Exercise walk-through

Resource allocation in different economic systems ▪ 1.4

eXercise

You must be able to

- describe market, planned and mixed economies
- explain the three functions of the price mechanism (signalling, incentive, rationing)
- analyse and evaluate the strengths and weaknesses of each system

Method — Systems and the price mechanism

- **Market economy 市场经济**: prices and private owners decide; **planned 计划经济**: the government decides; **mixed 混合经济**: both (almost every real country).
- **Price mechanism 价格机制** does three jobs: **signalling 信号** (shows where resources are wanted), **incentive 激励** (rewards producers to supply more), **rationing 配给** (shares out a scarce good).

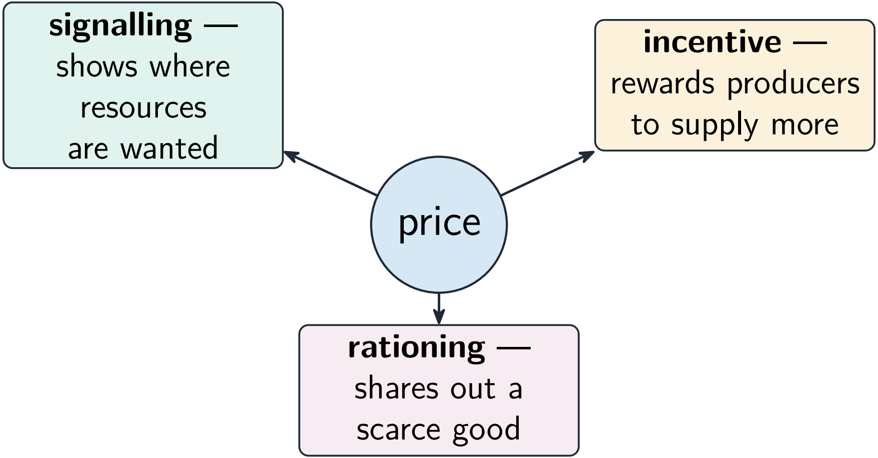
Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

Method — Systems and the price mechanism

Market	**Mixed**	**Planned**
firms own resources; prices decide; little government	private + public sectors both decide; almost every country	government owns and decides what, how and for whom

Economic systems form a spectrum from free market to full planning

Method — Systems and the price mechanism



Practice 2.1 ▪ 2 marks

Define the term *market economy*.

Solution 2.1

Method: Systems and the price mechanism

Worked steps

an economy in which resources are owned privately and prices, set by demand and supply, decide what is produced (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 3 marks

State the three functions of the price mechanism.

Solution 2.2

Method: Systems and the price mechanism

Worked steps

signalling; incentive; rationing $(1 + 1 + 1)$.

Practice 2.3 ▪ 2 marks

State one strength and one weakness of a planned economy.

Solution 2.3

Method: Systems and the price mechanism

Worked steps

strength: smaller gap between rich and poor / key goods provided for all; weakness: weak incentive / shortages and surpluses / slow to change $(1 + 1)$.

Exam-style 3.1 ▪ 1 mark

In a market economy, a rising price acts as an **incentive** because it:

A signals where resources are wanted

B rewards producers, so they supply more

C shares out a scarce good

D reduces consumer demand

Solution 3.1

Method: Systems and the price mechanism

A signals where resources are wanted

B rewards producers, so they supply more ✓

C shares out a scarce good

D reduces consumer demand

Worked steps

B. An incentive rewards producers so they supply more.

Exam-style 3.2 ▪ 6 marks

Explain how the price mechanism allocates resources in a market economy.

Solution 3.2

Method: Systems and the price mechanism

Worked steps

[6] AO1 1–2 + AO3 up to 4 — a rise in demand pushes the price up → the higher price *signals* that the good is wanted and gives producers an *incentive* to supply more → it also *rations* the scarce good to those willing to pay → resources move to where they are most valued.

Exam-style 3.3 ▪ 12 marks

Discuss whether a mixed economy allocates resources better than a pure market economy.

Solution 3.3

Method: Systems and the price mechanism

Worked steps

[12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **Mixed:** keeps market incentives and choice while the government provides public/merit goods and reduces inequality. **But:** the right balance is hard to find, and too much intervention can weaken incentives. **Pure market:** efficient and innovative, but ignores public goods, externalities and the poor. Judgement: a mixed economy usually allocates resources better because it corrects market failure, but its success depends on how well the government intervenes.