The pros and cons of market system economics essay

The pros and cons of market system have been debated for years. Some say that it is good, however some say in a different way. In fact each systems, either capitalism, which is also known as market system, or socialism have their advantages and disadvantages.

1. 2 Question 1 – Pros of Market System

1. 2. 1 Encouraging Competition

Market system encourages competition between firms. Besides allowing everyone to own private property, there will be less complicated rules and procedures like red tapes for investors to invest in the country, which encourage more investors to invest in the country. This can be proven by United States, where the investment rate in the country is high because of more than 60% of lands is owned privately (Economic Research Service, 2002).

When there is more investors invest in the country, consumers benefit. This is because there will be many firms in the market, and they compete with each other to obtain sales. They cannot increase the price as they wish; this will cause the firms to lose customers. Besides, firms will compete with each other by producing better quality products. Varieties of products increase as well. This is due to the supply and demand theory; if there is demand for particular product, supply of the product will be available, vice versa.

When there are many firms in the industry, investors benefit. Firms have incentive to be productively efficient by cutting costs to improve productiveness in order to compete with other firms. Firms that failed to do so will go out of the business. On the other hand, firms that worked hard will be rewarded. They are able to grow their assets as much as they can, since there is no limit to how much wealth an individual can accumulate. In the long run, this will lead to economic growth.

United States, which practising capitalism, is one of the first world countries (Nations Online, 2010).

Source: World Economic Outlook Database, 2005[*]

Figure 1. 1: Top 10: First World Countries in terms of their Gross National Income

United States' Gross National Income (GNI) per capita is $41, 941. This ranking position shows that United States has a high GNI. In another word, United States has a high economic growth. And this proves that market system can lead a country to sustainable economic growth. Indirectly, the number of people living in poverty will decrease. United States has a low poverty rate of 12% in 2004, while the highest poverty rate of that year is 81% in Gaza Strip (NationMaster, 2004).

1. 2. 2 Efficient in Allocation of Resources

Figure 1. 2: Graph of Supply and Demand Curve in Market System

In market system, resources are allocated by market itself, it relies mainly on the market forces to allocate resources. If the price is higher than P1, there will be occurrence of surplus in the market. The price will fall as suppliers are trying to dispose extra stock. This will lead to the expansion of demand curve as consumers are more interested with product instead of substitutes. At the same time, contraction of supply curve occurs. This is because producers are more interested with substitutes; hence they will switch to the substitutes.

On the other hand, if the price is lower than P1, shortages will be occurred. The price will rise since there are more buyers than suppliers. This will lead to the contraction of demand because consumers will switch to substitutes. The expansion of supply curve happens since producers found that product is more attractive than substitutes, so they switch away from substitutes.

Either when the price is at P2 or P3, it will end up with the price of P1. This is because market system is depends on the demand and supply sides in order to get an equilibrium point. Thus firms won't produce goods that consumers don't want, and they won't raise the prices as they wish. This is because these of firms will be eliminated. By this force, there will be lesser firm to waste resources to produce things that consumers don't want. Not only consumers will be benefited, scarce resources will also be allocated efficiently.

1. 2. 3 A Market with Less or Without Taxes

When there is market system, it is basically a tax-free market. Even if there is any taxes, taxes are lesser compare to market which intervened by government. Hence consumers gain benefit because the products sold will not taxed by government; consumers can purchase cheaper products.

On the other hand, firms also have advantages because the revenue earned will not be taxed by government and hence firms gain more profits. This encourages more investors to invest in the country. These profits incentives encourage firms to be more efficient too. Firms can improve existing products and at the same time innovating new products, which benefit consumers. Consumers also gain advantage because firms can cut the product selling costs due to more profits earned.

1. 3 Question2 – Cons of Market System

1. 3. 1 Monopoly Power

In contrast, many of the pros of market system are also its cons. Although it seems to be good that market forces determine the price of product, it is not the same case when it comes to monopoly industry. Firms will exploit consumers by charging high prices, yet selling consumers less innovative products. Consumers have no choices besides purchasing from firm. This is because there is no similar substitute for consumers as the entry to barrier is high. And this decreases the gratification of consumers.

Monopoly power is also harmful to the firms. When there is no government intervention, firm with monopoly power will use its power to avoid competitors from entering the market. For example the firm will use predatory pricing method by reducing its products' costs less than production costs to defeat competitors. This is harmful to consumers as the firm will later increase the price as high as possible. On the other hand, investors will not invest to the country anymore because the " bully practices" causing unfair to the investors.

A report has shown that Microsoft has harmed public by retarding innovation, denying consumers' choices, degrading product's quality, and increase product's selling cost (Jackson, n. d.). Microsoft has been exploiting consumers through preventing its products to be developed, and at the same time avoiding other software companies from devoting time and capitals into new products. This leads to a bad investment climate seeing that the public has been exploited, and there is no longer a balance range for social interests.

Government intervention to the market is important. Action like setting act is needed to control anti-competition behaviour. For instance, in United States, Sherman Act is set to abolish monopoly practice (Federal Trade Commission, 2010). With this regulation, investors are easier to enter the industry as everyone has the equal opportunity. Besides, consumers also gain benefit as the price of the product is cheaper, and there will be more choices for consumers.

1. 3. 2 Equal Distribution of Income

Market system causes inequality. Wealth tends to redound to a small percentage of the population, where individuals who are rich will become richer. On the other hand, individuals who are not rich will never get rich. Same to the market, large organisation will be getting larger; while small business will remain small.

In 2007, United States has a Gini index of 45. 0 (CIA World Factbook, 2010). The Gini index is a measurement for household incomes inequality, the higher the value, the more the inequality. The highest ranking of the same year is Bosnia and Herzegovina, with a Gini index of 56. 2. This shows that United States' income distribution is unequal.

Hence, government interference to the economy is important. With government intervention, where government imposes different tax rates to different income groups in United States, individuals have a more equal income as high income earners will be taxed more and low income earners will be taxed less (Tax Foundation, 2010). The same thing goes to the firms; small business will be imposed lesser tax and incentives are given. This encourages positive ‘ investment climate’ in a country because this is fair for investors to invest in the country. At the same time individuals’ social interest increases too.

1. 3. 3 Underproduction of Public Goods

In market system, where there is no government intervention, will be lack of public goods like street lights and highways. Since public goods benefits to everyone including nonpayer, it will be ends up with nobody paying for it. On the other hand, private firms will not use their profits to provide free service. This shows that market system fails to provide public goods.

A country without public goods is a country which lack of infrastructure. Lack of infrastructure is bad for both individuals and investors. If a country is built without providing street lights, is that everyone staying at home and not going out at night? Furthermore a totally dark night increases criminal rate, this causes consumers and investors to feel insecure. And this eventually leads to a bad ‘ investment climate’.

To avoid this bad ‘ investment climate’ happens, government has to intervene into the economy by imposing tax to everyone. The purpose of collecting taxes is to build public goods since everyone is not paying for it if they are not forced to do so.

1. 4 Question3 – Government Policies to Improve ‘ Investment Climate’

1. 4. 1 Policy to Encourage New Businesses

In Malaysia, it takes an average of 144 days in registering property; it ranks 67th among 178 countries for the ease of registering property. Besides, starting a business, which involves 9 government-required procedures, takes about 24 days; it ranks 74th in the list (U. S. Department of State, 2010). These are the complex rules and red tapes by government will reduce investors to invest in Malaysia.

A new policy: Malaysian Corporate Identity Number (MyCoID) has been introduced by the Prime Minister of Malaysia, Datuk Seri Najib Abdul Razak. MyCoID is the company number that will be used as a single serial reference number for various registrations and transactions at relevant government agencies (Sun Media Corporation, 2010). This can reduce the time used to start up a business to 3 days only. With this new policy, investors will be more interested to invest in Malaysia, as the business start up time reduces from 24 days to 3 days, which has fasten the process about 7 times. With this, consumers benefit as there will be more firms, and consumers can have more choices.

1. 4. 2 Policy to Abolish Corruption

In 2010, Malaysia ranks 56th in Transparency International’s Corruption Perception Index among 178 countries (Star Publication, 2010). It is getting worse, as 2009 Corruption Perception Index was 4. 5 and in 2010, the index score is 4. 4. In 2007, the ranking was in 43rd, just in three years time, the ranking fell from 43rd to 56th! This is an important issue that government should take note about it. When a country is with a high corruption rate, the number of investors will be drastically reduces. This is because bribery causes unfair to the investors. And their confidence toward to country will be losing.

A new set of policies have been set by government recently. To tackle grand corruption, they have to enforce existing political laws (PEMANDU, 2010). Besides, announcement of zero tolerance policy has been made. Government will reinforce whistleblower protection too. In addition, government will endeavour to complete prosecution of corruption cases within a year, particularly for public interest cases to regain public's confidence on government. Stiffer punishments for those guilty of corruption are enforced as well. Convicted public officers will receive harsher penalties. Lastly, a public name and shame database of convicted offenders will be developed; it can be a deterrent and can facilitate employment decisions. These actions can reduce corruption rate efficiently and able to attract and retain more investors' confidence towards Malaysia.

1. 4. 3 Policy for Equal Income Distribution

Malaysia has a high Gini index with the value of 46. 1 in 2002; the rank of 36 compared to over hundreds countries (CIA World Factbook, 2010). This shows that Malaysia has high unequal income distribution. An unequal income distribution will cause less investors invest in Malaysia as it will be unfair for them, especially if the business is small. Besides, individuals will be demotivated to work as their wealth will not grow much while the small population of high income earners will become wealthier over time.

Hence Malaysia government collect corporate and personal taxes. Different rates are available for different groups of income earners. For low income earner group, where income is lesser than RM2, 500 are not required to pay for income tax. For high income earner group, the tax imposed is from the range of 1% to 26%. This goes the same to the firms. Corporate with paid up capital more than RM2. 5 million has to pay 25% corporate tax. This policy makes the gap between different classes income earner smaller. When there is low unequal income distribution, investors will be interested to invest in Malaysia. At the same time, individuals are motivated to work as there is no unfairness in distributing income. It will help Malaysia’s economic growth to be higher in the long run.

1. 5 Conclusion

The market will be perfect, if there is a mix economy, where the market is run by capitalism and government at the same time.

2. 1 Question 1

2. 1. 1 Introduction

In the past, oil price is determined by the supply side (Gibson, 2009). OPEC used to control oil prices by controlling supply. However, from 1990 onwards, this has changed. The oil price is depended on the demand side (Gibson, 2009). The more the demand of oil, the higher the price is.

Source: WTRG Economics, 2009

Figure 2. 1: Crude Oil Prices – 2008 Dollars

Figure 1 shows the wide price swings of crude oil from 1947 to 2009. The unsteady prices are caused due to various reasons, for example oil price increases when revolution occurs; and oil price decreases when there is a recession.

Conversely, APS Review Oil Market Trends (2004) posted that not only demand affecting the price of oil, there are some factors like American Strategic Petroleum Reserve (SPR), and European winter affecting oil prices.

2. 1. 2 Forecasting Oil Price in 2012

2. 1. 2. 1 The Past Trend

Source: IOGA, 2010

Figure 2. 2: Yearly Average Crude Price – 1977 to Present

The price oil crude oil was lesser than $40 per barrel before 2004.

Source: International Energy Agency, 2010

Figure 2. 3: Total IEA – Average CIF Costs of Imported Crude Oil

After the price hit $50 per barrel in 2005, the price become unstable, it rises and drops frequently. In 2008, the price even hits over $130 per barrel. After that, the price drops until it is lesser than $50 per barrel.

2. 1. 2. 2 The Future Trend

The price of oil will be increasingly higher each and every year because of the scarcity of oil. Through the past trend, I can foretell that the price of oil in 2012 will be within the range of $100 and $200 per barrel.

According to Morgan Stanley (2009), oil prices will be $85 per barrel in 2010; and it would rise until $95 and $105 in 2011 and 2012 correspondingly. At the beginning of 2010, Morgan Stanley reported that at the end of 2010, oil prices would be $95 per barrel; while at the end of 2011 and 2012, oil prices would be $100 and $105 per barrel respectively.

On the other hand, in 2008, the chief economist of CIBC World Markets, Jeff Rubin said that the price of crude oil would be $150 per barrel in 2010. This price growing phenomenon will sustained in years, hence in 2012, the price would be over $200 per barrel. Again in 2010, Jeff Rubin said that the price of crude oil will hit $100 per barrel in 2010, and in 2012, the price will reach $225 per barrel (Carrett, 2010).

Although Jeff Rubin has predicted correctly that oil price will hit $50 before 2005, and he foresaw the huge price spike for oil in 2008 (HeatingOil. com, 2010), it is impossible that the oil price will exceed $200 per barrel in 2012. The $200 per barrel oil is coming soon, either in the next five years, or the next eight years, but it won't be in the next two years.

2. 1. 3 Reasons behind Forecasting

2. 1. 3. 1 Supply Side of Oil

The Thunder Horse Oil Field, which is located at Gulf of Mexico, is the largest semi-submersible oil platform. It is owned by British Petroleum and ExxonMobil. Today, British Petroleum produces approximately 400, 000 boe/d (barrels of oil equivalent per day), from nearly two dozens of fields (BP, 2009). Among 400, 000 boe/d, 250, 000 boe/d is produced by Thunder

Horse. British Petroleum wished to have a production of 4 million boe/d at Thunder Horse in 2020.

However British Petroleum’s wish could not comes true because of hurricanes. In 2008, Hurricane Ike and Gustar hit Thunder Horse. This has caused the increase in oil price at West Texas Intermediate, where the price increased in 10% to $70 per barrel, while the price at gas stations rose by 50%, to $3 per gallon (Rubin, 2010). When Hurricane Ike hit Thunder Horse again in 2008, gasoline prices have soared to as much as $5 per gallon (Rubin, 2010). It was followed by Hurricane Gustar and Ivan. This has leaded the shut down of half of the production, where approximately 500, 000 people unemployed; recession occurred. At the same time, oil price increased because of the reduction of oil supply.

2. 1. 3. 2 Demand Side of Oil

When the world oil price is increasing, everyone in the world is paying for the expensive oil, except for the countries in OPEC. Hence when everyone is consuming less because of the expensive oil, people in OPEC countries can consume the oil as usual, or even more, because they are not affected by the high oil prices. For instance, Ski Dubai, where the Ski Dubai’s Snow Park ‘ supply’ the snow for 3, 000 square meters of year round perfect snow in one of the world’s hottest deserts (Rubin, 2010). These artificial snows are made of oil. Ski Dubai uses 3, 500 barrels of oil a day, which can be used for one month by American drivers pumping their gas tank.

Almost 90% of every barrel of oil consumed in the world goes for transport fuel. This is because the world economy is growing, especially in BRIC countries: Brazil, Russia, India, and China. In these countries, car sales are booming. Unlike America, where the car sale only grows 1% to 2% in the best economic times, car sales in BRIC countries are growing at ten to twenty times to that pace (Rubin, 2010). When the demand for car is rising, the demand of oil is rising; cars need oil to operate. There are more cars in the road when Tata Nano in India and Chery in China are introduced to the market. These cars are so cheap that the prices are between ranges of $2, 500 to $10, 000. It seems to be a miracle for many people, as they finally afford to buy a car. However it is actually a nightmare, where the cars in the road increase and will lead to high oil prices.

2. 1. 3. 3 Increase in Demand and Decrease in Supply

When the decrease of supply and increase of demand happen at the same time, the price of the product will increase.

Figure 2. 4: Graph of Increase in Demand more than Decrease in Supply

Figure 2. 5: Graph of Increase in Demand less than Decrease in Supply

Either increase in demand more or increase in demand less than supply, it will result to the increase in oil prices. Hence oil prices will hit more than $100 in 2012.

2. 1. 4 Conclusion

In 2012, the oil price will not hit over $200 per barrel because when oil price hits over $100, recession will occur; just like what had happened in 2008. When oil price increases, there will be a massive knock-on effect. Starting by increasing in prices of goods and services, which will eventually leads to slowdown in economic activities, as consumers refuse to spend more. Then recession happens; some firms close down and there is high level of unemployment. Due to economic contraction, consumption of oil decreases as well and there will be a sharp decrease in oil price.

2. 2 Question 4

2. 2. 1 Introduction

Apple Inc. has been a leading company in electronic products. It was established on 1st April 1976 in US by Steve Jobs, Steve Wozniak, and Ronald Wayne (Apple, 2010).

During a conference call with investors, which held by Tim Cook, the Chief Operating Officer of Apple Inc., a question was raised up. Someone asked about how Apple Inc. would function without Steve Jobs, the Chief Executive Officer and the co-founder of Apple Inc., as he was unable to run the business operation due to medical leave (Cable News Network, 2009). Tim Cook answered:

‘ We believe that we are on the face of the earth to make great products and that’s not changing. We are constantly focusing on innovating. We believe in the simple not the complex. We believe that we need to own and control the primary technologies behind the products that we make, and participate only in markets where we can make a significant contribution. We believe in saying no to thousands of projects, so that we can really focus on the few that are truly important and meaningful to us. We believe in deep collaboration and cross-pollination of our groups, which allow us to innovate in a way that others cannot. And frankly, we don’t settle for anything less than excellence in every group in the company, and we have the self-honesty to admit when we're wrong and the courage to change. And I think regardless of who is in what job those values are so embedded in this company that Apple will do extremely well.'

Cook's statement clearly explained that Apple Inc.'s mission, which is designing and making great electronic products, will not change. While Apple Inc.'s vision is to focus on what that is truly important to the company.

2. 2. 2 SWOT Analysis on Apple Inc.

Figure 2. 6: Table of SWOT Analysis on Apple Inc.

Apple Inc. has a strong brand, with a high reputation as its strengths. This is because a well-known brand with a good reputation attracts customers. Apple Inc. is a highly diversified company in technological products. It sells not only software, but also hardware. This can attract different types of customers which can lead to higher revenue. In addition, Apple Inc. has a strong international presence. It has more than 300 stores worldwide, and has online store where the products are sold (Apple, 2010).

The most visible weakness of Apple Inc. is selling expensive technological products compare to its competitors. Consumers who cannot afford such expensive products will choose to purchase from Apple Inc.'s competitors, such as Dell and Nokia. Apple Inc. should perhaps do some promotions sometimes to attract more customers. Besides, Apple Inc. loses its sales in personal computers to other competitors because of its operating system supports limited software. Apple Inc. should improve more in its software so that consumers will not stick only to Window's software. Another weakness to Apple Inc. is the criticisms to the company. Types of criticism to Apple Inc. will ruin its reputation. So Apple Inc. should take some actions to abolish these rumours.

The opportunity for Apple Inc. to be more successful is to sustain a low-cost leadership. Technological products are expensive, if Apple Inc. makes its price lower than other competitors, yet providing a good quality products, it probably will turn one of its weakness into strength. Apple Inc. is great in innovation. If it can keep up with great and innovative products from time and time, Apple Inc. could increase its market share without decrease any of the product price. Apple Inc. should market Itunes as well since demand for online music is increasing.

It is not easy to be in this industry. Technology changes rapidly; it takes a little time to switch to new technology. There is also a very high level of competition in the industry because it is profitable. So Apple Inc. should focus in its research and development department in order to lead the industry. Economy crisis such as recession is a treat too. This is because Apple Inc. is selling its products in a high price. During recession, consumers are not willing to spend much, so they will purchase from other cheaper brands. Apple Inc. should aware of this to avoid losing its customers.

2. 2. 3 Porter’s Five Forces Analysis

Personal Computers (Mac)

Cell Phones (iPhone)

Portable Music Devices / Online Music Services (iPod / iTunes)

Threat of New Entrants

Low

Low

Low

Economies of scale

Economies of scale

Economies of scale

Product differentiation

Product differentiation

Product differentiation

Cost advantages

Cost advantages

Cost advantages

Threat of Substitute Products or Services

Low

Low

Moderate

Switching costs

Switching costs

Switching costs

Substitute’s performance

Substitute’s performance

Substitute’s performance

Buyers’ willingness to change

Buyers’ willingness to change

Buyers’ willingness to change

Bargaining Power of Buyers

Moderate

Low

Low

Buyers are fragmented

Buyers are fragmented

Buyers are fragmented

Substitute available

Substitute available

Substitute available

Product differentiation

Product differentiation

Product differentiation

High price sensitivity

Low price sensitivity

Low price sensitivity

Bargaining Power of Suppliers

Moderate

Low

High

Suppliers have power to impact prices

Suppliers have power to impact prices

Suppliers have power to impact prices

High switching cost by suppliers

High switching cost by suppliers

High switching cost by suppliers

Existence of illegal free music download

Competitive Rivalry

High

High

Moderate

A few competing firms, with a clear leader

Large number of competing firms

A few competing firms

Existence of low priced PC makers

Figure 2. 7: Table of Porter's Five Forces on Apple Inc.

Competitive rivalry is the largest external force to Apple Inc. In computer industry, Apple Inc. is neither leading company, nor low-cost leader in computer industry; it has a high competitive rivalry. In cell phone industry, there are many competitors like Nokia, Samsung and etc. Luckily among the high degree of competition, Apple Inc. has a market share of 28%, which is higher than most of the competitors (AppleInsider, 2010). Although there are only a few competitors in portable music industry, Apple Inc. has to keep its product innovative to prevent other competitors take over its leading position.

Overall, Apple Inc. is not affected much by these threats. The barrier of entrance to technological product industry is high. A new firm needs a huge number of capitals to enter this industry. Besides, a new firm will not have a strong reputation on its brand. Thus fewer consumers will purchase it. This causes the firm has to produce products in a high cost because unable to achieve economies of scale. The threat of substitute products is low too. This is because Apple Inc. produces differentiated products compare to other competitors. It seemed to be a weakness as the operating system support limited software. However this causes the switching cost to other brands higher, so consumers will not change to other products. As the quality of Apple Inc. products are good, it creates many loyal customers. 80% of the customers who are using Apple iPhone will continue purchasing iPhone in the future (AppleInsider, 2010).

2. 2. 4 Boston Matrix

Figure 2. 8: Boston Matrix on Apple Inc.

Apple Inc. sells three main products: Mac, iPod and iPhone. iPod and iPhone are in the category of star in Boston matrix. iPod has a high market share of 73. 8% and a high market growth with a sales of 225 million unit iPods in 2009 (AfterDawn, 2009). Among so many competitors, iPhone has a high market share of 28%, which is the second smartphone highest market share (AppleInsider, 2010). It has a high market growth that 10 million units of iPhone will be sold in 2010 (Reuters, 2010). However, Apple Inc.'s personal computer is not doing as well as iPod and iPhone. It has a low market share of 10. 4% and has a sales figure of 1. 83 million personal computers for a quarter (9to5 Mac, 2010).

Apple Inc. has to secure the dominance of the growth market on iPod and iPhone. At the same time, Apple Inc. needs to improve on its software. Mac has a low market share and market growth is because of its operating system support limited software. This means consumers who purchase Mac could not use Windows software. Apple Inc. has to innovate and improve better software to gain more customers.

2. 2. 5 Conclusion

Overall, Apple Inc. is doing perfectly in the business. As a leading company in technological products, Apple Inc. has to keep focus not only on itself, but also its competitors. Apple Inc. needs to improve on its weaknesses to avoid competitors from taking over its leading position. It also needs to prevent the threats to become its weaknesses. In addition, it has to put effort to change its opportunity into its strengths to become a better company. Lastly, its mission and vision have to always be on the first place before making any decisions.

2. 3 Question 5

2. 3. 1 Introduction

Monopoly is usually defined as an industry where there is only a seller. In UK, when a single firm or a group of linked firms have more than 25% of the output of a product in the hands, monopoly is formed in that particular industry (Griffiths and Wall, 2008). There are two types of monopoly: natural monopoly and coercive monopoly.

When a firm has monopoly power, it will only face a little competition. Hence the firm will be a price maker; it can set the price for a product based on its market share within a particular market. This usually occurs when there is coercive monopoly.

2. 3. 2 Disadvantages of Monopoly

2. 3. 2. 1 Monopoly Exploits Consumers

Some observers argue that companies should not have monopoly power because monopoly exploits consumers. When there is monopoly, there is an extremely high barrier to entry for other firms; hence there is no close substitute for a particular product. The firm will have the ability to control the price of the product to some degree.

Figure 2. 9: Graph of Inelastic Demand

Figure 1 shows the exploitation of monopoly firms to