

# Edexcel Economics AS-level

## **Unit 1: Markets in Action**

### Topic 1: Nature of Economics

#### **1.4 Free market and mixed economies**

Notes



 **Free market economies:**

- Also known as *laissez-faire economies*, where governments leave markets to their own devices, so the market forces of supply and demand allocate scarce resources.
- Economic decisions are taken by private individuals and firms, and private individuals own everything. There is no government intervention.
- In reality, governments usually intervene by implementing laws and public services, such as property rights and national defence.
- Adam Smith and Friedrich Hayek were famous free market economists. Adam Smith's famous theory of the invisible hand of the market can be applied to free market economies and the price mechanism, which describes how prices are determined by the 'spending votes' of consumers and businesses. Smith recognised some of the issues with monopoly power that could arise from a free market, however. Hayek argued that government intervention makes the market worse. For example, shortly after the 1930s crash, he argued that the Fed caused the crash by keeping interest rates low, and encouraging investments which were not economically worthwhile: 'malinvestments'.
  
- **What to produce:** determined by what the consumer prefers
- **How to produce it:** producers seek profits
- **For whom to produce it:** whoever has the greatest purchasing power in the economy, and is therefore able to buy the good
  
- **Advantages:**
- Firms are likely to be efficient because they have to provide goods and services demanded by consumers. They are also likely to lower their average costs and make better use of scarce resources. Therefore, overall output of the economy increases.
- The bureaucracy from government intervention is avoided.
- Some economists might argue the freedom gained from having a free economy leads to more personal freedom.
  
- **Disadvantages:**
- The free market ignores inequality, and tends to benefit those who hold most of the wealth. There are no social security payments for those on low incomes.



- There could be monopolies, which could exploit the market by charging higher prices.
- There could be the overconsumption of demerit goods, which have large negative externalities, such as tobacco.
- Public goods are not provided in a free market, such as national defence. Merit goods, such as education, are underprovided.

 **Mixed economy:**

- This has features of both command and free economies and is the most common economic system today. There are different balances between command and free economies in reality, though. The UK is generally considered quite central, whilst the US is slightly more free (although the government spends around 35% of GDP) and Cuba is more centrally planned.
- The market is controlled by both the government and the forces of supply and demand.
- Governments often provide public goods such as street lights, roads and the police, and merit goods, such as healthcare and education.
  
- **What to produce:** determined by both consumer and government preferences
- **How to produce it:** determined by producers making profits and the government
- **For whom to produce it:** both who the government prefers and the purchasing power of private individuals.

