



# *Economic Systems*

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# Economy

An economy is any sized geographical area that uses its resources to produce goods / services to **satisfy** its residents needs and wants.

An economy can be classified as cities, provinces, countries, continents and as world. However for the sake of simplicity we will refer to economy **as a country** until otherwise specified.

# Economic Systems

All economies have to decide upon their resource allocation decisions.

The following questions need to be answered:

1. What to produce?
2. How to produce?
3. And for whom to produce?

# Economic Systems

For instance Pakistan needs to decide what goods and services to be produced. What **combination of factors** of production should be used to produce these products. And how to distribute the produced goods and services.

# Economic Systems

Different countries / economies have different economic systems. The type of economic system that is prevalent in any economy determines its answers to above mentioned questions.

Different economic systems are classified in three categories namely

1. Command / Planned Economy
2. Mixed Economy
3. Free Markets

# Command Economy

When state / government is main decision maker concerning allocation of country's resources is known as Command Economy. This is when most resources are **state owned** and therefore state decides upon type of goods to be produced, combination of factors of production to be produced and upon distribution of produced goods and services.

# Command Economy

This economic system is prevalent in *very few countries* including North Korea, Russia and China (to an extent).

# Free Market

Economies where individuals own most of country's resources are known as Free Markets.

Individuals possessing resources are free to decide upon their allocation decisions. People owning different resources can decide what to produce and for whom to produce. For instance if I own a piece of land then **I am free** to use it for personal or business purposes.



# Free Market

State's role in Free Markets is **minimal** and is limited to the extent of regulation and tax collection for provision of public goods.

# Mixed Markets

Unlike Free and Command economies where most resources are held by individuals and state respectively, Mixed economies' resources are distributed among individuals and state.

Hence in Mixed economies both individuals and state are responsible for **resource allocation decisions.**

# Mixed Markets

State has more role in Mixed economies than Free Markets and much lesser involvement concerning resource allocation as compared to Command economies.

# Pros and Cons of Different Economic Systems

No economic system is best for each one of them have few disadvantages.

**Free Markets**

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# Pros and Cons of Free Markets

Profit maximization being primary objective of resource owners make them produce goods and services that are most demanded. This type of resource allocation does not take into consideration the nature of goods / services.

# Pros and Cons of Free Markets

Free Markets will manufacture Demerit goods if their production is profitable.

Cigarette smoking has to be controlled by state to limit the damage caused to society.

Producers try **charging higher prices** to **maximize** their profits.

# Pros and Cons of Free Market

Presence of **multi firms** in an industry increase competition hence forcing manufacturers to constantly improve product quality.

# Pros and Cons of Free Market

**Greater choice** is another natural consequence of Free Market economic system. Consumers' demand for products determine their prices and hence influence producers' resource allocation decisions. If consumers demand certain products then they will be most probably provided by manufacturers.



# Pros and Cons of Command Economy

*Citizens' welfare* is primary consideration while deciding upon country's resource allocation.

Command economic system tries providing similar living standards to all of its inhabitants. This is something that is nearly impossible in Free Markets and hence huge income inequalities can be observed.

# Pros and Cons of Command Economy

State's ownership of resources result in **limited choice** and competition. State owned firms are often operating as monopolies in each industry.

# Pros and Cons of Command Economy

Consumers' wishes as depicted through their demand for various products does not affect state's resource allocation decisions.

Provision of **basic necessities of life** to all citizens prevent social unrest like corruption, theft etc.

# Pros and Cons of Mixed Economy

Comparatively greater choice and competition than Command Economy and better provision of public and merit goods than **Free Markets** is biggest advantage of Mixed Economy.

# Pros and Cons of Mixed Economy

Individuals get to register their wishes to producers through changing demand trends for different products.

Similarly **increased competition** among multi firms in each industry ensure constant product innovation.

# Pros and Cons of Mixed Economy

However greater government intervention in country's economic decisions might result in more regulation and higher taxes to finance public goods.

Less privileged individuals benefit from **state's provision of merit goods** like education, health-care, public transportation.

# Pros and Cons of Mixed Economy

**Financial assistance schemes** like Income Support Program of Pakistan and unemployment benefits are of immense help for less-wealthy families and individuals.