Resource allocation in different economic systems and issues of transition

Key terms

Economic structure: the way in which an economy is organised in terms of sectors.

Economic system: the means by which choices are made in an economy.

Market economy: one where most decisions are taken through market forces.

Command or planned economy: one where resource allocation decisions are taken by a central body.

Key terms

Mixed economy: one where market forces and government, private and public sectors are involved in resource allocation decisions.

Market mechanism: where decisions on price and quantity are made on the basis of demand and supply alone.

Economic structure

The term **economic structure** refers to the way in which an economy consists of **various** sectors.Those sectors used to show the **balance of economic activity**, usually measured in terms of the **value of total output**, between these sectors.

The following sectors are recognised

- **Primary sector**: This consists of

  agriculture, fishing and activities

  such as mining and oil extractio

- **Secondary sector:** This term is used to describe the wide range of manufacturing activities that are found in an economy. Typical examples are: food processing, textiles and clothing, iron and steel production, \and electronics.

- **Tertiary sector:** This is the service sector and covers a range of diverse activities such as retailing, transport, banking, insurance and education.

- **Quaternary sector:** A relatively new term to denote the knowledge-based part of the economy, especially the provision of information. Typical examples are scientific research and product development, computing and ICT.

Systems of resource allocation

The problem of **scarcity**, we need to make choices. The choices that are made and which can realistically be made are determined by the **economic system** of a particular country.

Economists have recognised three distinct types of economic system – these are the **market economy**, the **command or planned economy** and the **mixed economy**.

The market economy

In a market economy, decisions on how resources are to be allocated are usually taken by millions of **households** and thousands of **firms** – the exact number will, of course, depend on the **size of economy**. The key point is that they interact as **buyers** and **sellers** in the market for goods and services.

a commodity in short supply but that has a high demand attached to it will have a high price. Alternatively, one that has a high supply and low demand will have a much lower price attached to it. Prices and the self-interest of people and businesses therefore act as a guide to the decisions that have to be taken.

Economics as a subject has its origin in the notion that prices and the **market mechanism** are the ‘best’ way of handling economic problems.

Scottish economist Adam Smith-‘invisible hand’ (the price system)

The government has a very **restricted** part to play in a market economy. For example, in Smith’s view, it should control **national defence**, act against **monopolies**, **issue money**, **raise taxes** and so on, while protecting the rights of the private sector. It certainly should not try to influence the dealings of individuals in the market or to regulate the workings of that market.

The planned economy

Like the market economy, the command or planned economy in its purest form exists **only in theory**. In this second type of economy, the government has a **central role** in all decisions that are made and, unlike the market economy, the emphasis is on **centralisation**.

The outcome of the planned economy is that central planning tends to set goals for the economy that differ from those of the market economy. In particular they have a clear objective of achieving as high a rate of economic growth as possible in order to ‘catch up’ on the progress being made by much more advanced market economies.

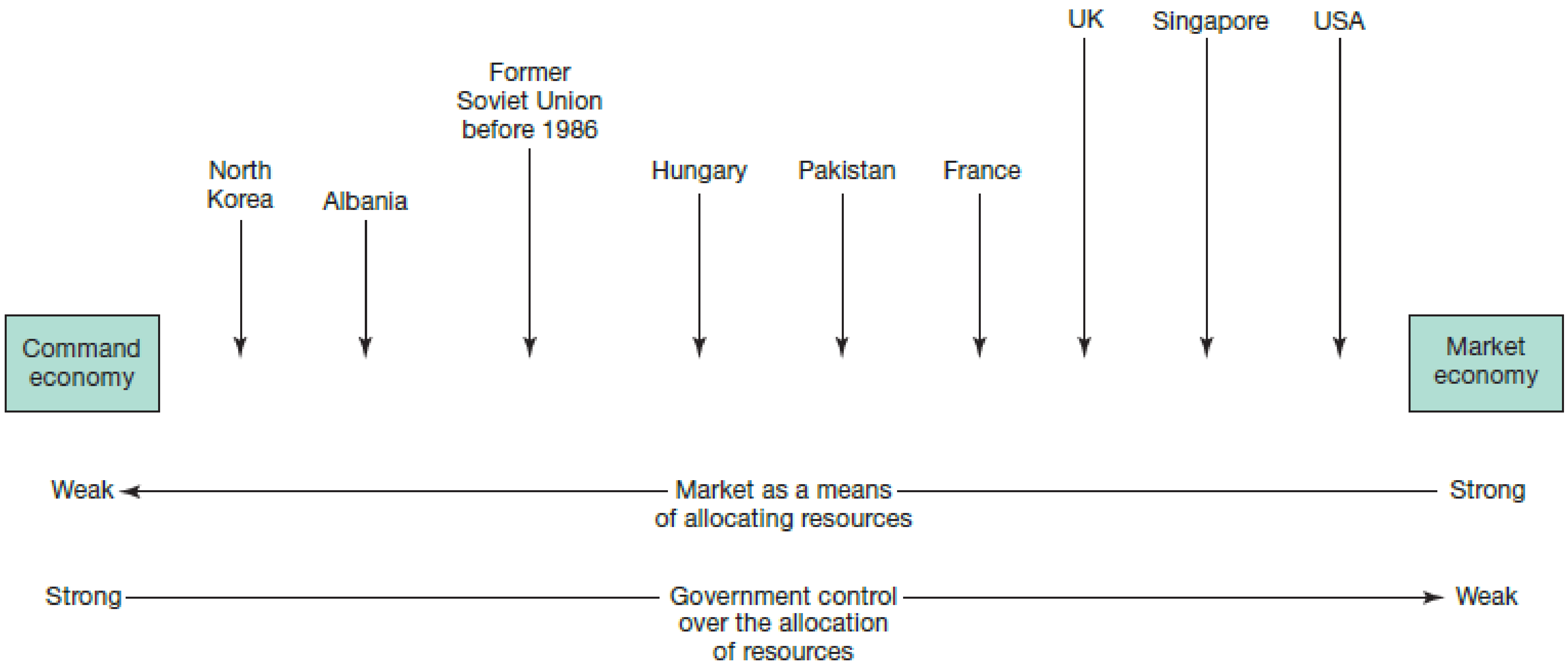
It is increasingly difficult to provide examples of truly planned economies. Th e most obvious cases are North Korea, Venezuela, Cuba and Eritrea.

the key features of a planned economy are that central government and its constituent organisations take responsibility for:

- the allocation of resources
- the determination of production targets for all sectors of the economy
- the distribution of income and the determination of wages
- the ownership of most productive resources and property
- planning the long-term growth of the economy.

The mixed economy

The mixed economy is undoubtedly the characteristic form of economic organisation within the global economy. As its name indicates, it involves both **private** and **public** sectors in the **process of resource allocation**. Consequently, decisions on most important economic issues involve some form of planning (by private as well as public enterprises) and interaction between government, businesses and labour through the **market mechanism**.


UK
Singapore
USA
Former
Soviet Union
before 1986
North
Korea
Albania
Hungary
Pakistan
France
Command
economy
Market
economy
Weak
Market as a means
of allocating resources
Strong
Strong
Government control
over the allocation
of resources
Weak