized' system in which millions of individual household units and firms shall contribute and participate in the process of making resource allocation decisions with complete independence based on the self-interest of each decision maker

Price mechanism is the invisible hand by which resources are allocated within a liberal or free market economic system. Consumer and producers make purchasing and production related decisions based on price signals which are issued with in product and factor markets, with the objective of maximizing their self-interest.

Accordingly 'Price' is the invisible hand by which resources are allocated among competing ends within a free market economy.

[E] Functions of the Price Mechanism

Adam Smith, one of the Founding Fathers of economics described the “invisible hand of the price mechanism” in which the hidden-hand of the market operating in a competitive market through the pursuit of **self-interest** allocated resources in society’s best interest.

The **price mechanism** describes the means by which millions of decisions taken by consumers and businesses interact to determine the allocation of scarce resources between competing uses. The **price mechanism** plays **three important functions** in a market:

- 1) Signaling Function
- 2) Incentive Function
- 3) Rationing Function

(1) Signaling function

- ☐ Prices perform a **signaling function** – they adjust to demonstrate where resources are required, and where they are not
- ☐ Prices rise and fall to reflect scarcities and surpluses. If prices are rising because of high demand from consumers, this is a signal to suppliers to expand production to meet the higher demand
- ☐ If there is excess supply in the market the price mechanism will help to eliminate a surplus of a good by allowing the market price to fall.

(2) Incentive function (Transmission of preferences)

- ☐ Through their **choices** consumers send **information to producers** about the **changing nature of needs and wants**
- ☐ Higher prices act as an incentive to raise output because the supplier stands to make a better profit.
- ☐ When demand is weaker in a recession then supply contracts as producers cut back on output.
- ☐ One of the features of a market economy system is that decision-making is **decentralized** i.e. there is no single body responsible for deciding what is to be produced and in what quantities. This coordination is done by price mechanism.

(3) Rationing function

- ❑ Prices serve to **ration scarce resources** when demand in a market outstrips supply.
- ❑ When there is a **shortage**, the price is bid up – leaving only those with the **willingness and ability to pay** to purchase the product. The market price acts a **rationing device** to equate demand with supply.
- ❑ The popularity of **auctions** as a means of allocating resources is worth considering as a means of allocating resources and clearing a market.

[G] Transition Economies'

Transition economies are countries moving (transforming) from one economic system to another. Today this transition mainly takes place from a **socialist planned economic system towards a more capitalist market economic system**.

The main reason for this transformation is the relatively inelastic and inherent limitations of mainly socialist **planned economic systems**. Accordingly transition economies use a variety of market driven economic policies within this transition process.

Examples

- China Hungary
- Vietnam Russia
- Bulgaria Mongolia

Special Note:

EMERGING MARKET ECONOMIES (EMES)

- EMEs are countries which are becoming developed countries driven by relatively **high economic growth** and **rapid expansion** of **foreign trade** and **investment flows** (foreign direct investments: **FDI**). These include countries with low to middle income.
- The main strategy is to have an **open economy**, **deregulate**, promote **competition** and encourage **private sector investments**
- The most common examples include the **BRICS** countries (Brazil, Russia, India, China and South Africa), among a total of 24 countries.

Special Note:

NATURAL RATE OF UNEMPLOYMENT

- The resource utilization of an economy is said to be at a full and optimum level, when the economy's actual output equals potential output.
- In such a situation even though it is stated that the economy is at full employment, it cannot be stated that the unemployment level will necessarily be zero.
- This is because even in such situation, where the economy is operating at its potential output, there can be a certain level of frictional and structural unemployment. At any given point of time, the economy may experience these two forms of unemployment.
- In economics theory the existence of a certain level of such forms of unemployment is considered an unavoidable and expected situation, and therefore termed as a natural rate of unemployment.

Primary Source;

- Official Marking Schemes: 2011 - 2023 A/L [Post marking discussion]
- Prof. D. Atapattu [Basic economic text – 1 New Edition/2017]
- Prof. P. Perera [Introduction to Economics Text – 1 /First Print/2020]
- Prof. D. Atapattu [Teacher training workshop material – 2016 - 2019]
- Official NIE Teachers Guide for Economics
- Specialized Expert Review – Mind-ventures Educational Services
- Mind-ventures Overall Mock Exams 2018/19, Suggested Answer Material

Further References:

Powell, R. (1996) ***A Level Economics***. Revised ed. BPP, Letts Educational Publications.

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