



# Holiday Assignments

## ADVANCE LEVEL

Subject: Economics

Grade 12

Medium: English

### *Economic systems – how economic resources are allocated*

power stations, steelworks, etc.) must all be fitted together. For example, the planned output of a large steelworks becomes the planned inputs of many other industries that use steel. A large number of officials are required to prepare and operate a national economic plan.

#### 3 Prices

In a centrally-planned economy, prices are not free to change in response to changes in supply and demand; they are fixed by the government. In a market economy, a shortage of a commodity will cause its price to rise. In a command economy, however, a shortage will often mean that some form of physical rationing has to be used.

#### 4 Profits

In a market economy, the main incentive for firms to supply goods and services is the prospect of making a profit. This is not the case in a command economy. Enterprises are not privately owned and there are no shareholders. They do not produce for profit; they produce what the government thinks will be in the best interest of the people.

#### Mixed economies

In the real world, there are no completely planned economies. In the centrally-planned economies such as those of the USSR and the countries of Eastern Europe, we find some features of the market economy, and some use is made of the price mechanism. For example, if there is a shortage of workers in particular industries or regions, workers are not normally directed to where the shortages exist. Workers are often attracted to where they are most needed by being offered higher wages.

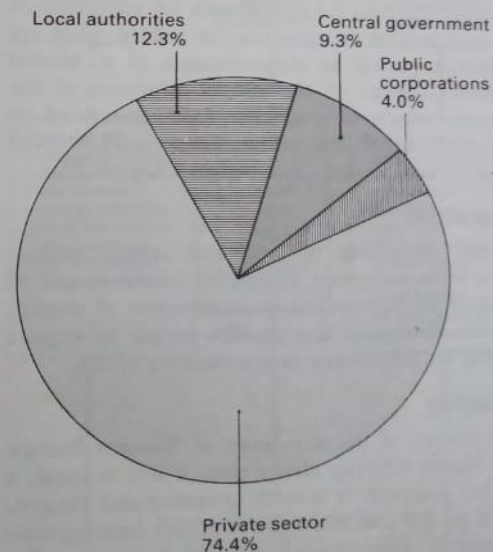
Similarly, there is no example of a completely free market economy. In all of the so-called market economies in the real world, we find a great deal of state control of economic activity.

It would be true to say, therefore, that, to some extent, most real-world economies are mixed economies. They have both a public and a private sector; some enterprises are owned by the state, while some are privately owned. But there are very important differences.

Communist countries lean very strongly towards the fully planned economy – there is relatively little private ownership, and the market system plays little part in the way the economy is run. In the non-communist countries, far more reliance is placed on private ownership, the price mechanism and free markets.

The term 'mixed economy' is commonly used to describe the economies found in North America, Western Europe, Japan and other developed countries in the non-communist world. In the UK, which is a typical mixed economy, about 26 per cent of the labour force is employed in the public sector and about 74 per cent in the private sector (see Figure 3.1).

Figure 3.1  
Percentages of the UK labour force employed in different sectors, mid-1987



Source: *Economic Trends*, HMSO, December 1987

### 3.4 Why governments exercise control over the economy

Many people believe that the market economy has several advantages over other types of economic

## Test Your Understanding

1. Which **THREE** of the following economic resources are non-replaceable?
  - A timber
  - B highly skilled labour
  - C natural gas
  - D copper
  - E coal
2. Which **TWO** of the following are features of a centrally-planned economy?
  - A The prices of most goods are fixed by the state.
  - B Firms are owned by shareholders.
  - C A firm's success is measured by its profits.
  - D Most of the land and capital is publicly owned.
3. Which **ONE** of the following statements is *not* true in a mixed economy?
  - A Most people work for privately-owned firms.
  - B The government normally provides education and health services.
  - C There is no public ownership of land and capital.
  - D The prices of most goods and services are free to change according to movements in supply and demand.
4. Say whether these statements are true or false:
  - (a) In a market economy, there are often great inequalities in the ownership of wealth.
  - (b) In a capitalist economy, most of the land and capital is owned by the state.
  - (c) Lighthouses are examples of public goods.
  - (d) In a command economy, firms produce only those goods and services which are profitable to produce.
5. Explain how the price mechanism would bring about a re-allocation of resources in the following situations:
  - (a) A world shortage of oil causes a very steep rise in its price, and there seems little prospect of this situation changing.
  - (b) A new invention greatly reduces the costs of producing nylon and terylene.

### 1 Private property

Individuals have the right to own, control and dispose of land, buildings, machinery and other natural and manufactured factors of production. It is this feature of market economies which causes them to be described as *capitalist* economies.

### 2 Freedom of choice

Individuals are free to set up in business for themselves, firms are free to decide what and how they should produce, workers are free to enter and leave occupations, and consumers are free to spend their incomes as they wish.

### 3 Self-interest

The system encourages people to do what is best for themselves. Firms will try to maximise profits, workers will try to maximise their incomes, and consumers will try to maximise their satisfactions.

### 4 The price mechanism (competition)

In a market economy, changes in the demand for goods and services, or changes in the supply of goods and services, or both, cause changes in prices. It is these changes in prices which lead to changes in the way in which economic resources are used.

For example, if the demand for a commodity increases, the commodity will become more scarce and its price will increase. This increase in price will make it more profitable to produce. Firms producing this commodity, therefore, will increase their outputs and other firms will be tempted to enter this industry. An increase in demand, therefore, will cause more resources to be used in the production of this commodity.

If the demand for a commodity falls, its price will tend to fall. It will become less profitable to produce, and this will lead to a fall in output. Fewer resources will be used in this industry.

A fall in the costs of producing a commodity will lower its price. Consumers will tend to buy more at lower prices, and production of the commodity will increase.

In a market economy, changes in prices act as a kind of signalling device to producers and consumers, and cause them to change their plans. This is more fully explained in Chapter 8.

### 5 A very limited role for government

A market economy is often described as a *free enterprise* economy, where the word 'free' means 'free from government controls'. A government has very few economic functions in a market economy. Early economists who were very much in favour of the market economy thought that the main business of government was to secure the defence of the country and to maintain law and order.

### Command economies

These economies are so named because the government has the power to *command* the nation's economic resources. It has complete control over the way these resources are used. It is the government which decides how land, labour and capital shall be employed. It has the powers to decide *what* shall be produced, *how* it shall be produced and *for whom* it shall be produced. These economies are generally described as *centrally-planned* economies. Some of the main features of this type of economy are set out below.

#### 1 Public ownership

A most important feature of command economies is the public ownership of 'the means of production'. The land and all types of capital are owned by the state. Private ownership is usually limited to personal possessions, although small businesses are sometimes privately owned, and farm workers are often allowed to own small plots of land and sell their produce in local markets.

#### 2 Planned production

Production is carried out according to a national plan which sets production targets for the different industries. Resources are allocated to industries by government directives. In this type of economy, resources are *directed* to different uses by the government. In the market economy, they go to the highest bidders – the successful firms are able to offer higher prices for the services of land, labour and capital.

A national plan consists of thousands of very complicated relationships. The planned outputs of the various enterprises (mines, factories, farms,

### 3.3

## Types of economic system

The economic systems which have been adopted to deal with these economic problems differ from country to country; each has its own particular features. Nevertheless, some of the systems are very similar to one another, and they can be classified into three or four groups.

### Traditional economies

These are communities with relatively low living standards, where the way of life has remained virtually unchanged for centuries. Isolated villages in Africa and Asia, and the nomadic Bedouin tribes, provide examples of traditional economies.

In this type of economy, people live according to age-old customs – doing things the way they have always been done. What is to be produced, and how it is to be produced and shared out, are not seen as economic problems, because these things have all been decided long ago. These economies are often described as *subsistence economies* because what is produced, in most cases, amounts to little more than the minimum necessary for survival.

### Market economies

Any arrangement which enables buyers to do business with sellers is described as a market. A market economy is one in which there is considerable freedom for people to buy what they want and sell what they produce. Prices are determined by the strength of people's demand for goods and services, and the quantities which suppliers are prepared to offer for sale, that is, by the *market forces* of demand and supply. Some of the main features of a market economy are set out over the page.