Edexcel IGCSE Economics

Your notes

The Mixed Economy

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- Characteristics of Mixed Economies
- Resource Allocation in Mixed Economies
- Inefficient Resource Allocation & Market Failure
- Public Goods: The Free Rider Problem
- The Importance of the Public & Private Sectors
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Introduction to Mixed Economies

- A **mixed economy** is a blend of the free market and a planned economy
- It is an economy in which there is both a **public and a private sector**
  - Individuals, firms and the government **own factors of production** and distribute goods/services. E.g UK, Germany, Ireland, Japan
  - Some **mixed economies** have a higher level of **government intervention** than others
- Government intervention occurs mainly through **taxation (**to raise revenue) and then **spending** that revenue to **redistribute income** and **provide essential goods/services**
  - There are many different type of **tax interventions,** including personal income tax, corporation tax, value added tax, tariffs on imports, inheritance tax etc.
  - Income is redistributed through the creation of a **welfare system,** which often includes unemployment benefits, healthcare, and pension provision
- Government spending is often focused on **infrastructure, merit goods** (e.g. schools) and **public goods** (e.g. national defence)

Public & Private Sectors

- **Public sector** organisations are **owned and controlled by the Government**
  - Their goal is to **provide a service** rather than maximise profit
- Public sector organisations are funded by central and local governments, but some may **charge a fee for selected services**
  - They provide **essential** services such as water, electricity supply or emergency services
    - They are **merit goods** that may not be provided in sufficient quantities by private businesses, such as education or health services
    - Some public sector organisations were **once owned by private individuals** and have been **nationalised** to ensure their survival
  - A range of government-owned organisations exist in the UK
    - **Corporations** like the *BBC* and *Channel 4*
    - **National services** such as *schools* and the NHS
    - **Local services** such as *Transport for Greater Manchester* and county-based Social Services
    - **Civil service** departments such as Defence, Police and Social Security
    - **Regulatory bodies** such as the *General Dental Council*

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- **Private sector** organisations are **owned and controlled by private individuals**
  - Owners can be sole traders, partners or **company** shareholders
  - The goal of most private sector organisations is **profit maximisation**
    - This may mean that the private sector is **more efficient** than the public sector, with higher levels of **productivity**
    - They may be more efficient as they seek to maximise profit


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Ownership & Control

- There are several types of business ownership in the private sector, the most common of which are **sole traders**, **partnerships and companies.**
- **Public sector firms may be partially owned by private shareholders** (less than 50%), with the balance being owned by the government

Ownership and Control of a Business

Type of Business	Ownership	Control
Sole Trader	▪ A firm that has a **single owner** ▪ E.g a small bakery business	▪ A **single owner** makes all the decisions and gets to keep all of the profits ▪ The owner is **legally responsible** for all debts of the business
Partnership	▪ **Two or more** people join together to form a business ▪ E.g lawyers and accountants	▪ Shared control between partners ▪ In an **agreed-upon partnership,** partners have voting rights
Private limited company (plc)	▪ The company is divided into a **specified number of shares** that are sold to owners, called shareholders ▪ Private limited companies are often **family-owned**	▪ Decision-making is usually carried out by an appointed **CEO or managing director**
Public limited company	▪ A large business that owned by shareholders who can buy and sell shares on the stock exchange	▪ The company will have a **board of directors** made up of independent directors and representatives from major shareholders

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		▪ Shareholders have voting rights that can impact decision making
Public sector firms	▪ Government ownership of firms, industries or other assets ▪ Also known as **state ownership** ▪ E.g. Defence or healthcare	▪ Controlled by the government, which appoints a Chair and Board and usually funded through **taxation**



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Aims of a Business

- The **aims** of a firm are a **reason for their existence** or the desired focus of their owners
  - These aims typically include profit maximisation, growth, survival and social welfare

1. Profit Maximisation

- Most firms have the **rational** objective of profit maximisation
- Profit = Total Revenue (TR) - Total Costs (TC)
- To maximise profits, firms can either **increase their sales revenue** or **decrease their costs**
  - Firms continuously analyse their costs to see if they can reduce them so that profit can be maximised

2. Growth

- Some firms have the business objective of **growth**
- In subtopic 3.5 we considered the different metrics that firms use to **compare their size** which include the number of employees, market share, size of profits & market capitalisation
- Firms with a growth objective often focus on increasing their **sales revenue** or **market share**
- Firms will also **maximise revenue** in order to increase output and benefit from **economies of scale**
- A growing firm is **less likely to fail**

3. Survival

- In the short term, many new firms focus solely on **business survival**
- Generally, as much as **25% of new firms fail** in their first year of business

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- Once a firm is established, it may then begin to focus on **profit maximisation** as its new objective



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4. Social welfare

- More firms than ever are launching with a **social welfare objective**
  - These typically include a focus on **climate action & addressing poverty or inequality**
- They still **require profit to survive**, but will accept less than if they were profit maximising as long as they are meeting their social objective

5. State provision

- Businesses in the **public sector** aim to provide goods and services that **may not be provided** or would be underprovided in a **free market**
  - E.g. Street lighting, elderly social care, education

6. Generate a surplus

- Some publicly-owned organisations, such as the BBC and Channel 4, aim to generate a surplus
  - This surplus can be reinvested into services or returned to the government



Examiner Tips and Tricks

The aims of a firm can change over time. Successful firms that have been profit maximising for decades may find themselves in a a difficult market environment (e.g. during Covid 19 lock downs) and switch their objective to survival. Likewise, firms previously focussed on profit maximisation may desire to be more prominent in the battle against climate change and so change to a social welfare objective.

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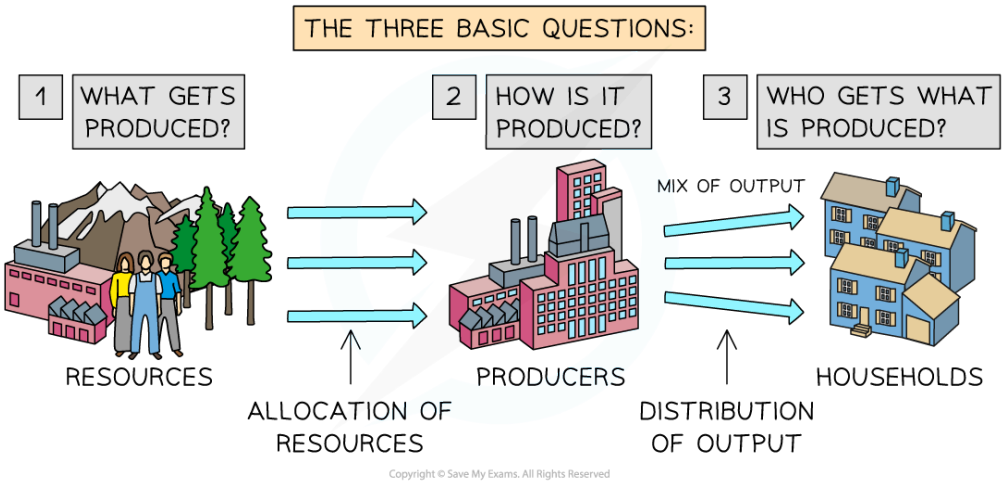
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What is an Economic System?

- In order to solve the basic economic problem of **scarcity,** economic systems emerge or are created by different **economic agents** within the economy
  - Economic agents include **consumers, producers, the government, and special interest groups** (e.g. environmental pressure groups or trade unions)
  - Any economic system aims to allocate the **scarce factors of production**
- The three main economic systems are a **free market system**, a **mixed economy**, and a **planned economy**
  - In a mixed economic system, the level of government intervention varies
- Ultimately, the economic system is determined by how an economy answers the three fundamental economic questions
  - **What to produce?**
  - **How to produce it?**
  - **And who to produce it for?**

The Three Fundamental Economic Questions

Diagram: Three Fundamental Economic Questions



How these three questions are answered determines the economic system of a country

Explaining the Three Questions

What to produce?

- As resources are limited in supply, decisions carry an opportunity cost. Which goods/services should be produced, e.g. better rail services or more public hospitals?

How to produce it?

- Would it be better for the economy to have labour-intensive production so that more people are employed, or should goods/services be produced using capital-intensive production (machinery)?

Who to produce it for?

- Should goods/services only be made available to those who can afford them, or should they be freely available to all?



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The Three Economic Questions in Different Economic Systems

Type of System	What to Produce?	How to Produce?	For Whom?
Market System	▪ Demand and supply **(the price mechanism)**. ▪ Produced by the the **private sector**	▪ Aim is profit maximisation ▪ Most efficient and profitable way possible ▪ Fewer resources wasted to keep costs low	▪ Those who can afford it
Mixed System	▪ Demand, supply ▪ Produced by the **public and private sector**	▪ Some efficiency but also a focus on welfare and wellbeing	▪ Those who can afford it, with some provision for those who cannot afford it
Planned System	▪ The **public sector** produces goods / services	▪ Ensure everyone has a job	▪ Everyone ▪ Best interest of the public

If the economy is mostly based on a free **market system** it has more **private ownership**

- The main aim is to profit maximise and tend to minimise resource waste by allocating resources according to supply and demand forces
- If the economy is mostly based on **planned system,** it has more **public ownership**
    - It prioritises the public's best interests, is more effective in providing goods and services such as education and healthcare, which may not be adequately supplied

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by private firms



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Examiner Tips and Tricks

You may be asked to **assess** how effective public or private sector ownership is in solving the economic problem of scarcity. Make sure to think critically and consider how well the public or private sector provide goods / services in terms of what they produce, how they produce them, and for whom they produce them.

If the economy is mostly based on a free **market system,** it has more **private ownership.** They may provide goods and services more efficiently, as their main aim is to profit maximise. To achieve this, they minimise costs and resource waste by allocating resources according to the forces of demand and supply (the price mechanism)

However, if the economy is mostly based on **planned system,** it has more **public ownership** and prioritises the public's best interests. It is more effective in providing goods and services such as education and healthcare, which may not be adequately supplied by private firms

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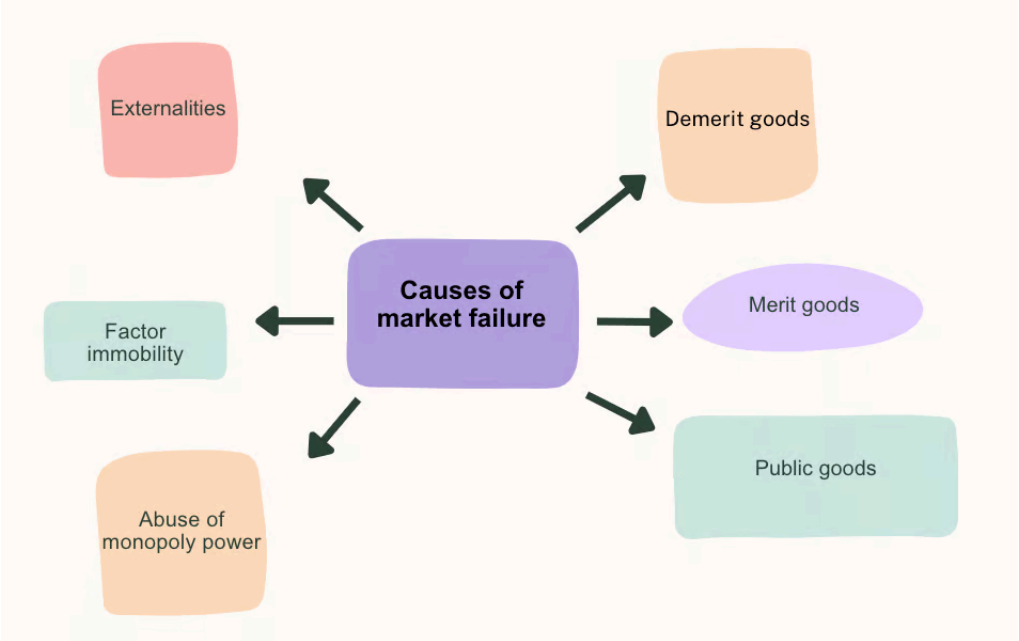
Understanding Market Failure

- In a **free market,** the price mechanism determines the most efficient allocation of scarce resources
  - **Scarce resources** are the **factors of production** (land, labour, capital, and enterprise)
- Free markets often work very well, matching the **competing wants and needs** in the marketplace
- However, the free market sometimes leads to **market failure**
  - This occurs when there is a **less than optimal allocation of resources** from society's point of view
    - If resources were allocated in a different way, more output could be produced
    - When the free market causes a **lack of equity** (inequality) or **environmental degradation**

Market Failure & Government Intervention

- Market failure occurs when free market activity results in a **less than optimum allocation of resources** from the point of view of society

Diagram: Causes of Market Failure



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Market failure includes demerit, merit & public goods, abuse of monopoly power, factor immobility & externalities

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Explanation of causes of Market Failure and Government Intervention

Cause	Explanation	Government Intervention
Demerit goods	▪ These are goods which have **harmful impacts** on consumers or society as a whole ▪ They are often addictive ▪ E.g. Gambling, alcohol, drugs, sugary foods and drinks	▪ They are **over-provided** in a market and their consumption often creates **external costs** ▪ Governments often have to **regulate** these goods in such a way that they raise the prices or limit the quantities consumed
Merit goods	▪ These are goods that are **beneficial to society** but consumers **under-consume** them as they do not fully recognise the **private or external benefits** ▪ E.g. Vaccinations, education, electric cars	▪ They are **under-provided** in a market, and their consumption generates both **private and/or external benefits** ▪ Governments often have to **subsidise** these goods in order to lower the price or increase the **quantities consumed**
Public goods	▪ Public goods are beneficial to society but would be **under-provided by a free market** ▪ There is little opportunity for sellers to make profits from providing them, as they are **non-excludable** and **non-rivalrous** in consumption ▪ Good examples include national defence, parks, libraries and lighthouses	▪ **Non-excludability** refers to the inability of private firms to exclude certain customers from using their products. In effect, the price mechanism cannot be used to exclude customers, e.g. street lighting ▪ **Non-rivalry** refers to the inability of the product to be used up, so there is no competitive rivalry in consumption to drive up prices and generate profits for firms ▪ Therefore, **governments** will often provide these beneficial goods themselves, and so they are called **public goods**
Abuse of monopoly power	▪ The development of **monopoly** markets is a natural outcome of a **market system**	▪ The outcome is that goods and services are purposely **under-provided** in order to raise prices and profits

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	▪ Firms seek to **eliminate competition** by buying out competitors and increasing their ownership of **factors of production** ▪ With less competition, firms can raise prices, reduce the choice available to consumers, or **limit the supply**	▪ Governments often intervene to ensure that there is **healthy competition** in markets and sufficient provision of goods and services
Factor immobility	▪ **Factor immobility** occurs when it is difficult for **factors of production** to move or switch between different uses or locations ▪ The two main types of factor immobility are the **geographical** and **occupational** immobility of labour	▪ Factor immobility results an **inefficient allocation of resources** in a market (usually under-provision) ▪ Governments often implement programs to **reduce the factor immobility** in order to raise production and output ▪ E.g. Support relocation of workers when one industry closes down in a particular area
Externalities	▪ Externalities occur when there is an **external cost or benefit on a third party** not involved in the economic transaction ▪ These impacts can be **positive or negative** ▪ The price mechanism in a free market ignores these externalities ▪ If these external costs/benefits were acknowledged, the **price and output in the market** would be different	▪ Generally, governments will seek to subsidise products which have positive externalities (or provide the product themselves) ▪ Generally, governments will seek to tax products which have negative externalities (or limit their output through regulation)



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Characteristics of Public Goods

- **Private goods** are goods that firms are able to provide to **generate profits**
  - They can generate profits as these goods are **excludable** and **rivalrous**
    - The firm is able to **exclude** certain customers from purchasing their goods **through the use of the price mechanism,** as some customers cannot afford to buy them
    - Customers also **compete** for these goods, which are limited in supply and this **rivalry** helps to generate profits for firms
- **Public goods** are goods that are beneficial to society (e.g. roads, parks, lighthouses, national defence) but which private firms do not provide as they are unlikely to be capable of generating a profit
  - This is due to the principles of **non-excludability** and **non-rivalry**
    - **Non-excludability** refers to the inability of private firms to exclude certain customers from using their products. In effect, the price mechanism cannot be used to exclude customers, e.g. street lighting
    - **Non-rivalry** refers to the inability of the product to be used up, so there is no competitive rivalry in consumption to drive up prices and generate profits for firms
    - Therefore, governments will often provide these beneficial goods themselves, and so they are called **public goods**
- If firms decide to provide these goods anyway, it would give rise to what is called the **'free rider' problem**
  - This is a situation where customers realise that they can **access the goods**, even **without paying** for them
  - If they are paying, they can stop and **continue to enjoy the benefits**, **'free-riding'** on the backs of paying customers
  - Over time, any customers who are paying for the goods stop doing so
  - At some point, **firms cease to provide these goods** and they become **under-provided** in society

Examiner Tips and Tricks

Paper 1 will explore your understanding of the **free rider problem.** Often you will be asked to analyse why some goods need to be provided by the government (e.g. street lighting). Remember to explain the concepts of **non-rivalry and non-**

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excludability when governments provide **public goods**. Make sure to link this to the concept of free rider problem



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The Relative Importance of each Sector

- Most economies have a mixture of **public and private sector** provision of goods and services
- The United States and Japan are have a **smaller public sector** than Norway, Germany or China
  - The **USA** leans towards a free market economy
    - E.g Private firms often provide education and healthcare
- Countries with a **large public sector** include **Cuba and China**
  - The government exerts a **high degree of control** of key sectors such as banking, airlines, communications, energy production and manufacturing

Benefits of a Large Public Sector

Benefit	Explanation
Provision of goods and services	▪ A large public sector makes it easier to provide public goods efficiently ▪ This ensures that essential goods and services are accessible to all citizens, contributing to overall **standard of living** ▪ E.g China invests heavily in public infrastructure projects and healthcare and education for its citizens
Employment	▪ Many **jobs are guaranteed** by the state, providing employment ▪ In China, state-owned enterprises are major employers, offering job security
Reduce negative externalities	▪ State control over key sectors allows governments to regulate and reduce negative externalities ▪ E.g Cuban government control over the economy enables it to regulate **environmental pollution** and ensure **sustainable development practices**

Comparison of Public Sector Sizes

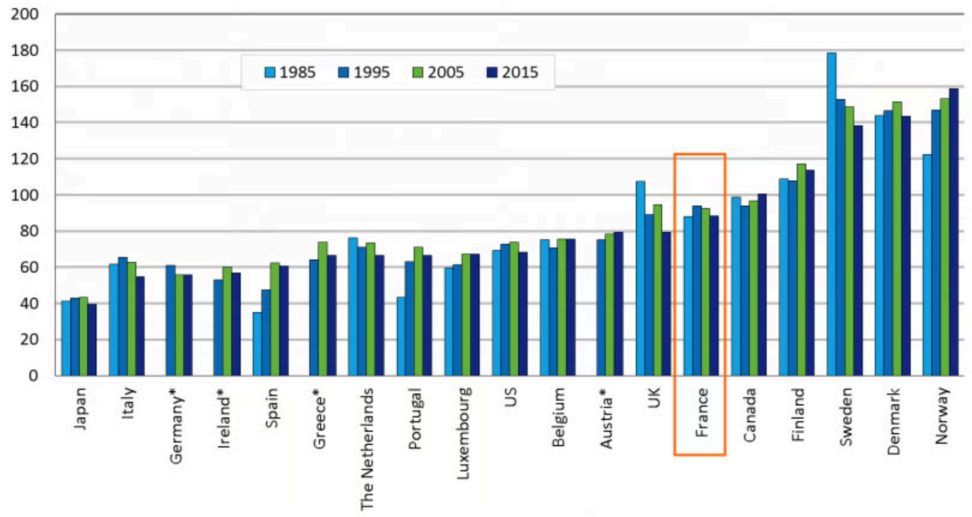
- The size of the public sector can be measured by considering
  - GDP **per capita** spending on the public sector

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- The **number of employees** per 1,000 of the population

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Graph: Public Sector Employees by Country



Source: France stratégie

Graph analysis

- **Nordic countries**, such as Norway, Denmark, Sweden and Finland have larger numbers of employees in the public sector
  - This indicates that their government allocate a considerable amount of government revenue towards the provision of merit and public goods
  - These countries frequently rank at the **top of quality of life indexes**, as result of their excellent **education and healthcare systems**
- In contrast, the **UK and USA** have a smaller number of employees in the public sector
  - This indicates that USA and UK government allocate **less revenue** towards the provision of **merit and public goods**
  - USA and UK rank **lower in quality of life indexes**, reflective of less spending on education and healthcare
- Countries like Norway **prioritise the public sector** and **provision of goods and services**
  - Particularly in the provision of healthcare, educations and social welfare
- Data would suggest that many countries with a **larger public sector** enjoy a better quality of life and its citizens are happier
  - Usually, the larger the public sector, the higher the level of taxes
  - This is one reason why capitalists and **free market economists** argue against having a larger public sector

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Examiner Tips and Tricks

The material on this page is frequently examined in the Paper 1 structured questions. You will be asked to **analyse** a large public or private sector of a country in a given scenario. Consider how large public/private sector impacts the provision of public goods, employment and negative externalities

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Privatisation of State-owned Enterprises

- **Privatisation** is the **transfer of assets** from the **public sector (state)** to the **private sector**
  - An asset becomes the property of a firm
  - Its pricing and availability are determined by the **free market**
  - E.g, **British Airways**, formerly owned and controlled by the UK government, was privatised in 1987and has operated in the competitive market since this time
- The **ethics** of privatisation, particularly in **essential services** like water utilities, are a subject of debate
  - On one hand, private firms are often more efficient and can use profits to **invest large sums** in water distribution infrastructure, improving **service quality**
  - However, under private ownership there may be rising water bills due to the profit motive
    - This has a disproportionately high impact on **low-income households**
- There is also a need to regulate private water firms to ensure equitable access to water services
  - Without regulation, water companies may neglect non-profitable parts of the network

Effects of Privatisation on Stakeholders

Stakeholder	Advantages	Disadvantages
Consumers	▪ Competition may result in greater choice and **lower prices** ▪ The privatisation of **British Rail** in the UK, increased competition and led to improved service quality, and different companies offering various ticket prices	▪ The price of the good/service usually increases as **firms seek to maximise their profit** ▪ Private firms often provide **substandard goods or services** as they cut quality to increase profits
Workers	▪ Potential for higher wages and improved working conditions ▪ The privatisation of **British Telecom** (BT) improved working conditions as	▪ Job losses occur as private firms reduce costs to increase profits ▪ Following privatisation, BT made many workers

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	they sought to compete in the telecommunications market	redundant
Businesses	▪ Privatisation **encourages new entrants** to the industry as they have a greater chance of **competing** with private firms, which may have fewer resources available ▪ Smaller gas suppliers entered the British gas market after privatisation, leading to more **profit maximising, efficient** firms	▪ Privatised, profit-maximising monopolies can **restrict output** to **generate supernormal profits**
Government	▪ **Raises revenue** for the government ▪ The sale of state-owned assets can raise short-term revenue for the government ▪ Reduces the overall level of **public spending** and the size of the state	▪ Government assets are often sold well **below their actual market value** ▪ Many privatised companies still maintain **considerable market power** and need to be **regulated**

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Nationalisation

- Nationalisation is is the **transfer of assets** from the private sector into public ownership, most often used for **public goods and merit goods**
- Some public sector organisations were once owned by private individuals and have been **nationalised** to ensure their survival
  - E.g In 2008, the UK government nationalised Northern Rock, a bank which was on the verge of collapse as a result of the global financial crisis
  - Protection of the banking system was considered **necessary** to prevent significant economic difficulties

Worked Example

Which one of the following is defined as 'to bring business, industry, or land under the control or ownership of the government' (1)

A: Mixed economy

B: Nationalised

C: Public sector

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D: Private sector

Answer: B Nationalised

It refers to the transfer of assets from private sector ownership into public ownership



Examiner Tips and Tricks

Evaluation of privatisation is a common question. Make sure to think critically and consider the advantages and disadvantages for different stakeholders (consumers, producers and consumers). You will be asked to apply this understanding to a given scenario



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