Types of economic system and how policies effect organizations

In this report I have outlined Economic systems, type of Economies System, Government Intervention and Policies, Fiscal & Monetary Policies influence an Organization, International Trade, Importance of International Trade, The European Union (EU), An Organization in UK – Bristol & West Bank, Economic Implications for the UK of entry into EMU. To explain the above factors I have used more examples and theories for the reader to understand cleary about these factors and its mainly in Sri Lanka's economic system.

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Economic Systems

An economic system is the system of production, distribution and consumption of goods and services of an economy. Alternatively, it is the set of principles and techniques by which problems of economics are addressed, such as the economic problem of scarcity through allocation of finite

productive resources. The economic system is composed of people and institutions, including their relationships to productive resources, such as through the convention of property. Examples of contemporary economic systems include capitalist systems, socialist systems, and mixed economies. “ Economic systems” is the economics category that includes the study of respective systems.

The fundamental economic problem in any society is to provide a set of rules for allocating resources and consumption among individuals who can’t satisfy their wants, given limited resources. The rules that each economic system provides function within a framework of formal institutions (e. g., laws) and informal institutions (e. g., customs).

In every nation, no matter what the form of government, what the type of economic system, who controls the government, or how rich or poor the country is, three basic economic questions must be answered. They are:

What and how much will be produced? The different outputs could be produced with society’s scarce resources. Some mechanism must exist that differentiates between products to be produced and others that remain as either unexploited inventions or as individuals’ unfulfilled desires.

How will it be produced? There are many ways to produce a desired item. It may be possible to use more labor and less capital, or vice versa. It may be possible to use more unskilled labor to substitute for fewer units of skilled labor. Choices must be made about the particular input mix, the way the inputs should be organized, how they are brought together, and where the production is to take place.

For whom will it be produced? Once a commodity is produced, some mechanism must exist that distributes finished products to the ultimate consumers of the product. The mechanism of distribution for these commodities differs by economic system.

Capitalism

Capitalist economic system, individuals own all resources, both human and non-human. Governments intervene only minimally in the operation of markets, primarily to protect the private-property rights of individuals. Free markets in which suppliers and demanders can enter and exit the market at their own discretion are fundamental to the capitalist economic system.

What and how much will be produced? How will it be produced? For whom will it be produced?

In a capitalist system, individuals own resources, either through inheritance or through industry. The individual receives compensation for the use of resources by others. This, combined with inherited wealth of the person, determines an individual's spending power. The accumulated spending power and the willingness of individuals to allocate resources to consumption determine demand. The availability and costs of resources, together with the potential for profits of firms, determine supply. In a market system the demand of consumers combined with the supply of producers determines what and how much will be produced.

Because of the economic competitiveness of the market system, the lowest-cost production method will be used. If anything other than the lowest-cost production method was being used, a competing firm would have an

incentive to enter production to earn a greater profit and could afford to sell at a lower price, thus driving the original firm out of production. Consumers could then purchase more of the product at a lower price, allowing their limited resources to purchase more.

Production will be allocated to those with available resources and a willingness to purchase the output of production. These purchases then become information for suppliers in determining what and how much to produce in the future.

Thus, pure capitalism is an economic system based upon private property and the market in which in principle individuals decide how, what, and for whom to produce. Under capital ism, individuals are encouraged to follow their own self-interests, while the market forces of supply and demand are relied upon to coordinate economic activity. Distribution to each individual is according to his or her ability, effort, and inherited property. Typically the economies of Canada, the United States, and Western Europe are considered to be capitalist.

Socialism

Socialist economic system, individuals own their own human capital and the government owns most other, non-human resources that is, most of the major factors of production are owned by the state. Land, factories, and major machinery are publicly owned.

What and how much will be produced? How will it be produced? For whom will it be produced?

A socialist system is a form of command economy in which prices and production are set by the state. Movement of resources, including the movement of labor, is strictly controlled. Resources can only move at the direction of the centralized planning authority. Economic decisions about what and how much, how, and for whom are all made by the state through its central planning agencies.

In theory, socialism is an economic system based upon the individual's good will toward others, rather than a function of his or her own self-interest. Socialism attempts to influence individuals to take other people's needs into account and to adjust their own needs in accordance with what's available.

In socialist economies, individuals are urged to consider the well-being of others; if individuals don't behave in a socially desirable manner, the government will intervene. In practice, socialism has become an economic system based on government ownership of the means of production, with economic activity governed by central planning. The economies of Sweden and France are examples of a socialist economic system.

Communism

Communist economic system, all resources, both human and non-human, are owned by the state. The government takes on a central planning role directing both production and consumption in a socially desirable manner.

What and how much will be produced? How will it be produced? For whom will it be produced?

Central planners forecast a socially beneficial future and determine the production needed to obtain that outcome. The central planners make all decisions, guided by what they believe to be good for the country. The central planners also allocate the production to consumers based on their assessment of the individual’s need. Basic human needs and wants would be met according to the Marxist principle, “ From each according to his ability to produce, to each according to his need.”

The economies of China, the former Soviet Union, and the former East Germany are examples of communist economies.

Countries have scarce resources. The economic systems of countries are designed to allocate those resources, through a production system, to provide output for their citizens. The fundamental questions that these systems answer are:

What and how much will be produced?

How will it be produced?

For whom will it be produced?

Market economies leave the answers to these questions to the determination of the forces of supply and demand while command economies use a central planning agency to direct the activities of the economy. Pure capitalist economies are market economies in which the role of government is to ensure that the ownership of the resources used in production are privately

held. Socialist economies are primarily command economies where most non-human resources are owned by the state but human capital is owned by the individual. Communist economies are also command economies but all resources, both human and non-human, are owned by the state.

In practice, all economies are actually mixed economies, incorporating some facets of both market and command economies. The relative importance of the particular economic system in the country is the determinant of the type of economic system that it is generally considered to be.

Type of Economies System

Three types of economic systems exist, each with their own drawbacks and benefits; the Market Economy, the Planned Economy and the Mixed Economy.

An economic system is loosely defined as country’s plan for its services, goods produced, and the exact way in which its economic plan is carried out. In general, there are three major types of economic systems prevailing around the world.

Market Economic System

In a market economy, national and state governments play a minor role. Instead, consumers and their buying decisions drive the economy. In this type of economic system, the assumptions of the market play a major role in deciding the right path for a country’s economic development.

Market economies aim to reduce or eliminate entirely subsidies for a particular industry, the pre-determination of prices for different commodities, and the amount of regulation controlling different industrial sectors.

The absence of central planning is one of the major features of this economic system. Market decisions are mainly dominated by supply and demand. The role of the government in a market economy is to simply make sure that the market is stable enough to carry out its economic activities properly.

Planned Economic System

A planned economy is also sometimes called a command economy. The most important aspect of this type of economy is that all major decisions related to the production, distribution, commodity and service prices, are all made by the government.

The planned economy is government directed, and market forces have very little say in such an economy. This type of economy lacks the kind of flexibility that is present a market economy, and because of this, the planned economy reacts slower to changes in consumer needs and fluctuating patterns of supply and demand.

On the other hand, a planned economy aims at using all available resources for developing production instead of allotting the resources for advertising or marketing.

Mixed Economic Systems

A mixed economy combines elements of both the planned and the market economies in one cohesive system. This means that certain features from

both market and planned economic systems are taken to form this type of economy. This system prevails in many countries where neither the government nor the business entities control the economic activities of that country – both sectors play an important role in the economic decision-making of the country. In a mixed economy there is flexibility in some areas and government control in others. Mixed economies include both capitalist and socialist economic policies and often arise in societies that seek to balance a wide range of political and economic views.

Economic System of Sri Lanka

The Constitution of Sri Lanka establishes a democratic, socialist republic in Sri Lanka, which is also a unitary state. The government is a mixture of the presidential system and the parliamentary system.

Elaborating the economic system in Sri Lanka it can be categorized under mixed economic system as resources & factors of production are owned by both private sectors (Capitalism) & state ownership (Socialism). Market socialism refers to various economic systems in which the government owns the economic institutions or major industries but operates them according to the rules of supply and demand. In a traditional market socialist economy, prices would be determined by a government planning ministry, and enterprises would either be state-owned or cooperatively-owned and managed by their employees.

Infra-structure & other public goods (free education & health, street lamps, subsidies) are being provided by the government.

Supporting services like banking & financial services are provided by both private sector (Commercial Bank, Eagle Insurance. etc) & the government (State banks such as people’s bank, BOC)

Private sector also involves in providing same goods like education & health at a price.

E. g.: Private hospitals like Nawaloka, Asiri & Private schools.

Prices are decided & resources are allocated in the free market, by demand & supply forces.

Government intervenes in setting maximum prices. etc.

Government play a vital role in the economic system by setting rules & regulations (Acts)

Exchange rates are decided by market forces, government intervene in special occasions.

Few of the three fundamental questions in economy (how & whom to produce) are solved by the government according to the resources distribution (priority on poor majority) thus it gives private sector the chance of fulfilling need & allocate resources among people whom they can charge a price.

What economic system suites best to Sri Lanka? In personal point of view.

As discussed earlier Sri Lanka’s prevailing economic system is mixed economy, means both private ownership as well as the state takes part in

the means of production, distribution and other types of economic activities. Government acts the major role in the economy while private sector also involves in economic activities. This is actually a common economic system commonly used in many other developed & developing countries. Thus it is a good suitable economic system to a country like Sri Lanka. Besides it should be more accurate & efficient in practical performance. In my point of view this economic system should be maintained in Sri Lanka with a proper plan to help the economic well being of the country.

The government authorities & functions should be more efficient. They can combine government authorities with private sector companies to get a better output. There are several ways of involving private sector in construction & infra-structure providing projects (BOO , BOOT, MOT, and BOT methods).

Government Intervention

Government intervention is a set of actions on the part of government that affect economic activity, resource allocation, and especially the voluntary decisions made through normal market exchanges. Government, by its very nature, is designed to intervene in voluntary market activity. Some of the more common types of government intervention include taxes, price controls, assorted regulations, and control over government spending. The general justification for government intervention is that voluntary decisions by consumers and businesses fail to achieve efficiency or other goals deemed important by society.

What are the reasons for Government Intervention?

Government should intervene in economic activities where private sector fails to efficiently allocate resources to achieve the greatest possible consumer satisfaction. The four main market failures are public good, market control, externality, and imperfect information. In each case, market acting without any government imposed direction, does not direct an efficient amount of our resources into the production, distribution, or consumption of the good.

There are two major reasons why government intervention is important.

to overcome market failure

to overcome market power

Overcoming Market Failure

Provision of public goods & services. Private sector doesn’t provide public goods as they cannot charge a price from the public for consumption.

Externalities in production. The price of positive & negative externalities of production & consumption doesn’t include in final outputs, so the government involves by levying taxes & allowing subsidiaries to overcome externalities.

The price system & the redistribution of income. Setting minimum & maximum prices, price control, income tax…etc

Maintaining competition & efficient resource allocation.

Managing the whole economy & minimizing economic fluctuations.

Overcoming Market Power

Price Fixing

Price discrimination

Vertical & horizontal agreements

Cartels

Primary & secondary boycotts

Penalties

Merges

Government Policies

Fiscal Policy

Fiscal policy refers to government attempts to influence the direction of the economy through changes in government taxes, or through some spending (fiscal allowances). The two main instruments of fiscal policy are government spending and taxation. Changes in the level and composition of taxation and government spending can impact on the following variables in the economy:

Aggregate demand and the level of economic activity;

The pattern of resource allocation;

The distribution of income

Monetary Policy

Monetary policy is the process by which the government, central bank, or monetary authority of a country controls the supply of money, availability of money, and cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy. Monetary theory provides insight into how to craft optimal monetary policy. Monetary policy rests on the relationship between the rates of interest in an economy, that is the price at which money can be borrowed, and the total supply of money. Monetary policy uses a variety of tools to control one or both of these, to influence outcomes like economic growth, inflation, exchange rates with other currencies and unemployment.

Foreign Exchange policy

Policy of government towards the level of the exchange rate of its currency. It may want to influence the exchange rate by using its gold and foreign currency reserves held by its central bank to buy and sell its currency. It can also use interest rates (monetary policy) to alter the value of the currency.

How do Fiscal & Monetary Policies influence an Organization?

Fiscal Policy

Taxes & government spending are the key drivers behind this policy. They can influence organizations in several ways.

There are two types of taxes as Direct taxes & Indirect taxes. Indirect taxes (e. g. VAT) can effect on increments in prices of good & services, especially prices of materials & inputs (Oil price) & import taxes on materials can effect

on prices. Increasing prices can de-motivate customers & consumption; finally this may lead to less demand & less profit for organizations.

Direct taxes (Income tax) can also influence an organization's employees. When income tax rates are increased people will have to spend a greater part from their earnings to the government. Employees can be de-motivated & perhaps they will make efforts to work more with the intention to earn more to cover what they lose as income taxes, this may add additional cost to the organizations (overtime payments). Besides, corporate income taxes can also influence organizations.

Another equipment is fiscal policy is government spending. In Sri Lanka government expenses can be shown as military expenses, allowing subsidiaries, free education & health, building infrastructure, paying for government workers & maintaining nonprofit earning essential service authorities, parliament expenses & salaries for members of the parliament.. etc

These expenses are decided & funds are allocated by annual budgets. Government can prioritize some expenses & cut off some others. These decisions can effect on organizations. For example if an organization is being highly performed with a government subsidiary & when government decides to reduce or cut off the subsidiary it can make negative results in that organization functions. Thus when government spends more on military & defense some essentials (infrastructure, education) will have fewer funds; therefore both private & public organizations may have downfalls in their business activities.

Monetary Policy

As mentioned earlier, monetary policy is the process by which the government, central bank, or monetary authority of a country controls the supply of money, availability of money, and cost of money or rate of interest, in order to attain a set of objectives oriented towards the growth and stability of the economy. Controlling money supply makes major effects on organizations, mainly financial institutions & banks. Governments take several steps to control money supply such as open market operations, rate of interest. By selling & purchasing securities in the open market government can make changes in the money supply in a country. When the money supply is high in an economy more money circulates & purchasing power of increases.

International Trade

International trade is exchange of capital, goods, and services across international borders or territories. In most countries, it represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history (see Silk Road, Amber Road), it’s economic, social, and political importance has been on the rise in recent centuries.

Industrialization, advanced transportation, globalization, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalization. Without international trade, nations would be limited to the goods and services produced within their own borders.

International trade is in principle not different from domestic trade as the motivation and the behavior of parties involved in a trade do not change fundamentally regardless of whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

Another difference between domestic and international trade is that factors of production such as capital and labour are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labor or other factors of production. Then trade in goods and services can serve as a substitute for trade in factors of production. Instead of importing a factor of production, a country can import goods that make intensive use of the factor of production and are thus embodying the respective factor. An example is the import of labor-intensive goods by the United States from China. Instead of importing Chinese labor the United States is importing goods from China that were produced with Chinese labor.

International trade is also a branch of economics, which, together with international finance, forms the larger branch of international economics.

Importance of International Trade

International trade is that kind of trade that gives rise to the economy of the world. In this the demand and supply and the prices are affected by the global events. For example, the change in political conditions in Asia can

increase manufacturing cost and cost of labor of an American company located in a country in Asia. This would then result in increase in the price of the product that you need to buy from a local. If there is a decrease in cost of labor, on the other hand then you may have to pay relatively less amount on the product.

Global trading provides countries and consumers the chance to be exposed to those services and goods that are not available in their own country. Clothes, food, jewelry, stocks, wines, spare parts etc. and many more products are available in international market. Trading of services is also done like: banking, consulting and transportation, tourism. The goods and services that are bought from the global market are called imports and the goods and services that are sold in the overseas market are called exports. Exports and imports are recorded in a country’s balance of payments (current account).

International trading lets the developed countries use their resources effectively like technology, capital and labor. As many of the countries are gifted with natural resources and different assets (labor, technology, land and capital), they can produce many products more efficiently sell at cheaper prices than other countries. A country can obtain an item from another country if it cannot effectively produce it within the national boundaries. This is the specialty of international trade. Global trading allows the different countries to participate in global economy encouraging the foreign direct investors. These individuals invest their money in the foreign companies and other assets. Hence the countries can become competitive global participants.

International trading has become very important for every country of the world – be it big or small, developing nation or developed nation. The concept of globalization started way back 1980, developed due advancement of technology in areas transport and communication.

Another encouraging aspect is that the poor and developing nations are trying hard to beat the competition and to satisfy the needs of the customers overseas. An increase from less than twenty five percent to eighty percent has been observed after the initiation of globalization. The major contribution is made by the countries like Hungry, China, Mexico, India and Brazil.

Economic Integration

Economic integration refers to trade unification between different states by the partial or full abolishing of customs tariffs on trade taking place within the borders of each state. This is meant in turn to lead to lower prices for distributors and consumers (as no customs duties are paid within the integrated area) and the goal is to increase trade. The trade stimulation effects intended by means of economic integration are part of the contemporary economic Theory of the Second Best: where, in theory, the best option is free trade, with free competition and no trade barriers whatsoever. Free trade is treated as an idealistic option, and although realized within certain developed states, economic integration has been thought of as the “ second best” option for global trade where barriers to full free trade exist.

Global Market

The activity of buying or selling goods and services in all the countries of the world, or the value of the goods and services sold. Global marketing is simply marketing to the entire world and destroy the differences between barriers and meet the expectations of varieties of consumers all over the world. Marketing consists of establishing relationships with others through planning, execution and successful distribution of goods to satisfied consumers.

Some of the most successful companies to achieve global marketing include auto manufacturers such as Toyota, Ford, Honda, General Motors, and Volkswagen. These companies all started as small entities in their own countries and eventually achieved successful global implementation. New companies have modern marketing tools to help them achieve successful global marketing. The internet and e-commerce immediately makes a company a global business.

Since the internet is a world-wide entity, a small company based in South Dakota can easily reach customers in China with the click of a mouse. Customers can literally come from anywhere.

Successful global marketing was not achieved overnight for companies. Global marketing is a process just like other aspects of marketing. Usually a company starts out with a small export base. They work hard to achieve domestic marketing first and then they begin tackling the rest of the world. Some companies tackle the small export base and they don’t get any further from there. Global marketing is more than just exporting goods to another country; it is successful implementation of a product into a foreign trade

market. Marketing decisions are made at the home front and sent overseas and expected to sink or swim. The foreign customer is very different from the domestic customer. Language barriers, customs paperwork, and shipping costs deter many companies from becoming global entities.

The European Union (EU)

Main feature of the EU

Number of Members : 27

Aims & goals

Mainly its aim is peace, prosperity & freedom for the citizens in all the membership countries, in a fairer & safe world.

The EU charter has mainly set 10 key areas that EU support & action, those areas are as follows…

Education and training for entrepreneurship

Cheaper and faster start-up

Better legislation and regulation

Availability of skills

Improving online access

Getting more out of the Single Market

Taxation and financial matters

Strengthening the technological capacity of small enterprises

Making use of successful e-business models and developing top-class small business support

Developing stronger, more effective representation of small enterprises' interests at Union and national level

Main Governing bodies:

The commission

Parliament

Council

European Council

Political Centers

Brussels

Luxembourg

Strasbourg

An Organization in UK – Bristol & West Bank

Bristol & West (B&W) is a commercial bank in the United Kingdom which is a division of the Bank of Ireland. Bristol & West has its headquarters in Bristol, England. It was previously a building society known as the Bristol and West

Building Society. The bank's main business is mortgage lending for residential and commercial customers.

It's Impacts made by the EU

Creating a legal framework that will boost cross-border European ecommerce is a key part of banking and government guidelines issued this week aimed at creating a single EU financial services market by 2005.

The Financial Services Action Plan was formulated by the European Commission in 1999 and consists of a set of measures intended to fill gaps and remove remaining barriers to an integration of EU financial markets.

The new guidelines have been issued by City watchdog the Financial Services Authority, the Bank of England and the Treasury and are intended for financial institutions, companies and consumer groups in the UK that are not yet sufficiently fam