

CHAPTER 2 THE MARKET SYSTEM AND THE CIRCULAR FLOW

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Learning Objectives

- ❖ Identify how changes in prices influence decision-making and resource allocation in the market system.
- ❖ Analyze the benefits of competition and consumer choice in promoting efficiency and innovation.
- ❖ Evaluate the concept of diversification and its role in minimizing risk in personal finances and investments.
- ❖ Describe the purpose and functions of insurance in protecting against unforeseen events and managing risk.
- ❖ Discuss the role of government regulation and safety nets in ensuring market stability and protecting the interests of consumers and businesses.

01

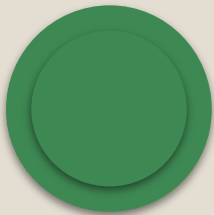
Economic
System

Economic System



Definition

Economic system based on private ownership of the means of production. Market-driven allocation of resources. Emphasis on individual initiative, entrepreneurship, and profit motive.



- **Examples:**
 - **United States**
 - **United Kingdom**
 - **Singapore**
 - **Hong Kong**
-

02

Characteristics of the Market System

**Private
Property:**

01

Individuals and businesses have the right to own, use, and dispose of property and resources as they see fit.

Individuals are free to enter into any legal business activity and compete with others in the market.

02

**Freedom of
Enterprise:**

Competition:

03

Multiple buyers and sellers operate in the market, leading to competitive pricing and efficiency in resource allocation.

Prices of goods and services are determined by supply and demand interactions in the market..

04

**Market
Prices:**

Self-Interest:

05

Participants in the market act in their own self-interest, seeking to maximize their utility or profit.

Businesses aim to maximize profits, which drives innovation, efficiency, and investment.

06

Profit Motive:

Limited Government Intervention:

07

The role of government is primarily to enforce property rights, contracts, and ensure competition, with minimal interference in market transactions.

Transactions in the market system are based on voluntary agreements between buyers and sellers, without coercion.

08

Voluntary Exchange:

03

Five

Fundamental

Questions

Five Fundamental Questions



What to Produce?

- This question pertains to the selection of goods and services to be produced in the economy.
- It involves decisions about the types and quantities of goods and services that will be most beneficial to society.



When to Produce?

- This question revolves around the methods and techniques used in the production process.
- It considers factors such as the combination of resources (land, labor, capital) and the technology employed to produce goods and services.



For Whom to Produce?

- This question addresses the distribution of goods and services among different individuals and groups in society.
- It involves decisions about income distribution and how the benefits of production are allocated among consumers.

Five Fundamental Questions



How Much to Produce?

- This question concerns the determination of the optimal level of production for each good and service.
- It involves balancing supply and demand to ensure that resources are allocated efficiently and that production meets the needs and wants of consumers.



How to Produce?

- This question relates to the timing of production and consumption decisions.
- It involves considerations such as seasonal variations in demand, production lead times, and inventory management to ensure that goods and services are available when needed.

04

The Circular
Flow Model

Businesses

- Produce and sell products to households
- Hire inputs or resources from households



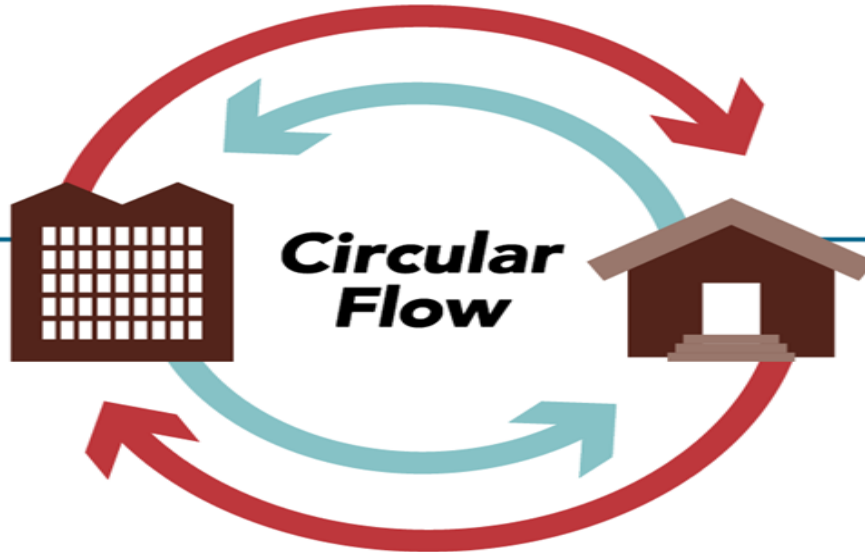
Circular Flow

Outputs:
Goods and services
(products)

Inputs:
Labour
Capital
Land
Entrepreneurship

Households

- Buy products from firms
- Provide inputs to firms



05

How the
Market System
Deals with Risk

How the Market System Deals with Risk



1. Prices Tell Us Stuff:



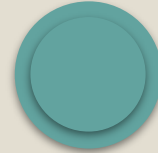
2. Make Money, :



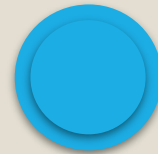
**3. Lots of Choices,
Good for You:**



4. Spread Your Eggs in Many Baskets:



5. Get Some Backup:



6. Help When Needed:

How the Market System Deals with Risk

1. Prices Tell Us Stuff:

When prices go up or down, it tells us if something is scarce or if people want it more or less. This helps businesses and people decide what risks they should take.

2. Make Money:

Businesses want to make money, but they also need to be careful not to lose it. They try new things to make money but avoid taking too much risk because they might lose instead.

How the Market System Deals with Risk

3. Lots of Choices, Good for You:

When there are many businesses offering similar things, you have more options. This means if one company messes up or charges too much, you can go to another one.

4. Spread Your Eggs in Many Baskets:

Instead of putting all your money in one place, it's smart to spread it around. That way, if something goes wrong in one place, you won't lose everything.

How the Market System Deals with Risk

5. Get Some Backup:

If something bad happens, like your house gets damaged or you get sick, insurance can help cover the costs. You pay a little money regularly, and if something bad happens, they give you some money to help fix it.

6. Help When Needed:

The government makes rules to keep things fair and safe. They also have programs to help people if they're struggling, like if they lose their job or get sick.

Discussion

•**Price Signals and Decision Making:**

- How do changes in prices affect your decisions about what to buy or sell?
- Can you think of an example where a change in price influenced a big decision for you or someone you know?

•**Balancing Risk and Reward:**

- Why do you think it's important for businesses to balance making money with being careful not to take too much risk?
- Can you think of a time when taking a risk paid off for you or someone you know?
- What about a time when it didn't?

•**Consumer Choice and Competition:**

- How does having many choices benefit consumers?
- Can you think of a situation where having more options helped you make a better decision?
- Why is competition between businesses important for consumers? How does it affect prices and quality?

•**Diversification and Investments:**

- Why is it smart to spread your money across different investments instead of putting it all in one place?
- Can you think of an example where diversifying your investments helped someone minimize their losses during tough times?

•**Insurance and Protection:**

- Why might someone choose to get insurance for things like their car, home, or health?
- Have you or someone you know ever had to use insurance to cover unexpected expenses? How did it help?

•**Role of Government and Regulation:**

- Why do you think governments make rules to regulate businesses and protect consumers?
- Can you think of an example where government programs or regulations helped someone in need? How do you think these programs affect society as a whole?

**THANK
YOU!**