

What are the main characteristics of a free market economy and centrally planned

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Every country consists of a social institution which controls, manages, and attempts to solve the basic economic problems of what to produce, for whom to produce, and how to produce. Such social institutions are known as economic systems, and vary in their approach to solve the economic problem. The most basic and known economic systems are the Market Economy, the Mixed Economy, the Market Economy, the Planned Economy and the Traditional Economy. The two economic systems which are of complete contrasts are the Planned Economy, which is revolved around government decision and the Market Economy, which is based on the free-market.

A country which the government controls the factors of productions and resources, assesses the demand, sets production targets, and creates an input/output analysis in order to determine the required goods that need to be employed in order to achieve the target is following a Planned Economy, and can be said to a socialist country. In this economy, the government decides what to produce, how to produce, and for whom to produce. The fact that the government does set targets does mean that economic growth will be achieved when the targets increase and inputs reduce. However, often times, the target isn't met and if not, there is minimal ways of repayment. In addition, with the minimal incentives, the target is often manipulated.

In a planned economy, the government sets fixed price system, which implies that the state determines the price of goods with minimal account of the demand of the good; however, this also suggests that the goods are rarely over or under priced. In a fixed price system there is minimal incentive because the prices and wages are fixed, which demoralizes the employees,

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and thus decreases incentives. Nevertheless, the fixed price system also suggest that a greater majority of the society will be able to afford the good or service, and thus, it will be more beneficial for society, and not only those who can afford the good or service such as education and health care. A planned economy can often cause problems with the fact that they can misallocate resources, which means that there will be over production of goods. In addition, allocating enough resources for production on every single good and service is a demanding task and a slight miscalculation could ruin everything. There is however, in a planned economy, less wastage of resources, primarily labor.

In a planned economy, the government controls the freedom of entry and exit, because the state decides who works where, and often times, the state attempts to substitute a number of firms with a single firm per market, which will suggest that there is monopoly, and thus, minimal or nil competition. With less competition, there is no desire to improve ones level of production and resources, and thus, no development of resources and technology to help minimize the use of resources. This also implies that people will have no rights to become entrepreneurs or capitalists and set-up their own firm because the state will issue all that. In addition, as they organize how the economy is run, the government will ensure full employment, therefore there is no unemployment, however, this can also lead to over employment, where there are too many people working on the same profession. This might be perceived as a positive point but actually it is not good because it decreases efficiency of labor. Planned economies usually focus their production on capital, public and merit goods.

Firstly, the government focuses on capital goods rather than consumer goods, which can be seen on the PPF Figure 1. As a result on the greater concentration on producing capital goods, the curve will after a long time, shift to the right, as can be seen in Figure 2, which indicates economic growth, and the country will be more self-sufficient. However, this could also imply that the country is closed to trade and thus technology isn't very modern, and the most efficient way to shift the curve of the PPF to the right is ruled out. With the public goods, which are goods that are non-diminishing, the state will produce a majority of public goods in both countries which are run under a planned economy and free-market, because these goods consist of street lamps etc.

and if the government does not supply these goods through taxation, no one will as they are non-profitable, but only beneficial for society. Lastly, the government produces a great amount of merit goods, which are goods which are deemed socially desirable by the political process with positive externalities and social benefits outweighing social costs, through advertisement and then providing the goods at cheap or free prices using subsidies e. g. contraception.

Merit goods are usually underprovided in a free-market economy. In contrast to the Planned Economy, there is the ' Free Market', or ' Market Economy', in which there is consumer sovereignty, and the consumer has choices, self-interest, and the ability to own property, and the right to build an industry. The main objective in a free-market economy, unlike the planned economy, is to make a profit. However, there is rarely any country that is purely a free-market economy. image02.

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A ' free-market economy' consists of a free price system where prices are set by the interchange of supply and demand and the free-market. During this interchange of supply and demand, the consumer and seller bid for prices, which allow a transaction to occur and thus an equilibrium price will be met, which can be seen in figure 3. In figure 3, the increasing demand, which is seen by the shift in curve from the consumers signals the producers to supply more computer games as their main objective is to earn more profit. As we can see, the advantage of such a system is that prices will be set according to the demand of good, will aid in utilizing the allocation of resources because the price will determine how society will utilize its resources, and distribute income. As a result of the price mechanism, the supplier and seller could have more incentive for the business.

In a free price mechanism, the goods which command higher prices, which will force the suppliers to increase supply, will provide an incentive for the supplier and seller of the business because they are able to obtain greater profits. Unlike in a command economy, the increasing incentive in a free-market will create a great amount of competition between firms. In a free-market, the high incentive will stimulate the entry of firms, depending on the type of market i. e. oligopoly, monopolistic competition, perfect competition, or monopoly, which will create a lot of competition between firms, and thus more efficient production of goods and services to satisfy the consumers demand.

This also suggests that the firms must be efficient and provide good services and in most cases decrease prices. In addition, the competition instigates <https://assignbuster.com/what-are-the-main-characteristics-of-a-free-market-economy-and-centrally-planned-economy/>

research and development, which can improve the productivity and efficiency of goods and services and minimize the use of resources. The goods provided in a free-market, are usually consumer goods and any other good that there is a market for. Providing a good that has no market defeats the purpose of a free-market, and the firm will obtain minimal profits. The people have the decision to produce any good or service and with the main objective of earning money, they will produce what will satisfy the demand in the market.

As a result, one will only demand for what one is able to afford and thus one's income plays a major role. Unlike the planned economy, the goods produced and their value will only be of use for those who can afford it, which is why it is important for governments to produce public and merit goods. The producers will use, with their technological advancements, minimal resources, and thus minimize cost of production to produce the best product, which will maximize profits. It is evident that there are clear distinctions between the two types of economy, where one is more revolved around the decision of the government and the other based on the free-market and consumer sovereignty. Both markets have their own benefits and disadvantages and having a country which combines both factors and uses the benefits of each market to its advantage should be successful, however, in doing this, the country will have to go through being in a ' Transition Economy'.