

Centrally planned vs market economy

[Finance](#), [Market](#)



It is a cardinal truth that, in order to make the best possible use of the economic resources available in any economy, three basic decisions need to be taken - what to produce, how to produce and for whom to produce. The answers to these three fundamental questions are completely dependent to the extent of government's interference in the economy. Based on the government's role in the economy, the economic systems are divided into two major categories viz. market or capitalist economy and centrally planned or socialistic or command economy.

Market Economy and Centrally Planned Economy

The capitalist or market economic system emphasizes complete freedom of individuals as buyers and sellers through the price mechanism. In such a market, price of a commodity is based on market forces of demand and supply. The customers have complete freedom to make choices regarding their purchases and the producers, in turn, allocate their resources according to the respective demand. If the demand of a particular product increases, its price is expected to be increased initially and if the cost price remains the same as before, it will generate more profit for the producers.

Naturally, the producers will allocate more resources to that particular product. On the other hand, if the consumers are unwilling to buy a product, its price would fall, resulting in a lower profit or even loss to the producers. But the scenario is completely different in a centrally planned or command or socialistic economy. Here, the three major economic decisions - what to produce, how to produce and for whom to produce - are taken by the

government. All major decisions regarding investment, savings and consumptions are practically governed by the central authority.

Thus, all the decisions, starting from the allocation of resources to the distribution of end products, are taken care off solely by the government.

Unlike a capital market, efficiency in a centrally planned economy can only be achieved only when the demands are accurately estimated and the resources are allocated accordingly. The government fixes the output target for each state and industry and allocates the required resources accordingly.

Legal Institution of Private Property vs. Social Ownership: In a market or capitalistic economy, all the properties and means of production belong to the private individuals.

The enterprises execute complete freedom and, as a result, the system is often called private enterprise economy. The land, building, machine and other articles of wealth in the country are owned by private firms. This is termed as system of ' private property'. Social ownership of property is practically non-existent. But, the situation is completely different in case of a socialist economy. The basic feature of such an economic system is the social or government ownership of means of production such as, land, machine, mineral resources, capital etc.

The government allocates the resources according to the requirements and necessity of the nation as a whole, and not on individual preferences. Hence, property ceases to be a source of individual income. Privatization vs.

Socialization: Capitalism preaches the freedom of enterprise which means that one is free to engage oneself in whatever economic activity according to

one's own will. Almost all the economic activities, except some limited number of services rendered by the government (like railways, defense etc.), are left in the hands of private enterprise.

Trade, business and commerce are absolutely free from state intervention and control. Business decisions, made by private owners, are ultimate. This is regarded as 'freedom of enterprise'. In a centrally planned economy, the vital sectors of economy (like agriculture, industries, trade, commerce etc.) are owned and governed by the government ownership and management respectively. Almost all the production processes are controlled either directly or indirectly by the government.

Freedom vs. Restrictions on Consumer Behavior:

In capitalistic system, consumers have the complete freedom regarding their consumption. Consumers are at full liberty to buy whatever products and services they choose and are able to afford. It is the consumers who dictate what are to be produced and in what quantities. This is referred to as 'sovereignty of consumers'. The consumer is the dictator in such an economy. In socialist countries, the economic planning regarding 'what to produce' and 'for whom to produce' comes under the purview of the Central Planning Authority.

The goods and services are distributed among the people through the government agencies. All the decisions regarding the production of goods and services and distribution of end products are not based on individual tastes and preferences, but on national goals. Existence vs. Non-Existence of

Price-Profit mechanism: In a market economy, efficiency in the economy is achieved only through profit-motive and there is no existence of price-control system in such an economy. When the prices rise, profits will usually follow suit, and the rising profit would induce the producers to expand their business.

Herein lies the existence of 'invisible hand' of price-profit mechanism which always maintains a balance between consumer's demand and producers' supply. Here, the price plays a major role in determining the equilibrium of demand and supply of products and services. The United States, Britain, France etc. can be regarded as capitalistic or market economies. On the other hand, in centrally planned economies, owing to government's ownership and control on the production procedures, the price system ceases to provide an automatic control mechanism over the economic operations.

The elimination of the price system replaces the motive of private profit by that of social gain. In fact, social gain forms the basis of socialistic or centrally planned economy. Such an economy is based on the ideal of equal opportunities for all, equal distribution of income and wealth etc. The USSR was an example of such an economy. At present, China can be regarded as the best example of a centrally planned economy. Conclusion In fact, virtually all the economies are, to some extent, mixed in nature.

This is because, no socialistic economy is devoid of some private ownership, and capitalist economies invariably possess some Government-regulated enterprises. Even in the United States and Britain, both private and public

sectors exercise their control over the functioning of the economy. However, while the capital planning has brought about an amazing development in some European countries in the last fifty years, the remarkable success and miraculous achievement brought by central planning in several Asian countries has strengthened the people's confidence and interest in it.

Thus, it may be concluded that the private and public sectors should not be looked upon as two distinct entities within a same country; they are and must function as an integrated portion of the same organism.

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