Grade 8

Subject: Economics

Topic: Micro & Macro Economics and Economic Systems

Define Micro Economics.

Economics is divided into two categories: microeconomics and macroeconomics. Microeconomics is the study of individuals and business decisions. It is the study of decisions made by people and businesses regarding the allocation of resources, and prices at which they trade goods and services. It considers taxes, regulations and government legislation.

Define Macro Economics.

Macroeconomics looks at the decisions of countries and governments. It studies the behavior of a country and how its policies impact the economy as a whole. It analyzes entire industries and economies, rather than individuals or specific companies.

What is an economic system?

An economic system is a network of organizations used to resolve the problem of what, how much, how and for whom to produce

What are the 3 types of economic systems?

The three types of economic systems are:

1) Planned economy:
2) Market economy
3) Mixed economy

What is a free market economy or a laissez-faire system?

A free market is a system of buying and selling goods and services that is not under the control of the government. It is where people can buy and sell freely, or an economic system where free markets exist, and most companies and property are not owned by the state. There is limited government intervention to influence or change the outcomes of market activity. All the decisions of resource allocation are carried out by the system of price mechanism.

What is meant by price mechanism?

Price mechanism refers to the system where the forces of demand and supply determine the prices of commodities and the changes therein. It is the buyers and sellers who actually determine the price of a commodity.

What is planned Economy?

A planned economy (also called a command economy) is an economic system in which a government or ruler makes most or all of the important decisions about the production and distribution of goods and services in the society. Such as what to produce, how to produce and for whom to produce, the questions of resource allocation are all answered by the central planning authority, which is mostly the government.

What is a mixed Economy?

In a mixed economy, some resources are owned by the public sector (government) and some resources are owned by the private sector. The public (or state) sector typically supplies public, quasi-public and merit goods and intervenes in markets to correct perceived market failure.

What are the advantages of Market Economy?

- An efficient allocation of scarce resources – factor resources tend to go where the expected profit is highest.
- Competitive prices for consumers as suppliers look to increase and then protect market share.
- Competition drives innovation & invention bringing higher profits for businesses and better products for consumers.
- The profit motive stimulates investment which encourages economies of scale and lower prices for consumers.
- Competition through trade in goods and services helps to reduce domestic monopoly power and increases choice.

What are the disadvantages of market economy?

- Free markets can fail to achieve an economically and socially efficient and equitable allocation of resources – there are numerous potential causes of market failure that may require government intervention.

- Free market activity can lead to a rise in the scale of income and wealth inequality as shown by rise in the Gini coefficient
- Businesses can develop monopoly power which leads to higher prices and damage to consumer welfare
- Under or non-provision of pure public goods (e.g. defence – goods which are non-rival and non-excludable)
- Under-provision of merit goods such as health and education – which many cannot afford – leading to lower social welfare
- Free markets may fail to address negative externalities from production and consumption – unsustainable growth
- Deregulated financial markets often prone to bouts of instability – the fall out from which affects millions not directly involved

What are the advantages of planned economy?

- Supporters of command economies argue that it enables the government to overcome market failure, inequality and create a society that maximizes social welfare rather than maximizes profit.
- Command economies can prevent abuse of monopoly power.
- Command economies can prevent mass unemployment, often a feature of capitalist economies.
- Command economies could produce goods which benefit society and ensure everyone has access to basic necessities.
- Although Command economies are associated with failing inefficient economies of the late Soviet Union and Cuba, in the 1920s and 30s, the Soviet Union made periods of very rapid economic growth. Between 1928–40 – the first three Five-Year Plans, the Soviet Union made rapid economic growth changing from a largely agrarian society to a major industrial nation.

What are the disadvantages of planned economy?

- Government agencies usually have poor information about what to produce. Centralization means that decisions are taken by people who may have no access to what is actually happening. Command economies, like the Soviet Union, often produced goods that weren’t used.

- Unable to respond to consumer preferences.
- Inefficient firms are protected and kept going; making it hard for resources to move to dynamic and efficient firms.
- Threat to democracy and liberty. A command economy creates a very powerful government which limits individual's rights to pursue economic objectives. This invariably creates a climate where governments can extend their control into other areas of people's lives.
- Bureaucratic. Command economies tend to be very bureaucratic with decisions held up by planning and committees.
- Price controls invariably lead to shortages and surpluses.

What are the advantages of mixed economies?

- Incentives to be efficient. Most business and industry can be managed by private firms. Private firms tend to be more efficient than government-controlled firms because they have a profit incentive to cut costs and be innovative.
- Limits government interference. Mixed economies can reduce the amount of government regulation and intervention prevalent in a command economy.
- Reduces market failure. Mixed economies can enable some government regulation in areas where there is market failure. This can include:
- Regulation on the abuse of monopoly power, e.g. prevent mergers, prevent excessively high prices.
- Taxation and regulation of goods with negative externalities, e.g. pollution,
- Subsidy or state support for goods and services which tend to be under-consumed in a free market. This can include public goods, like police and national defence, and merit goods like education and healthcare.
- A degree of equality. A mixed economy can create greater equality and provide a 'safety net' to prevent people from living in absolute poverty. At the same time, a mixed economy can enable people to enjoy the financial rewards of hard work and entrepreneurship.
- Macroeconomic stability. Governments can pursue policies to provide macroeconomic stability, e.g. expansionary fiscal policy in times of a recession.
- Even libertarians who dislike government intervention believe there needs to be legal support for private property and government provision of law and order.

What are the disadvantages of mixed economies?

- It can be difficult to know how much governments should intervene; e.g. discretionary fiscal policy may create alternative problems such as government borrowing.

- Too much inequality? Mixed economies are criticized by socialists for allowing too much market forces, leading to inequality and an inefficient allocation of resources.
- Government failure. Mixed economies are criticized by free-market economists for allowing too much government intervention. Libertarians argue that governments make very poor managers of the economy, invariably being influenced by political and short-term factors.

Comparison between Market and Planned economy.

	Free Market economy	Command economy
Ownership	Firms owned by private sector	Industry owned and managed by the government
Incentives	Profit motive acts as incentive for owners and mangers	Government give little incentive to be efficient and profitable.
Prices	Prices determined by supply and demand.	Price controls
Efficiency	Incentives for firms to be efficient and cut costs	Government owned firms have less incentives to be efficient
Equality	Free market likely to lead to income and wealth inequality	Government may provide more equitable distribution of resources.
Examples	Hong Kong, Singapore – have limited government intervention.	Soviet Union, China (until 1970s), Cuba
Problems	Inequality, market failure, monopoly	Inefficiency, bureaucratic, shortages, surpluses, less choice, less freedom.