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M03EFA:

Economic Environment of Business: Essay Handout

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Explain the concepts of resource allocation in a modern society. Describe the different economic systems and relate it to practical situations. Include a discussion of advantage and disadvantages related to the different economics systems mentioned earlier. Remember to include the practical examples.

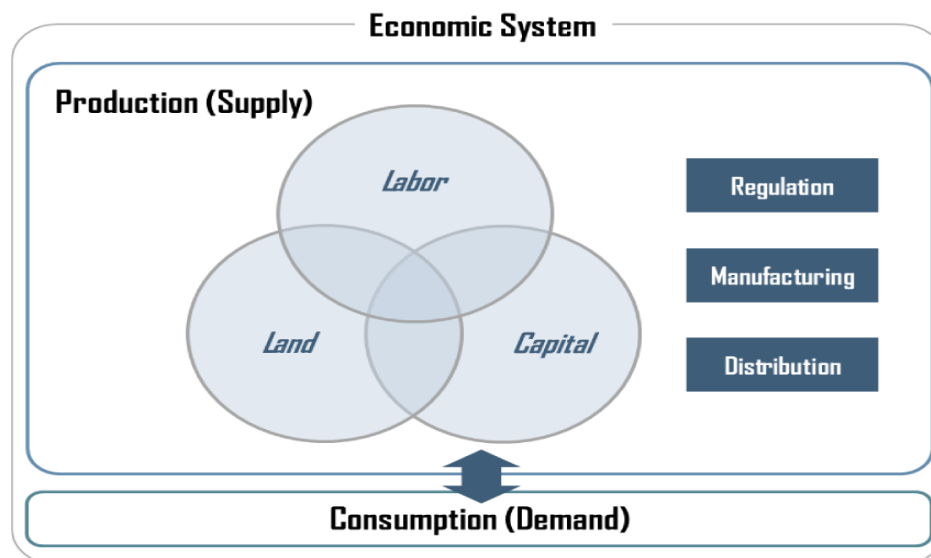
As defined by economists “ A country’s economy or economic system is that society’s way of coordinating the production and consumption of goods and services. “.

Or

“ An organized way in which a state or nation allocates its resources and apportions goods and services in the national community. “ (Businessdictionary, n.d.)

Basically there are three basic questions for an economic system.

What will be produced? How it will be produced ? For whom it will be produced?



The different goals of an economic system depends on the values of the society like Economic freedom, Economic growth, Economic security and Economic stability .

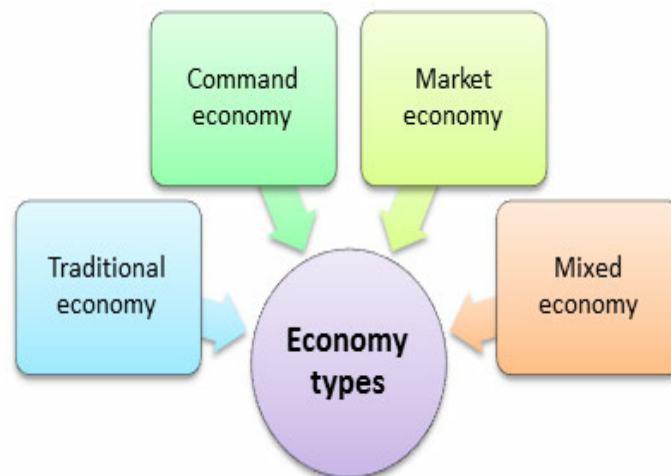
Allocation of resources can be defined as the allotment or distribution of productive assets among different uses. (Britannica, n.d.). It is very important to allocate the resources as the resources of the society are limited and human wants are unlimited. Economics is the study how different

alternatives and choices are evaluated to achieve given objective. Resources are allocated according to their highest valued uses. The tools that help in the allocation of the resources are supply, demand, cost, preference etc. are used by individual to allocate resources to satisfy their wants.

Due to certain limitations individuals have to make choices. So it is the challenge that how we prioritize and allocate our limited resources is one of the basic economic challenge faced by the nations.

Economists generally divide the societies in four different types.

- A traditional economy
- A market economy
- A command economy (Planned Economy)
- A Mixed economy (Hybrid Economy)



Traditional Economy is the economy based on Agriculture, Fishing or hunting . It follows the previous traditions. It may also use barter instead of money. Because of these characteristics traditional economy is found living in poverty and operated in emerging markets. These economies can be found in Africa, Asia, Middle East and Latin America. As the traditional economy centers a family or tribe it follows the traditions of their elders. Elements of Capitalism, Socialism and communism can be found in the setup of the traditional economy. (news, n.d.)

Advantages

As traditional Economy follows traditions and customs so the allocation of resources are well known. Individual roles are clear in production and it is also very less destructive to nature. It is found to be very sustainable.

Disadvantages

Traditional Economy are very vulnerable to nature. It also limits the growth of the population. They are also risky to market and command economies that have superior resources. For example Russian oil development in Siberia has damaged the streams that has reduced the traditional fishing .

Examples

Examples of traditional economy are some of the African and Asian countries that rely on farming as the main occupation in today's world . African countries – Malawi and Ivory Coast and some Asian countries like Bangladesh and Burma, Papua New Guinea. (Loudoun, n.d.)

Command Economy is also known as planned economy . in this economy the government has the power over the financial management of the country. Financial decisions like the prices of goods and services, wages rate of the labor and has full command over the resources. The command economy consists of state owned entities as well as privately owned entities that are controlled by the state. (study.com, n.d.). In command the three basic questions what to produce? How to produce? And for whom to produce? is determined by government preferences.

Advantages

Command economies provide the economic security to the country as well as have the ability to change with the changing circumstances. this economy has the ability to shift the resources from one industry to another if required. Government is capable of creating a healthy supply of resources by intelligent regulations. In this economy the government adjusts the production rate to meet the demand. The production is increased or decreased according to the specific regions. It is easily responding to the emergency and internal disaster. This economy also inform the government about the needs and the demands of the people according to which prices are kept nominal. (occupytheory.org, 2014)

Disadvantages

Command economy limits the economic freedom and provide very less incentive to the hard work. This kind of economy has very less economic efficiency and have not in practice tended to work well. Major disadvantages of this economy is failure of co-ordination between the planning and the execution of economic decisions pertaining to investment, trade and production. The other disadvantage is misplaced incentives. (occupytheory.org, 2014)

Examples

Countries like Cuba ,North Korea and Soviet union are the examples of command economy. In Cuba housing is free but no one can own houses and salaries are controlled by the government and are low and the government has control over the pricing. (study.com, n.d.)

Market Economy has several characteristics like in this economy people buy what they want to buy so money becomes necessary and to get money they are forced to sell anything. The main aim is to maximize profit rather than satisfying social needs. Rationing of scarce goods take place through money. (Ollman, oct 1999) .In market economy the decisions regarding investment, production and distribution are based on market determined demand and supply. Government role is to pass laws to protect businessman and consumers. It also provides certain services like police.

Advantages

Competition between the firms leads to the effective production without the wastage of resources. Only those goods are produced which have demand and other goods are dropped. Consumers gets a wide variety. Profit rewards are for the producers. This type of economy tend to be more effective than the command and traditional economies as it gives the individual more economic freedom. (WillGema, 2014)

Disadvantages

As in this type of economy the main aim is profit the firms may try to misuse the resources like polluting the environment or by exploiting the workers. The firms will not produce the goods that are not in demand due to which the rural communities suffer with the services like transport and post . (survey, n.d.)Another disadvantage of this economy is the mis-allocation of resources which creates inequality in the incomes, market imperfections and can lead to the encouragement of consumption of harmful drugs. It does not have any economic security as well

as the conservation of resources is a big challenge. (ssag.sk, n.d.)

Examples

Most of the countries today have a combination of Market economy and Command economy. There are no countries that have purely market economy. According to a study in 2007 The economically free countries are USA, Australia, Hong Kong, and Singapore. In USA companies are allowed to set prices whereas workers negotiate wages but the parameters are established by the government.

Hong Kong ranks as 89.3% economically free country which has extremely low tax rates and minimal regulations for business. It is the highest in the world. Where as Singapore ranks 85.7% and Australia 82.7% free economy.

Mixed Economy is the economy in which government and individuals both play an important role in deciding what to buy and how much to produce. The role of government varies from country to country. In some its function is to enforce laws and regulations and in some trapping of the welfare state such as universal health care etc. It is neither pure capitalism nor pure socialism but mixture of the both. In this economy both private and public enterprises operate in the economy of the country. Generally the basic and heavy industries like engineering goods, producing defense equipments and atomic power are put in public sector whereas agriculture and other small scale industries are put in private sector. (agridr.in, n.d.)

Advantages

This type of economy helps in increasing national production controls the problems created by free enterprises. It also provides freedom of enterprise ownership, profit sharing and social welfare. All the resources are utilized effectively. Advances of economic planning and less economic inequalities are also the part of mixed economy which leads to economic development of the country.

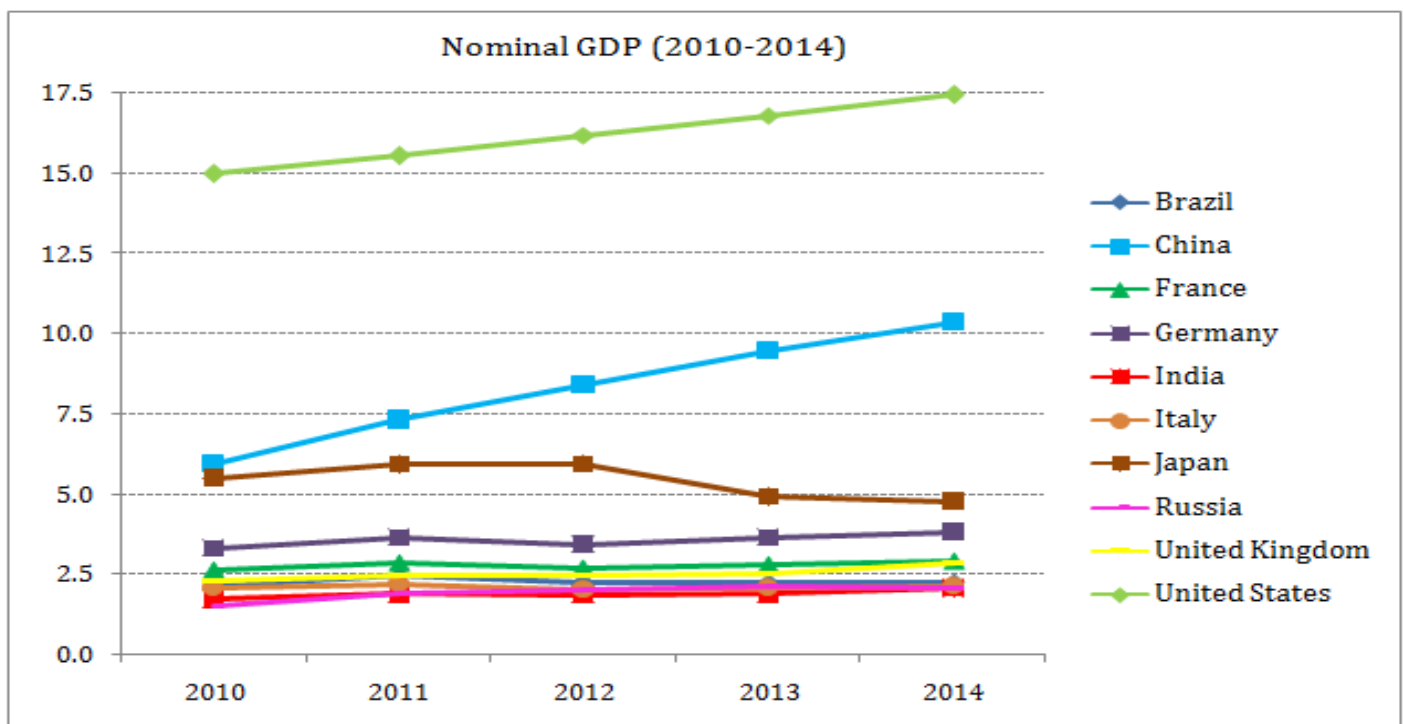
Disadvantages

Some economists states that mixed economy is very unstable. Lack of efficiency can be seen in this economy as the government employees do not perform their responsibilities and in private the efficiency goes down because government imposes so many restrictions. The decision making process is delayed specially in case of public sector. There is always corruption and black marketing in this system.

Examples

The best example of mixed economy is India and the other examples of Mixed economy as per the share of government spending as a %of GDP are highest in Iceland with 57% , Sweden 52%, France 52.8%, UK 47.3% , US 38.9% Russia 34.1%, China 20% of GDP and Hong Kong 18%. Bismarck's Germany is a good example of an early attempt to make a mixed economy.

Now as we have the idea of the economies and how they function. If we see today's economies of the different countries it is found that inequitable distribution of income can be seen presently at the global level. The top ten economies of the world contribute 65% of the world's economy and top 15 economies contribute 75% of the world's economy. If we consider the criteria of GDP current prices in US dollars and GDP based on PPP (purchasing power parity) there is a little difference in the list of the countries. USA is the largest economic power in terms of advanced technology, abundant resources and infrastructure. US contributes approximately 22.44% of gross world product but when we consider the GDP on PPP basis US loses economy by China which is \$17.63 trillion and US stands at \$17.41 trillion.

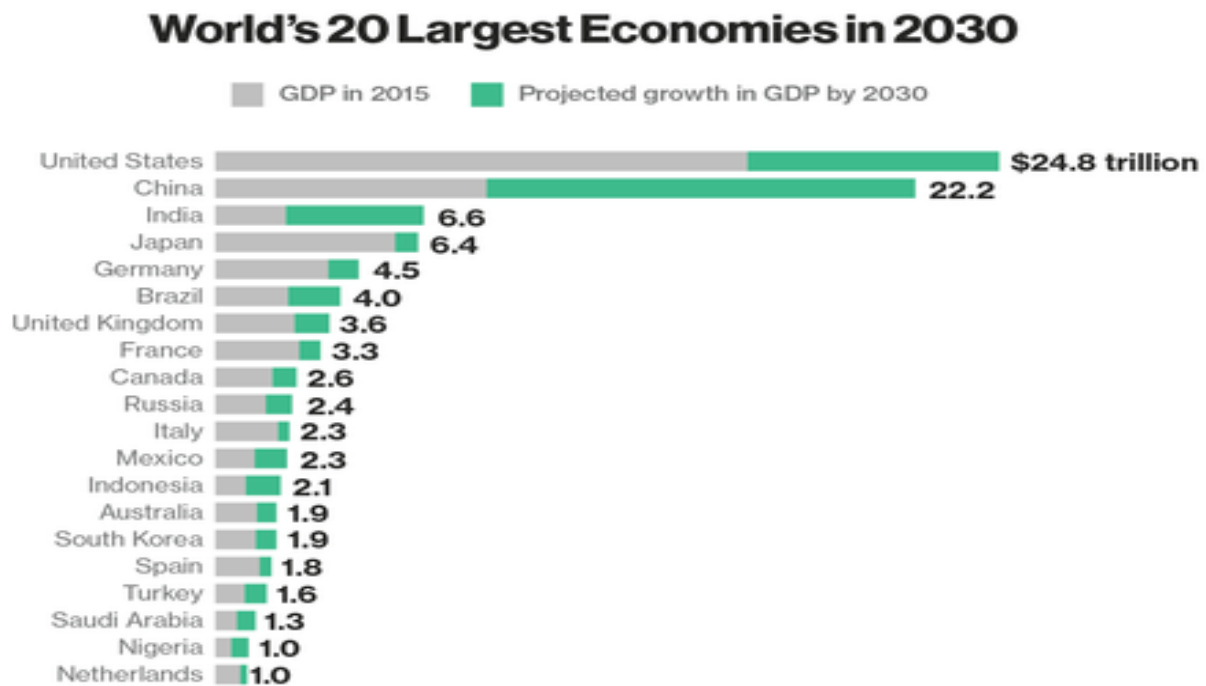


New Zealand is considered to be the number one country offering highest level of freedom world wide. Second comes the Neitherlands, Hong Kong , Australia, Canada and Ireland tied at fourth spot whereas US, and Denmark tied to place seventh. On the other hand Srilanka, Pakistan,

Syria and Zimbabwe is considered the lowest ranked countries.

As per World Economic form the report on The Global Competitiveness Report 2015-16 shows that the Top ten most competitive European economies that contribute to the most valuable places in the world ranking. It shows that European country Switzerland stands at first place in the Global rank- 1, Germany – 4th , Neitherlands – 5th , Finland -8th, Sweden- 9th, UK -10th , Norway 11th , Denmark -12th , Belgium 19th, Luxembourg 20th place . (Weforum.org, n.d.)

According to the U.S department of Agriculture the world from 15 years from now the U.S will be far less dominant and several emerging markets will come up leaving behind largest European economies. The latest macroeconomic projections that got out to year 2030 is displayed in the chart below.



Source: U.S. Department of Agriculture

The green bar represents the growth after 15 years from now. It is clear from the graph that China's GDP will grow more than twice it is today. India is at eighth rank will climb up by taking third position. Other developed economies like Japan will not be so lucky. As said by Bruce Kasman JPMorgan;s chief economist “ Japan is an important lesson in how quickly you can downshift your status of what a structure of economy delivers.” (Smialaek, n.d.)

So from the above discussions it is clear that the economic development is basically depends on

how well the resources are allocated and utilized effectively for best production through which the country's demand is met. The countries mentioned above with the best economies today have effectively managed the resources so that there is a rational growth of the country. If the resources are not effectively allocated the country can face the drastic changes.

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