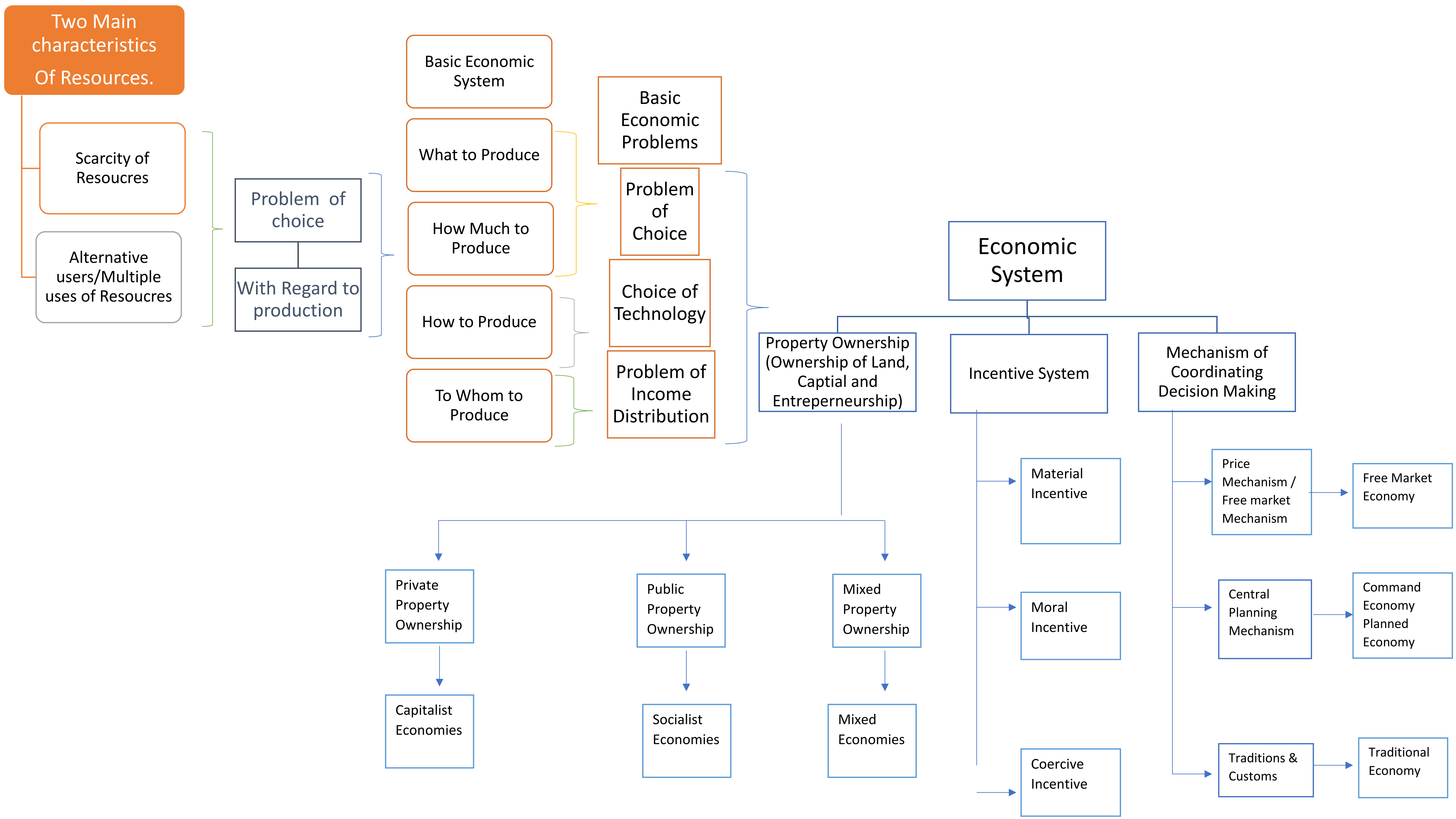
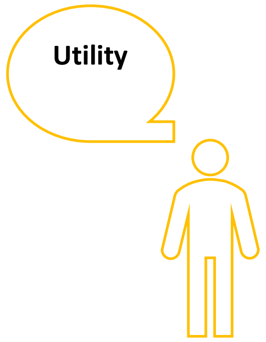
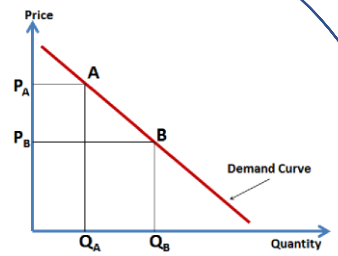
Mind Map 1 – Economic System



Mind Map 2 – Free Market Economy





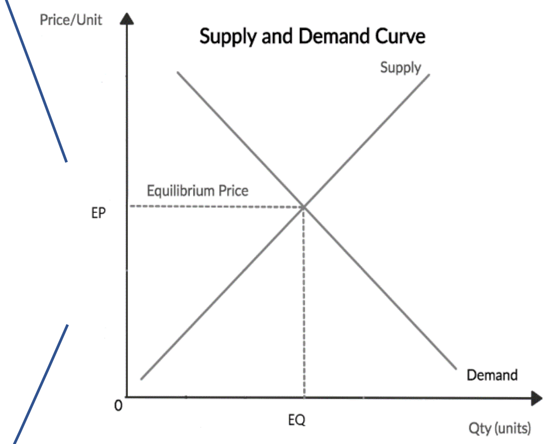
Functions of Price

Signal Function → What product gives more utility.

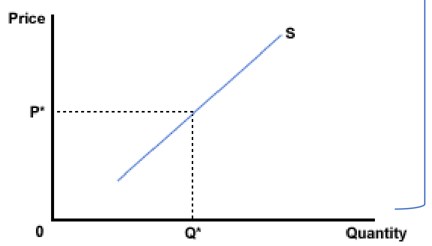
Incentive function → Create attraction towards same products as apposes to other products.

Ration Function → Based on the signals and incentive resources are Allocated and reallocated.

Demand Force (Customers)



Supply Force (Producers)



Functions of Price

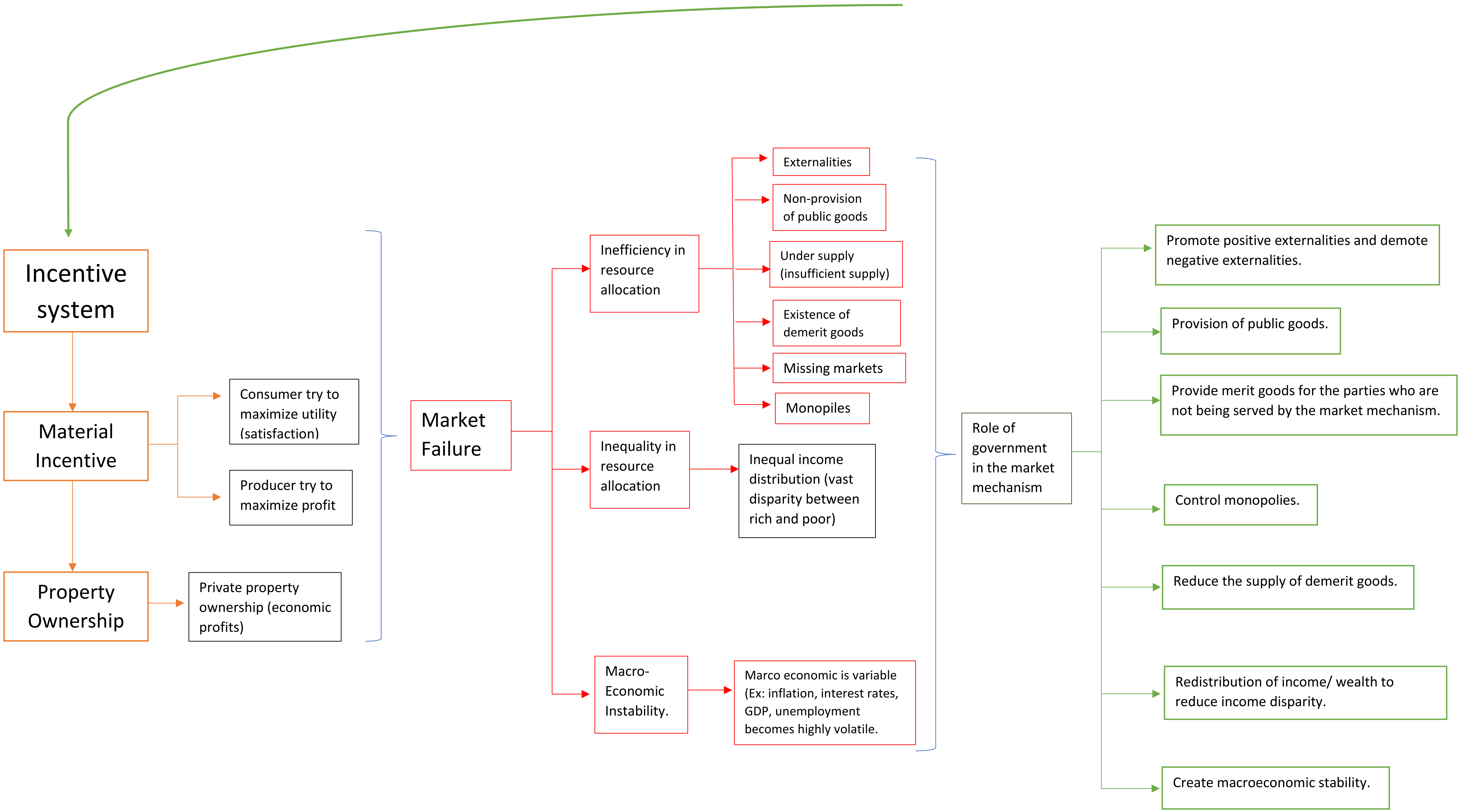
Signal Function → Which products are more Profitable.

Incentive function → Create attraction towards some Products as appose to other products.

Ration Function → Based on signals and incentive.

Basic Economic Problems

- Problem of Choice
  - Highly profitable products are produced in large quantities
  - Less profitable products are in less quantities
  - Non-profitable products will not be produced
- Choice of Technology
  - Based on cost advantage it decides whether production users labor intensive method or capital-intensive method.
- Choice of Income Distribution
  - Consumers who afford the market price will be given the ability to purchase and other will be illuminated from the production process.


Incentive system
Material Incentive
Consumer try to maximize utility (satisfaction)
Producer try to maximize profit
Property Ownership
Private property ownership (economic profits)
Market Failure
Inefficiency in resource allocation
Externalities
Non-provision of public goods
Under supply (insufficient supply)
Existence of demerit goods
Missing markets
Monopiles
Inequality in resource allocation
Inequal income distribution (vast disparity between rich and poor)
Macro-Economic Instability.
Marco economic is variable (Ex: inflation, interest rates, GDP, unemployment becomes highly volatile.
Role of government in the market mechanism
Promote positive externalities and demote negative externalities.
Provision of public goods.
Provide merit goods for the parties who are not being served by the market mechanism.
Control monopolies.
Reduce the supply of demerit goods.
Redistribution of income/ wealth to reduce income disparity.
Create macroeconomic stability.

Mind Map 3 – Command Economy (Planned Economy)

Basic Economic Problems

- Problem of resource allocation.
  - What to produce
  - How much to produce
- Choice of technology
  - How to produce
- Problem of Income Distribution.
  - To whom to produce

National plans to identify natural priorities.

Government

Appointed by the government.

Objective is to maximize social welfare and improve living standard of all the persons in the society

Central planning Committee

Detailed production plans

- Problem of resource allocation.
  - Based on national priories set by the government.
- Choice of technology
  - With the intention of utilizing existing resources fully (full employment of resources) some industries are operated with labor intensively whereas other industries will be operated capital intensively.
- Problem of Income Distribution.
  - All property ownership (ownership of land, capital and entrepreneurship) is with the government.
  - Therefore, general public can only earn income by providing their labor power to government production.
  - Central planning committee decides the wages level and the price of goods and services in such a manner that production of the economy is fairly distributed among everyone of the economy and ensure relative equal income distribution (relatively equal standard of living)

Key features of command Economic system

- Public Property ownership
- There is a relatively low disparity in income distribution (relatively equal income distribution)
- Government is highly involved in to economic activities
- Limited personal economic freedom and limited freedom of choice.
- Common interest of the society is given priority over individual material reward (individual profits)
- Basic economic problems are solved through central planning mechanism and command system.

Merits of command Economy

- Allocating sufficient amount of resources to provide public goods and merit goods.
- Create relatively low inequality of income and output distribution.
- Externalities (both positive and negative are considered in planned production.)
- Illuminates inefficiencies and drawbacks due to excessive competition.
- Production is carried out by considering best interest of the society of the society rather than individual material rewards.
- Economic activities are planned with a long-term vision.

Drawbacks

- Production shortage and surplus due to low reaction to market changes.
- Inefficiency due to bureaucracy.
- Inefficiency due to draw backs of common interest incentive system and public property ownership.
- No freedom of choice for consumer and no consumer sovereignty.
- Due to low competition and central planning mechanism, production quality get deteriorates and less innovations.

Mind Map – Short Run

Production function

$$Q = \int (\check{K}, L)$$

Definition

Short run is the time period where at least one factor of production is fixed.

Variable factors
Factors of production those will vary with the level of production.

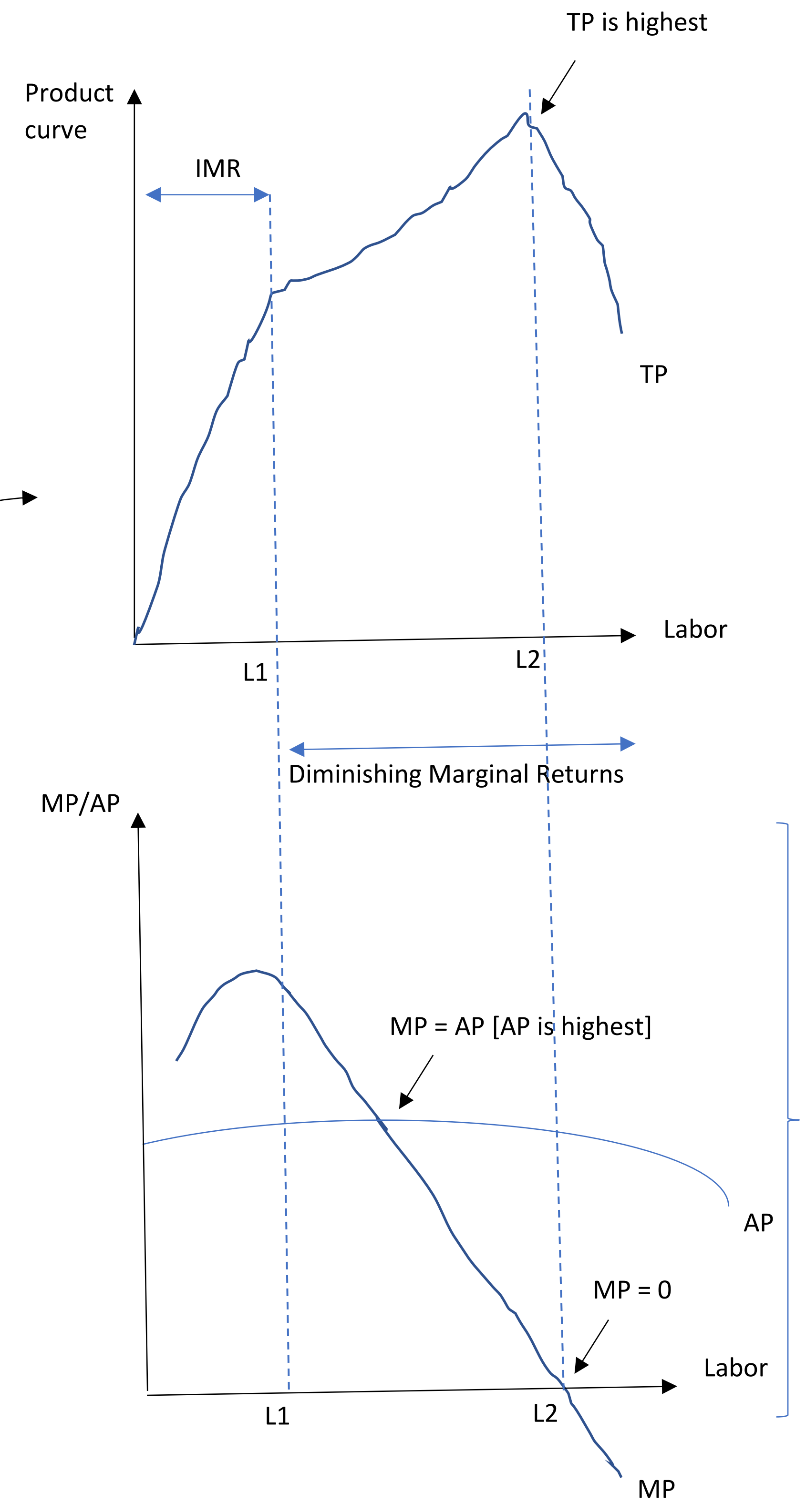
Fixed factors
Factors of production those will not vary with the level of production.

Objective of production in the short run is to produce the optimum quantity (best suited quantity) by changing variable factors while holding fixed factors constant.

Law of Marginals Returns

Increasing Marginal Returns
When additional variable factors are introduced to production by holding fixed factors constant, additional output added to the production get increased at an increasing rate up to a particular level of production.

Diminishing Marginal Returns
When additional variable factors are introduced to production by holding fixed factors constant, additional output added to the total production get decreased after a particular level of production.



$$MP = \frac{\Delta TP}{\Delta L}$$

Additional output produced by an additional worker (one extra worker)

$$AP = \frac{TP}{L}$$

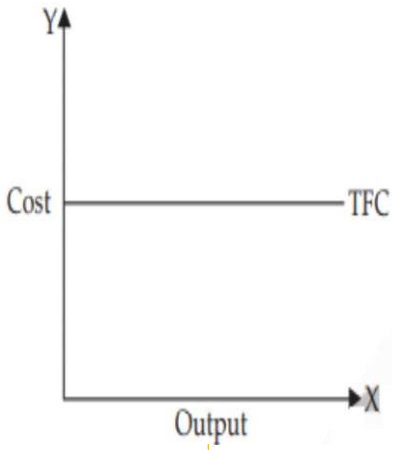
Per worker production (on average)

$Q = \int(\check{K}, L)$

Fixed Factors → Fixed Cost (TFC) + Variable Factors → Variable Cost (TVC) = Total Cost (TC)

Fixed Cost (TFC)

Cost that will not vary with the level of production



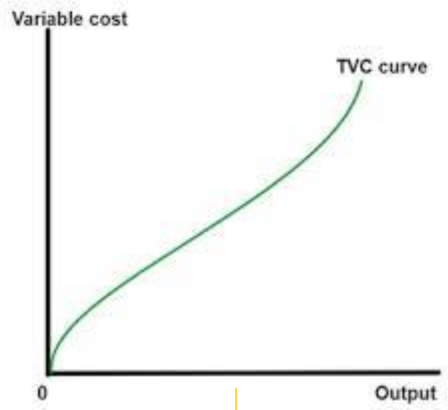
Average Fixed Cost

$$AFC = \frac{TFC}{Q}$$

[Per unit fixed Cost]

Variable Cost (TVC)

Cost that will vary with the level of production

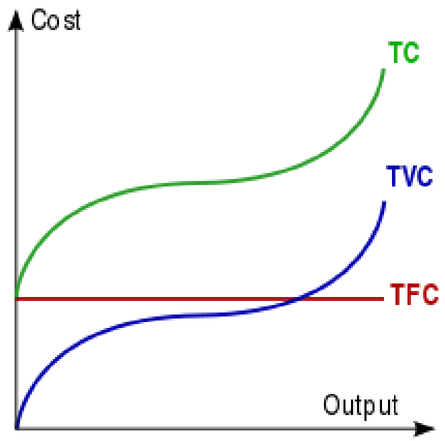


Average Variable Cost

$$AVC = \frac{TVC}{Q}$$

[Per unit Variable Cost]

Total Cost (TC)



Average Total Cost

$$ATC = \frac{TC}{Q}$$

$$ATC = AFC + AVC$$

[Per unit total Cost]