2 How the economy works

Economics is a school subject, but at present in the UK it is only studied in the sixth form, from age 16, and then only as an optional subject. I've never understood why it is not studied earlier. It is about how we organise society to allocate limited resources (both money and goods) in the fairest, most efficient and most effective way, and as such it touches on the most basic questions of values and how we think the world should be run (as you can see in the section on neo-liberalism vs social democracy in the last chapter).

What is the economy?

The economy is the system by which goods and services are produced and exchanged. It isn't just people who run businesses or banks who participate in the economy. Every time you go to a shop or a café or a restaurant or buy something online, you are participating in the economy. If you have a job for which you are paid (even a paper round), you are participating in the economy. If you can't get a job; or if the job you have doesn't pay enough; or if you're still living with your parents because you can't afford to move out - that's an economic problem. The economy exists, whether we like it or not; without it we would have nowhere to live, nothing to wear, nothing to do and nothing to eat. So the economy is pretty fundamental.

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Public sector and private sector

The economy is divided into the **public sector** and the **private sector**.

The **public sector** is the part of the economy which is owned and run by the government. In Britain, it includes:

- The National Health Service (the NHS)
- The road system
- The police
- The armed forces
- State (non fee-paying) schools
- Services provided by local councils, such as rubbish collection, libraries etc.

The **private sector** is everything else, owned either by private individuals or by public companies.

Public companies are, despite their name, not part of the public sector. They are so called because they are owned by shareholders. Shareholders are people who have bought shares in the company. Buying a share in a company means that you own a certain percentage of the company. If the company makes a profit (by receiving more in income for its goods or services than it spends on making or providing them), shareholders are paid a dividend, that is, a percentage of the profits based on how many shares they own.

Public company shares are bought and sold on the Stock Exchange. The value of the shares will go up and down depending on the demand for them, which is usually determined by how well the company is doing and is expected to do. As well as making money from dividends, you can make money by selling your shares at a higher price than you bought them.

Large companies are often international, with their UK holdings being only a small part of their worldwide operation. So, for example, when you buy a coffee from a café that is part of a global chain, you may be engaging with a business that is based in another country, and has thousands of outlets all round the world. Part of the money you pay for your coffee will go to shareholders in many different parts of the world. International businesses are harder for the government to control. Some companies may arrange their affairs so that they pay little or no tax in the UK, despite benefitting from many of the facilities provided by the public sector such as state education (ensuring their staff and customers can read the menu and count the change), the police (stopping people breaking into their cafés) and the roads (ensuring people can drive or take the bus to their cafés).

Social democrats tend to favour a larger public sector; neo-liberals tend to favour a larger private sector. See Chapter 9 for the reasons for these beliefs.

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The process of moving a business from the public sector to the private sector is called **privatisation**. Electricity, gas, water, the railways and telecommunications were once all in the public sector in the UK, until the Conservative government led by Margaret Thatcher in the 1980s privatised them. The process of moving a business from the private sector to the public sector is called **nationalisation**. Healthcare was in the private sector in the UK until 1948, when the creation of the NHS nationalised it.