

Exercise walk-through

# 1.2

## Resource Allocation and Economic Systems

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AP Microeconomics

# Three economic systems

## Market

buyers & sellers decide through **prices**

## Command

central **government** owns & plans

## Mixed

markets + government;  
almost every country

# Market, command, mixed – in words

## Fictional ways to allocate school meals

|                   |                                                                                         |
|-------------------|-----------------------------------------------------------------------------------------|
| Market mechanism  | Private canteens choose menus for profit; families choose what to buy at stated prices. |
| Command mechanism | A public agency sets menus, output quotas and who receives meals.                       |
| Mixed arrangement | Private canteens sell meals; public funding provides meals for eligible students.       |

Compare who decides what is produced, how resources are used, and who receives output. One school's arrangement does not identify an entire country's economic system.

# Prices coordinate a market

## A fictional bakery: a signal and a response

A sustained rise in demand raises the price customers offer for bread. Holding costs and other conditions constant, selling extra bread becomes more profitable. The bakery may use idle oven time to increase output.

higher demand  $\longrightarrow$  higher price  $\longrightarrow$  incentive to expand output

Prices carry information and **incentives**. This is not a guarantee of the best social outcome: market power or pollution can weaken the result.

# How the three systems answer the three questions

**an economic system**

a society's way of answering **what, how, and for whom** to produce

**market**

decentralised: prices and profit decide, with no planner

**command**

central planning guides production and allocation

**mixed**

markets for most goods, the state for public goods and redistribution

**why markets work**

prices carry **information** and **incentives** automatically – no one needs to know the whole system

**where they fail**

public goods, externalities, market power, and inequality of outcome

Prices coordinate decentralized choices; market failures can prevent an efficient outcome.

## Exercises 2.1-2.3

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**2.1** Name the three types of economic system. [2]

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**2.2** State how a market economy allocates resources. [1]

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**2.3** State one trade-off that an economic system must make. [1]

## Exercises 2.1-2.3

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**2.1** Name the three types of economic system. [2]

**2.1**

- command, market, mixed
- 

**2.2** State how a market economy allocates resources. [1]

**2.2**

- through the price mechanism (supply and demand)
- 

**2.3** State one trade-off that an economic system must make. [1]

**2.3**

- any one of: efficiency vs equity, or freedom vs government control

## Exercises 3.1-3.2

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**3.1** In a command economy, resources are allocated by

[1]

☐

- A market prices
- B the government
- C individual firms
- D consumers alone

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**3.2** The price mechanism in a market economy

[1]

☐

- A is set entirely by the state
- B signals and rations goods
- C ignores demand
- D fixes all wages

## Exercises 3.1-3.2

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**3.1** In a command economy, resources are allocated by

[1]

- ☐ A market prices  
B the government  
C individual firms  
D consumers alone

**3.1 B**

- the government.

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**3.2** The price mechanism in a market economy

[1]

- ☐ A is set entirely by the state  
B signals and rations goods  
C ignores demand  
D fixes all wages

**3.2 B**

- signals and rations goods.

## Exercise 3.3 (a)

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**3.3** A country uses both markets and some government planning.

(a) Name this type of economy.

[1]

## Exercise 3.3 (a)

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**3.3** A country uses both markets and some government planning.

(a) Name this type of economy.

[1]

(a)

- a mixed economy

## Exercise 3.3 (b)

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**3.3** A country uses both markets and some government planning.

(b) State one advantage of using markets.

[1]

## Exercise 3.3 (b)

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**3.3** A country uses both markets and some government planning.

(b) State one advantage of using markets.

[1]

(b)

- prices give efficient signals and incentives

## Exercise 3.3 (c)

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**3.3** A country uses both markets and some government planning.

(c) State one reason for government involvement.

[1]

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(c) State one reason for government involvement.

[1]

(c)

- to provide public goods, correct market failures, or improve equity (any one)