

CHAPTER

2

Economic Systems and the American Economy

Why It's Important

Why do we, as American consumers, have so many choices? How is our economy different from the economies of other countries? This chapter will explain the different kinds of economic systems.



*To learn more about economic systems, view the **Economics***

*& You Chapter 3 video lesson: **Economic Systems and the American Economy***

ECONOMICS
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Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on **Chapter 2—Chapter Overviews** to preview chapter information.

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SECTION

1

Economic Systems

COVER STORY

WE LIVE IN ARGENTINA, BY ALEX HUBER

Diaguita Indians have lived in this region for generations. . . . We grow beans, corn and potatoes on the mountain slopes. To irrigate these crops, we still use the channels built centuries ago by our ancestors. We also

breed llamas. . . . In our community, the more llamas you own, the richer you are.

. . . You can tell to which community someone belongs by the way they dress, the color of their clothes, and the hairstyle of the women.



READER'S GUIDE

Terms to Know

- economic system
- traditional economy
- command economy
- market economy
- market
- circular flow of economic activity
- mixed economy

Reading Objectives

1. What three questions must all economic systems answer?
2. What are the major types of economic systems and their differences?

You probably have set some goals for your life, such as going to college, learning a trade, or opening a business. If you were to compare your personal goals to the goals of a Diaguita living in Argentina or to a North Korean teenager, the lists might vary widely. One of the reasons for this variance is that each of these persons lives in a community or nation with a different **economic system**, or way of determining how to use resources to satisfy people's wants and needs. In this section, you'll learn about the different kinds of economic systems in the world.

economic system: way in which a nation uses its resources to satisfy its people's needs and wants

Three Basic Questions

Although nations will have different economic systems, each system is faced with answering the same three basic questions:



What goods and services should be produced? How should they be produced? Who should share in what is produced?

What Should Be Produced? As you've learned, we live in a world of scarcity and trade-offs. If more of one particular item is produced, then less of something else will be produced. If the government decides to use resources to build new roads, then fewer resources are available to maintain national parks. If a city decides to hire more police officers, fewer funds are available to add teachers to classrooms. Similarly, as shown in **Figure 2.1**, an automobile manufacturer must decide whether to produce pickup trucks, minivans, sports utility vehicles, or luxury cars—and how much of each.

FIGURE 2.1

What to Produce? An automobile manufacturer must decide which types of cars to produce with its limited supplies of labor, steel, rubber, and so on. *Why can't businesses or nations produce as much as they want?*

How Should It Be Produced? After deciding what to produce, an economic system must then decide *how* those goods and services will be produced. Will more laborers be hired? Will skilled laborers or unskilled laborers do the work? Will capital goods be used to manufacture the products, thereby reducing the number of laborers needed? As shown in **Figure 2.2**, a decision must be made as to how the combination of available inputs will get the job done for the least cost.

FIGURE 2.2

How to Produce? Trade-offs exist among the available factors of production. A farmer could use a horse-drawn plow to prepare a field for planting, or instead use modern equipment. *What factors must be considered when deciding how to produce a good or service?*



HAGAR THE HORRIBLE



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For Whom Should It Be Produced? After goods or services are produced, the type of economic system under which people live determines how the goods and services will be distributed among its members. See **Figure 2.3**. Who receives the new cars? Who benefits from a new city school? Who lives in new apartment buildings? As you will read, most goods and services in the United States are distributed to individuals and businesses through a price system. Other economies may distribute products through majority rule, a lottery, on a first-come-first-served basis, by sharing equally, by military force, and in a variety of other ways.

FIGURE 2.3

For Whom to Produce?

In the United States economy, people's career choices determine their level of income, which in turn affects their ability to purchase produced items.

How do you think people's educational choices play in the career choices that they have later in life?

Types of Economic Systems

Economists have identified four types of economic systems. They differ from one another based on how they answer the three basic questions of what, how, and for whom to produce. The four types of economic systems are traditional, command (or controlled), market (or capitalist), and mixed. Keep in mind that the four systems described here are theoretical representations of economies found throughout the world. No "pure" systems really exist—they are all mixed economies to some degree.

Traditional System A pure **traditional economy** answers the three basic questions according to tradition. In such a system, things are done "the way they have always been done." Economic decisions are based on customs and beliefs—often religious—handed down from generation to generation.

If you lived in a traditional economic system, your parents would teach you to perform the same tasks that they learned from their parents. As a male, for example, if your father was a fisherman, you would become a fisherman. You would learn to

traditional economy: system in which economic decisions are based on customs and beliefs that have been handed down from generation to generation

make fishing nets the same way he was taught. And you would distribute your catch in the manner that it had always been done.

An advantage of living in a traditional economy is that you know what is expected of you. In addition, family and community ties are usually very strong. Disadvantages include an economy in which change is discouraged and perhaps even punished, and one in which the methods of production are often inefficient. Consequently, choices among consumer goods are rare.

As Part C of **Figure 2.4** shows, traditional economies exist to some extent in very limited parts of the world today. The Inuit of North America, the San of the Kalahari in Africa, and the Aborigines of Australia are organized into traditional economic systems.

command economy: system in which the government controls the factors of production and makes all decisions about their use

Command System The pure **command economy** is somewhat similar to the traditional economy in that the individual has little, if any, influence over how the basic economic questions are answered. In a command or controlled system, however, government leaders—not tradition—control the factors of production and, therefore, make all decisions about their use.

Decisions in government may be made by one person, a small group of leaders, or a group of central planners in an agency. These people choose what is to be produced and how resources are to be used at each stage in production. They also decide how goods and services will be distributed. If you lived in a command economy, you would be paid according to what the central planners decide, and you might even lose your ability to make a career choice. Through a series of regulations about the kinds and amounts of available education, the government guides people into certain jobs.

An advantage of a controlled economy is the speed with which resources can be rerouted. If war is likely, the central planning agency can halt all manufacturing of civilian goods and channel the factors of production into making strictly military goods. Disadvantages include a lack of incentives to work hard or to show inventiveness, as well as a lack of consumer choices. Because the government sets workers' salaries, there is no reason to work efficiently or smartly.

Only a few countries in the world today still have much of a command economy. North Korea and the People's Republic of China are the two main examples because so much economic activity there is government-planned. See Part B of **Figure 2.4**.

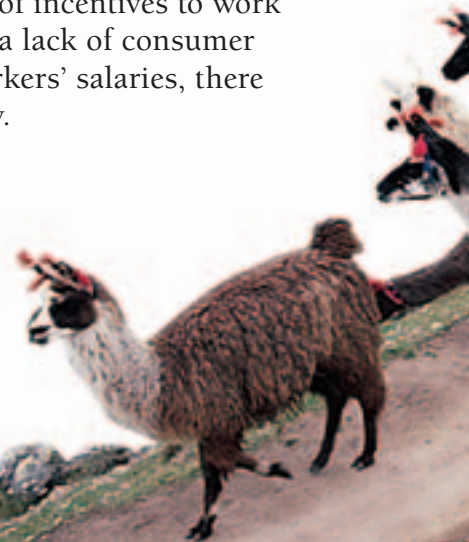


FIGURE 2.4

Types of Economic Systems The types of economic systems differ from one another based on how they answer the three basic questions of what, how, and for whom to produce.

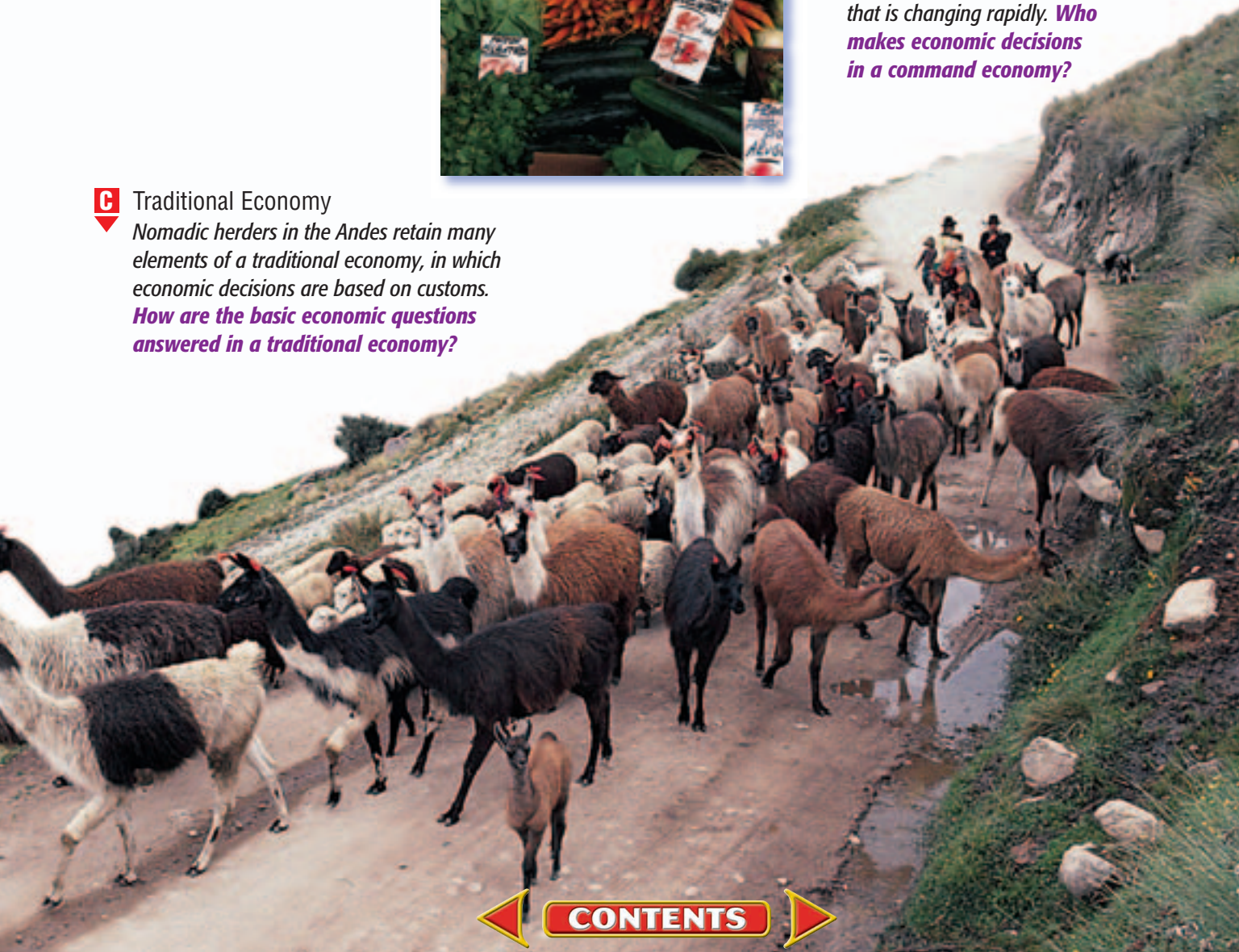
A ▶ **Market Economy**
*In a market economy, prices are an efficient means of providing information for voluntary exchange. **Why do you suppose that prices are considered “neutral”?***



B ▶ **Command Economy**
*Command economies were common throughout history. China's economy is still considered to be government-controlled, although that is changing rapidly. **Who makes economic decisions in a command economy?***



C ▶ **Traditional Economy**
*Nomadic herders in the Andes retain many elements of a traditional economy, in which economic decisions are based on customs. **How are the basic economic questions answered in a traditional economy?***



The Soviet Union's Quota System

In the former Soviet Union, workers often used resources inefficiently or completely wasted them when trying to fill government production quotas. For example, after the central planning committee ordered a quota for glass based on the number of panes,

workers made *many* panes of glass—each extremely thin and shattering easily! When the production quota was changed to be based on the weight of the panes, workers made the glass panes so thick that they were useless. ■

market economy: system in which individuals own the factors of production and make economic decisions through free interaction while looking out for their own and their families' best interests

market: freely chosen activity between buyers and sellers of goods and services

Market System The opposite of a pure command economy is a pure **market economy**—also called capitalism. In a market system, economic decisions are not made by government, but by individuals looking out for their own and their families' best interests. A limited government makes it possible for individuals to decide for themselves the answers to the three basic questions. Individuals own the factors of production, and therefore choose what to produce and how to produce it. Individuals also choose what to buy with the income received from selling their labor and other resources. All of these choices are guided not by tradition or a central planning agency, but by information in the form of market prices.

A **market** is not necessarily a place. Rather, it is the *voluntary exchange* of goods and services between buyers and sellers. This exchange may take place in a worldwide market for a good such as crude oil. It may also take place in a neighborhood market for services such as paper delivery, snow shoveling, and baby-sitting.

As shown in *Part A* of **Figure 2.4** on page 35, prices in a market coordinate the interaction between buyers and sellers. As prices change, they act as signals to everyone within the system as to what should

be bought and what should be produced. A high price for a good generally means that it is relatively scarce. A low price suggests that it is relatively abundant. The freedom of prices to rise and fall results in a neutral, self-organizing, incentive-driven system.



Student Web Activity Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on **Chapter 2—Student Web Activities** to learn more about the command economy of the former Soviet Union.

CLICK HERE

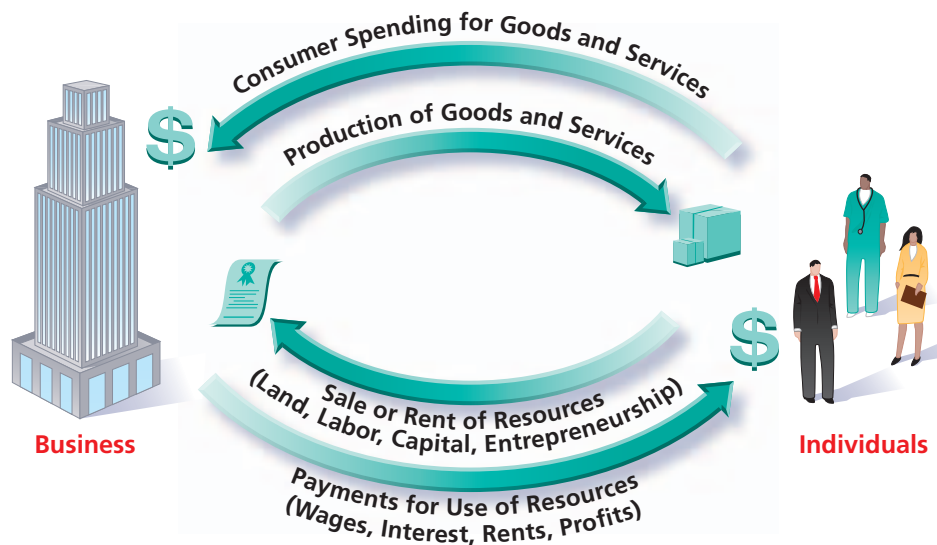
The flow of resources, goods and services, and money in a market system is actually circular, as shown in **Figure 2.5**. Economists use this model, called a **circular flow of economic activity**, to illustrate how the market system works. Note how dollars flow from businesses to individuals and back to businesses again. The factors of production flow from individuals to businesses, which use them to produce goods and services that flow back to individuals. The circular flow works because the information needed for its operation is scattered among all participants in the economy.

The advantages of a pure market system are many. People have freedoms—to choose a career, to spend or not spend their income how they wish, to own private property, to take risks and earn profits. In addition, the existence of competition provides consumers in a market economy with a wide array of goods and services from which to choose, as well as an efficient system of determining how much they cost. One disadvantage of a pure market system involves concern about those too young, too old,

circular flow of economic activity: economic model that pictures income as flowing continuously between businesses and consumers

FIGURE 2.5

Circular Flow The inside arrows on the graph show individuals selling the factors of production to businesses, who use them to produce goods and services. The outside of the graph shows the flow of money income from businesses to individuals in the form of rents, wages, interest, and profits; and the return of money to businesses as consumer spending. *What underlying factor makes this circular flow work?*

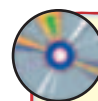


or too sick to work. Many fear that survival for these people would be difficult unless the government, churches, family members, or other organizations stepped in to provide goods and services.

mixed economy: system combining characteristics of more than one type of economy

Mixed System A **mixed economy** combines basic elements of a pure market economy and a command economy. Most countries of the world have a mixed economy in which private ownership of property and individual decision making are combined with government intervention and regulations. In the United States, most decisions are made by individuals reacting as participants within the market. However, federal, state, and local governments make laws protecting private property and regulating certain areas of business. In Section 2, you'll learn more about the United States's mixed economy, and the role of government in it.

To summarize, consider why a society has one type of economic system and not another. The goals that individuals set for their society help determine their economic system. The amount of government involvement in allocating scarce resources also determines a society's economic system.



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SECTION 1 Assessment

Understanding Key Terms

- 1. Define** economic system, traditional economy, command economy, market economy, market, circular flow of economic activity, mixed economy.

Reviewing Objectives

- 2.** What three questions must all economic systems answer?
- 3. Graphic Organizer** In a chart like the one below, list the major types of economic systems and their differences.

Type of System	Who Answers 3 Basic Questions?	Advantages	Disadvantages

Applying Economic Concepts

- 4. Economic Systems** A society's values determine how it allocates its resources. Identify and describe a societal value (for example, stability, certainty, quality, or personal freedom) that influences a traditional economy and a command economy. Then identify and describe a time in American history when each system was used.

Critical Thinking Activity

- 5. Synthesizing Information** Using **Figure 2.5** as a base, make a circular flow of economic activity reflecting your own life. Replace the general information shown on **Figure 2.5** with detailed specifics about your income, items you purchase, and so on. For help in using graphs, see page xvi in the *Economic Handbook*.



CRITICAL THINKING SKILLS

Making Comparisons

When you make comparisons, you determine similarities and differences among ideas, objects, or events. Making comparisons is an important skill because it helps you choose among alternatives.

- Identify or decide what will be compared.
- Determine a common area or areas in which comparisons can be drawn.
- Look for similarities and differences within these areas.

LEARNING THE SKILL

To learn how to make comparisons, follow the steps listed on the left.

PRACTICING THE SKILL

Read the passages below, then answer the questions.

“So long as mankind lived by raising crops and herding animals, there was not much need for measuring small units of time. The seasons were all important—to know when to expect the rain, the snow, the sun, the cold. Why bother with hours and minutes? Daylight was the only important time, the only time when men could work.”

—From Daniel J. Boorstin’s *The Discoverers: A History of Man’s Search to Know His World and Himself*, 1985

“Getting workers to work at the appointed clock hours was a recurring problem. In industrial cities, a steam whistle would blow at five in the morning to wrest people from their sleep. If that proved insufficient, employers would hire ‘knockers,’ men who went from flat to flat ‘rapping on bedroom windows with long poles.’ Sometimes the knockers even pulled on strings ‘dangling from a window and attached to a worker’s toe.’”

—From Jeremy Rifkin’s *Time Wars: The Primary Conflict in Human History*, 1987

1. What is the topic of these passages?
2. How are the passages similar? Different?

APPLICATION ACTIVITY

Survey your classmates about an issue in the news. Summarize the opinions and write a paragraph comparing the different opinions.



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Characteristics of the American Economy

READER'S GUIDE

Terms to Know

- capitalism
- laissez-faire
- free enterprise system
- profit
- profit incentive
- private property
- competition

Reading Objectives

1. What is the role of government in our free enterprise economy?
2. How do freedom of enterprise and freedom of choice apply to the American economy?
3. What roles do private property, the profit incentive, and competition play in the American economy?

COVER STORY

BUSINESS WEEK, MARCH 22, 1999



Ready to take the next step beyond Coke and Pepsi, orange and grape, tea and fruit drinks? Then how about some Wisdom or maybe a little Eros? Those aren't metaphysical thirst quenchers, but the real thing, examples of the latest trend in soft drinks: mystery concoctions that give little or no hint of what flavor is in the bottle.


Perhaps you wouldn't buy a soft drink called "Wisdom," but someone will. That's one of the characteristics of a market economy—freedom of choice. A seller can choose to make or not make a product, and you can choose to buy it or not.

In this section you'll learn that a pure market economic system has six major characteristics: (1) little or no government control, (2) freedom of enterprise, (3) freedom of choice, (4) private property, (5) the profit incentive, and (6) competition. These characteristics are interrelated, and all are present in the American economy to varying degrees.

Limited Role of Government

In his book *An Inquiry into the Nature and Causes of the Wealth of Nations*, economist Adam Smith in 1776 described a system in which government has little to do with a nation's economic activity. He said that individuals left on their own would work for their own self-interest. In doing so, they would be guided as if by an "invisible hand" to use resources efficiently and thus achieve the maximum good for society.

Smith's version of the ideal economic system is called **capitalism**, another name for the market system. Pure capitalism has also been called a **laissez-faire** system. The French term means "let [people] do [as they choose]." A pure capitalist system is one in which the government lets people and businesses make their own economic decisions without government constraints. Capitalism as practiced in the United States today would be best defined as an economic system in which private individuals own the factors of production, but decide how to use them within legislated limits. See **Figure 2.6**.



CAREERS

Environmental Scientist

Job Description	Qualifications
■ Locate water, mineral, and energy resources	■ Bachelor's degree in hydrogeology, environmental, civil or geological engineering
■ Protect the environment, predict geologic hazards, and offer advice on land use	■ A Ph.D. is necessary for most high-level research positions

Average Yearly Salary: \$44,180

Job Outlook: Above average

—Occupational Outlook Handbook, 2002–03

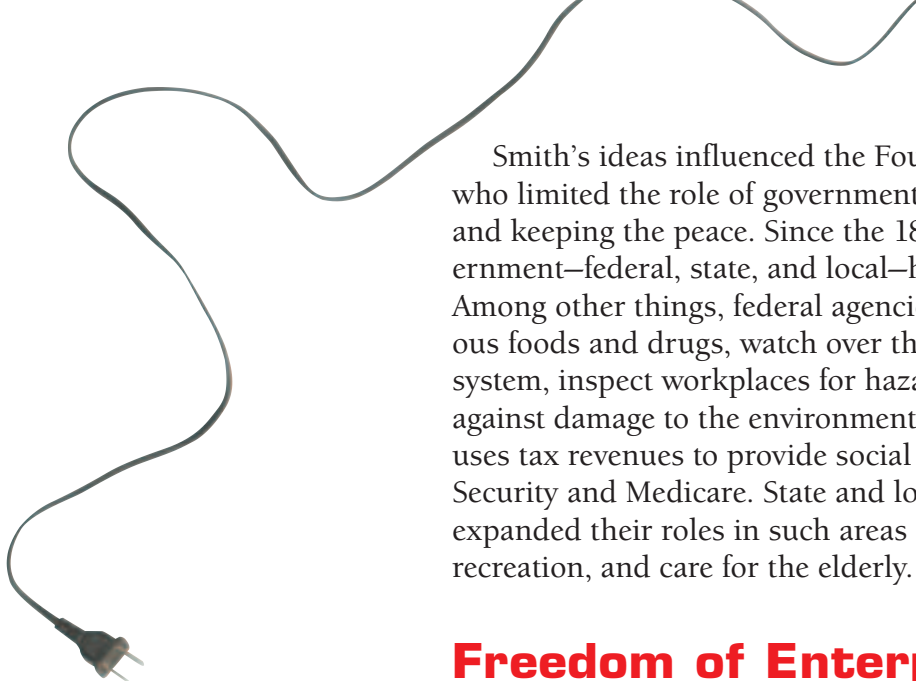
capitalism: economic system in which private individuals own the factors of production

laissez-faire: economic system in which the government minimizes its interference with the economy

FIGURE 2.6

Role of Government The government acts as a provider of public services, such as maintaining our national parks. It also acts as protector in the form of food and drug inspection. **List three more examples of how the government is involved in our economy.**





Smith's ideas influenced the Founders of the United States, who limited the role of government mainly to national defense and keeping the peace. Since the 1880s, however, the role of government—federal, state, and local—has increased significantly. Among other things, federal agencies regulate the quality of various foods and drugs, watch over the nation's money and banking system, inspect workplaces for hazardous conditions, and guard against damage to the environment. The federal government also uses tax revenues to provide social programs such as Social Security and Medicare. State and local governments have expanded their roles in such areas as education, job training, recreation, and care for the elderly.

free enterprise system: *economic system in which individuals own the factors of production and decide how to use them within legal limits; same as capitalism*

Freedom of Enterprise

As well as *capitalist*, the American economy is also called a **free enterprise system**. This term emphasizes that individuals are free to own and control the factors of production. If you go into business for yourself, you may become rich selling your product. However, you may instead lose money, because you—or any entrepreneur—have no guarantee of success.

The government places certain legal restrictions on freedom of enterprise. For instance, just because you know how to fix cars does not mean that you can set up an automobile-repair business in your backyard. Zoning regulations, child-labor laws, hazardous waste disposal rules, and other regulations limit free enterprise to protect you *and* your neighbors.

Freedom of Choice

Freedom of choice is the other side of freedom of enterprise. It means that buyers, not sellers, make the decisions about what should be produced. The success or failure of a good or service in the marketplace depends on individuals freely choosing what they want to buy. If a music company releases a new CD, but few people buy it, the music company most likely will not sign that particular group again. Buyers have signaled that they do not like that group.

Although buyers are free to make choices, the marketplace has become increasingly complex. The government has intervened in various areas of the economy to protect buyers. As shown in **Figure 2.7**, laws set safety standards for such things as toys, electric appliances, and automobiles. In industries dominated by just a few companies—such as public utilities selling natural gas or electricity—the government regulates the prices they may charge.



FIGURE 2.7

Freedom of Choice Consumers in a market economy have the advantage of being able to choose among products. Laws require producers to make sure that the products consumers choose are safe ones.
How do consumers' choices determine what will be produced?

Profit Incentive

When a person invests time, know-how, money, and other capital resources in a business, that investment is made with the idea of making a profit. **Profit** is the money left after all the costs of production have been paid, including wages, rents, interest, and taxes. The desire to make a profit is called the **profit incentive**, or profit motive. This desire motivates entrepreneurs to establish new businesses and produce new kinds of goods and services.

The risk of failing is also part of the free enterprise system. What happens when profits are *not* realized—when businesses fail? Losses are a signal to move resources elsewhere. Thus, the interaction of both profits and losses leads to an economy that is more efficient, adaptable to change, and continuously growing.

profit: money left after all the costs of production—wages, rents, interest, and taxes—have been paid

profit incentive: desire to make money that motivates people to produce and sell goods and services

Private Property

One of the most important characteristics of capitalism is the existence of **private property**, or property that is held by individuals or groups rather than by the federal, state, or local governments. You as an individual are free to buy whatever you can afford, whether it is land, a business, an automobile, or baseball cards. You can also control how, when, and by whom your property is used. What are called the rights of property, however, are actually the rights of humans to risk investment, own productive assets, learn new ways of producing, and then to enjoy the benefits if these choices result in profits.

The Founders of the United States recognized that such rights must not be violated, because these rights are the invisible engine for creating wealth and prosperity for all. The Constitution guarantees an owner's right to private property and its use. Thus, in principle, no level of government in the United States can seize or use private property, at least not without paying the owners.

private property: whatever is owned by individuals rather than by government



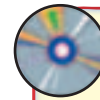
Competition

competition: rivalry among producers or sellers of similar goods and services to win more business

In a free enterprise system, the lure of profits encourages **competition**—the rivalry among producers of similar products to win more business by offering lower prices or better quality. Effective competition requires a large number of independent sellers, which means that no single company can noticeably affect the price of a particular product or service. If one company raises its prices, potential customers can simply go to other sellers.

Competition leads to an efficient use of resources. How so? Businesses have to keep prices low enough to attract buyers, yet high enough to make a profit. This forces businesses to keep their costs of production as low as possible.

For competition to exist, barriers to enter and exit from industries must be weak. Businesses must be free to expand into other industries. For the most part, the United States has weak barriers to entry and exit. Yet some industries have tougher barriers to entry. For example, a person cannot become a physician until he or she has received a license from a state government.



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SECTION

2

Assessment

Understanding Key Terms

1. **Define** capitalism, laissez-faire, free enterprise system, profit, profit incentive, private property, competition.

Reviewing Objectives

2. What is the role of government in our free enterprise economy?
3. How do freedom of enterprise and freedom of choice apply to the American economy?
4. **Graphic Organizer** Create a chart like the one in the next column to summarize the roles that profit incentive, private property, and competition play in the American economy.

Characteristic	Definition	Role in Capitalism

Applying Economic Concepts

5. **Competition** Describe a situation in which a lack of competition caused you to pay more for a good or service.

Critical Thinking Activity

6. **Synthesizing Information** Shoe Store A offers a pair of high-top sneakers for \$48, whereas a competitor—Shoe Store B—offers the same shoe at 25 percent off their regular price of \$62. From which store should you buy the shoes? *For help in understanding percentages, see page xix in the Economic Handbook.*

People & Perspectives



Adam Smith

ECONOMIST (1723–1790)

- Born in Kirkcaldy, County Fife, Scotland
- Called the founder of classical economics
- Teacher at the University of Glasgow
- Lectured and wrote on moral philosophy
- Wrote *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776)

In *An Inquiry into the Nature and Causes of the Wealth of Nations*, Adam Smith argues against government interference in the marketplace. He believed that individuals, seeking profit, end up benefiting society as a whole.

“[E]very individual, therefore, endeavours as much as he can [to direct his resources toward his own business] so that its produce may be of the greatest value; every individual . . . neither intends to promote the public interest, nor knows how much he is promoting it. . . . He intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.”

Smith criticized government officials who had “the folly” to attempt to direct people in what they should produce. He believed

that no single person could direct resources more efficiently than individuals watching out for their own self-interest.

“It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy. The ta[i]lor does not attempt to make his own shoes, but buys them of the shoemaker. The shoemaker does not attempt to make his own clothes, but employs a ta[i]lor. The farmer attempts to make neither the one nor the other, but employs those different [craftsmen]. All of them find it [in their best interests] to employ their whole industry in a way in which they have some advantage over their neighbours, and to purchase . . . whatever else they have occasion for.”

Checking for Understanding

1. How does an “invisible hand” directing an individual’s economic choices benefit society as a whole?
2. In Smith’s opinion, why should people not attempt to “employ their resources” in many industries?

The Goals of the Nation

READER'S GUIDE

Terms to Know

- economic efficiency
- economic equity
- standard of living
- economic growth

Reading Objectives

1. What are the major goals of a market economy?
2. How can people balance economic rights with economic responsibilities?

COVER STORY

PREAMBLE TO THE CONSTITUTION OF THE UNITED STATES

We, the people of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States.



Nations have values, and they set goals for themselves based on those values. The United States is no exception. Its goals are evident in the supreme law of the land—the Constitution—as well as in its government policies and in the actions of people like you. In this section you'll learn how the American economy strives to “promote the general Welfare.”

Goals of Free Enterprise

The United States has a free enterprise, or capitalist, system. Therefore, the major characteristics of a market economy should be evident in its goals. Among the national goals of Americans are freedom, efficiency, equity, security, stability, and growth. Although these goals have ethical, social, and religious elements, let's focus on their economic implications instead.

Economic Freedom The goal of economic freedom is to allow each member of society to make choices. Americans have the highest degree of freedom in the world to start their own businesses, to own private property, to make decisions in the marketplace,

FIGURE 2.8

Economic Freedom Along with the freedom to strive for profit comes the freedom to fail. *What economic choices will you be free to make upon graduating from high school?*



and to pursue other economic choices. People may choose to work nights or part-time, to have several jobs, and to move from place to place in search of work.

Along with this freedom come certain costs as shown in **Figure 2.8**. In particular, individuals must normally accept the consequences of their decisions in our free enterprise system. If an entrepreneur starts a business that fails, for example, the government usually won't help out.

Economic Efficiency Using our limited resources wisely is the goal of **economic efficiency**. Because of scarcity, if the factors of production are wasted, fewer goods and services overall will be produced. We must always be watchful that the costs of our economic actions do not exceed the benefits.

economic efficiency: wise use of available resources so that costs do not exceed benefits

Economic Equity The issue of fairness underscores the goal of **economic equity**. Americans want their economic system to be fair and just. That's why we encourage our policy makers to pass laws such as those dealing with equal pay for equal work, fairness in hiring practices, and help for disabled workers. See **Figure 2.9**.

economic equity: the attempt to balance an economic policy so that everyone benefits fairly



FIGURE 2.9

Economic Equity Laws requiring employers to hire disabled persons and minorities aim to promote economic equity. *What laws do you think should be passed to make our economy more fair? Explain.*

Global Economy

The Cybermarket

Markets exist for just about everything—computers, natural gas, shoes, labor services, and so on. Many markets used to be confined to specific geographical areas. Today the Internet has created a virtual worldwide marketplace for many goods and services. Just consider recorded music. Since the introduction of a secure music standard, those connected to the Internet anywhere in the world can buy and download songs. Information about jobs available anywhere on the earth is also easily found via the Internet. You may answer a job announcement, interview, and be hired without ever leaving your desk! ■

standard of living: *the material well-being of an individual, group, or nation measured by how well their necessities and luxuries are satisfied*

economic growth: *expansion of the economy to produce more goods, jobs, and wealth*

Economic Security Americans understand that making profits often means taking risks. Yet we also want protection against risks beyond our control—accidents on the job, natural disasters, business and bank failures, poverty in old age. Our economic system provides such security through a number of government social programs.

Economic Stability The goal of economic stability seeks to reduce extreme ups and downs in the **standard of living**—the material well-being of an individual, group, or nation. The standard of living is measured by the average value of goods and services used by the average citizen during a given period of time. The United States has more individuals enjoying a high standard of living than almost anywhere in the world.

Economic Growth **Economic growth** means producing increasing amounts of goods and services over the long term. As the population increases, the economy must also expand in order to provide for additional needs and wants. All nations have economic growth as a goal because it helps meet other goals.

Trade-Offs Among Goals In a world of scarcity, achieving national goals requires trade-offs. For example, any program that provides economic security—Medicare, Social Security, or unemployment compensation—uses resources that could have been directed elsewhere.

A plan of action must be developed in order to accomplish the nation's goals. Such a plan often involves economic policy-making by elected or appointed officials who must face the reality of scarcity. Understanding this will help you realize that not all political desires can be turned into economic reality.

Rights and Responsibilities

The American free enterprise system bestows numerous economic rights and protections on individuals like you. You have

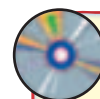
FIGURE 2.10

Economic Responsibility “There is no such thing as a free lunch.” This quote, often used in economics, means that nothing is free—including your education. Tax dollars pay for you to learn how to become a productive citizen. *What other economic responsibilities do you have?*

the right to enter into just about any profession or business you want. You have the right to work very little or to become a “workaholic.” You have the right to buy those products and brands that you like and to reject all others.

A well-functioning free enterprise system will not continue, however, if individuals do not take on certain economic responsibilities. The first, of course, is to be able to support yourself and your family. As shown in **Figure 2.10**, you have a responsibility to use your education in a reasonable manner that helps you become a productive member of the free enterprise system.

Finally, because government has become such an important part of our economy, individuals in our system have the responsibility of electing responsible government officials. This responsibility requires both the knowledge of possible government policies and the ability to analyze the consequences of those policies.



Practice and assess
key skills with
Skillbuilder Interactive
Workbook, Level 2.

SECTION

3

Assessment

Understanding Key Terms

1. **Define** economic efficiency, economic equity, standard of living, economic growth.

Reviewing Objectives

2. **Graphic Organizer** Create a diagram like the one below to list and describe the major goals of a market economy.



3. How can people balance economic rights with economic responsibilities?

Applying Economic Concepts

4. **Economic Goals** How can the goal of economic equity conflict with the goal of economic freedom? Provide an example for your explanation.

Critical Thinking Activity

5. **Summarizing Information** Summarize the goals of the American economy in a photo essay or through song lyrics. Share your presentation with the rest of the class. Ask class members to identify the goals evident in your presentation.

SPOTLIGHT ON THE ECONOMY

Save the Species—but Add Incentives



Bald eagle

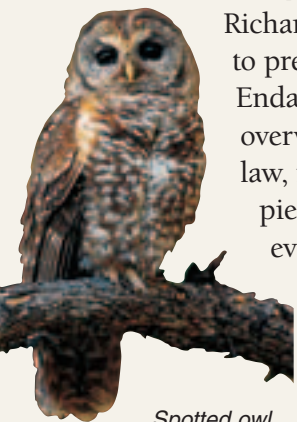
Check It Out! In this chapter you learned about six economic goals our nation strives to meet. The following article points out how the actions of people and the government may cause some economic goals to conflict.

In 1782, when the bald eagle became the American symbol, it ruled the skies—25,000 to 75,000 patrolled what would become the lower 48 states. By the early 1960s, however, fewer than 450 nesting pairs remained. Defenseless against human predators, the bald eagle was approaching extinction.

... [O]n December 28, 1973, President Richard M. Nixon took decisive action to prevent that. He signed the Endangered Species Act. Despite the overwhelming support for the new law, it quickly became the most reviled piece of environmental legislation ever enacted.

With his signature, Nixon had protected not only the bald eagle but also scores of other weird animals and plants. ...

Environmentalists seized on the Act as a powerful weapon to protect sensitive habitats; meanwhile developers, loggers, and cattle ranchers, to name a few, howled in pain. ... [C]ontroversy over protecting the spotted owl



Spotted owl

threatened to close down logging on millions of acres of forest in the Pacific Northwest. ...

Conservative critics have denounced the Act, arguing that it gives Fish & Wildlife Service biologists unlimited power to block development—without paying for it. They say that if the government cuts land values by blocking development, it should compensate the owners.

... Flexible interpretation of the Act now allows landowners and developers to destroy some endangered-species habitat if they agree to preserve or restore habitat for the species somewhere else. Adding more incentives, such as tax breaks, could also ease critics' concerns.

For all its shortcomings, the Act has slowed the decline of imperiled species. A few have been saved, including the bald eagle. ...

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Think About It

1. What argument do environmentalists make in support of the Endangered Species Act?
2. What argument do critics make against the Act?
3. What two economic goals are in conflict in this situation?

ECONOMICS
Online

CLICK HERE

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on **Chapter 2—Chapter Overviews** to review chapter information.

SECTION 1 Economic Systems

- Every type of **economic system** must answer three basic questions: What goods and services should be produced? How should they be produced? Who should share in what is produced?
- There are four types of economic systems: traditional, command, market, and mixed.
- In a **traditional economy**, economic decisions are based on customs and beliefs handed down from generation to generation.
- In a **command economy**, government leaders control the factors of production and, therefore, make all decisions about their use.
- In a **market economy**, individuals looking out for their own and their families' best interests make the economic decisions.
- Most countries of the world have a **mixed economy** in which private ownership of property and individual decision making are combined with government regulations.

SECTION 2 Characteristics of the American Economy

- A pure market economic system has six major characteristics: little or no government control, freedom of enterprise, freedom of choice, private property, the profit incentive, and competition.
- **Capitalism**, as practiced in the United States, has private individuals owning the factors of production but using them within the limits of the law.
- The **profit incentive** is the desire that motivates entrepreneurs to establish new businesses, expand existing ones, and change the kinds of goods and services produced.
- One of the most important characteristics of capitalism is the existence of **private property**.
- **Competition** leads to an efficient use of resources, better goods and services, and low prices for consumers.

SECTION 3 The Goals of the Nation

- The United States has a **free enterprise**, or capitalist, economic system.
- Among the economic goals of Americans are economic freedom, **economic efficiency**, **economic equity**, economic security, economic stability, and **economic growth**.
- A well-functioning free enterprise system requires individuals to take on certain economic responsibilities, including becoming productive members of society and electing responsible government officials.

Assessment and Activities

Economics Online



Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on **Chapter 2—Self-Check Quizzes** to prepare for the Chapter Test.

CLICK HERE

Identifying Key Terms

Use terms from the following list to complete the sentences below.

- | | |
|--------------------------|----------------------|
| ■ traditional economy | ■ private property |
| ■ command economy | ■ profit |
| ■ mixed economy | ■ invisible hand |
| ■ entrepreneur | ■ competition |
| ■ capitalism | ■ economic growth |
| ■ free enterprise system | ■ economic equity |
| | ■ standard of living |

- Other terms for the market economic system are _____ and _____.
- Many Americans believe that their economic system accounts for the high _____ in the United States.
- The concept of _____ allows people to buy and own land, a home, or their own business.
- The _____ can make profits or incur great losses.
- A person may keep the _____ they earn from selling.

- Most people live in countries that have a _____.
- Adam Smith said the economy is directed by an _____.
- Our government promotes _____, or fair and just economic policies.
- The existence of _____ keeps prices low for consumers.

Recalling Facts and Ideas

Section 1

- What basic economic question helps determine the career path of individuals?
- What economic question is being answered if an industry replaces some workers with machines?
- How does a traditional economy answer the basic question, "How should it be produced?"
- Who answers the three basic economic questions in a command system?
- Who owns the factors of production in a market economy?

Section 2

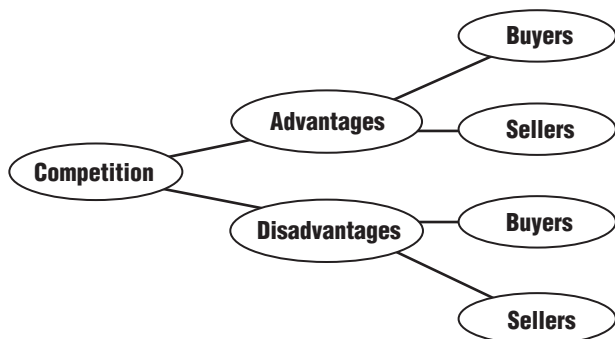
- What are six important characteristics of free enterprise?
- What is government's limited role in pure capitalism?
- Why is private property important in the American economic system?

Section 3

- What are three goals of the free enterprise system?
- What does the United States do to promote economic security for individuals?

Thinking Critically

- 1. Making Comparisons** Create a diagram like the one below to list the advantages and disadvantages of competition to buyers and sellers.



- 2. Categorizing Information** Explain what U.S. economic goal is being met by the following actions: (a) The government regulates the amount that an electric company can charge you for energy. (b) Juan moves to Seattle to work for a Web page designer. (c) Your savings account is insured up to \$100,000.

Applying Economic Concepts

Economic Systems An economic system within your school determines the answer to the basic question, “For whom should it be produced?” Make a list of the goods and services available to students within the school. After each item, write whether the distribution of this good or service is determined according to the principles of a market, command, or traditional economy.

Reviewing Skills

Making Comparisons Research Russia’s economy today and when it was a command economy under the Soviet Union. Prepare a chart listing the similarities and differences in how the three basic economic questions were and are answered under both economies.

Cooperative Learning Project

In small groups, submit plans for a national education system in a command economy. Provide answers to such questions as: What level of education should be available without cost to everyone? Should academic achievement or testing qualify students for higher levels of education?

Technology Activity



Using a Spreadsheet Create a spreadsheet like the one below highlighting your weekly spending habits.

	A	B	C	D	E	F
1		Food	Clothing	Entertainment	Other	TOTAL
2	Monday					
3	Tuesday					
4	Wednesday					
5	Thursday					
6	Friday					
7	Saturday					
8	Sunday					
9	TOTAL					
10						

1. In cell F2, use a formula such as `=SUM(B2:E2)` to calculate total expenditures on Monday. Click and drag this formula to cells F3 through F8 to find the other weekday sums.
2. Using the above summation method, compute total expenditures for cells B9–F9.
3. Print your results.

Analyzing the Global Economy

Review world economic news from magazines or Web sites. List the economic decisions of several nations and make a table that classifies the decisions as supporting free market or command systems.

Economics Lab

Testing Consumer Products

From the classroom of Mitzie B. Tabor, West Carter High School, Olive Hill, Kentucky

In Chapter 2 you learned that the free enterprise system allows individuals to take risks and go into business for themselves. In this lab, you'll become a business owner and select a product to make. After shopping for the resources needed to make that product, you'll perform tests on the items to see if they are quality, yet cost-effective, goods.

STEP A Tools Needed

- ✓ copies of *Consumer Reports* magazine
- ✓ supplies pertaining to your product (see procedure #3 in the next column)
- ✓ pencil
- ✓ writing paper
- ✓ graph paper and poster board

STEP B Procedures to Follow

1. Organize into groups of three.
2. Decide upon a small business operation to run. Choose one of the product ideas that follow, or develop your own product.
 - Sell "cookie-wiches" consisting of icing between two sugar cookies.
 - Sell hot chocolate with marshmallows.
 - Sell portraits sketched with markers on drawing paper.
 - Sell orange juice-banana fruit "smoothies."
3. Gather three samples of the items (resources) you'll need to make your products. For example:
 - To make the sandwich cookies, you need three different types of sugar cookies and icing.
 - For the hot chocolate, you need three different samples of cocoa and marshmallows.
 - For the portraits, gather three different types of markers and drawing paper.
 - To make the smoothies, gather three different brand names of orange juice and bananas.

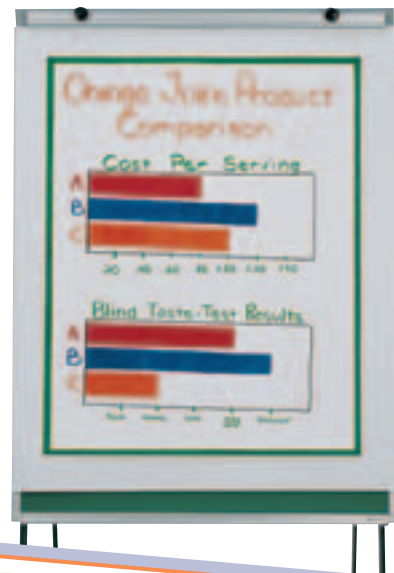




STEP C Creating an Economic Model

Use the results of your tests to draw a graph (bar, circle, or line) visually showing which item came out ahead of the others. Draw your graph(s) on poster board to use in a presentation to the rest of the class.

4. Now you'll devise a product-comparison test to use on the three versions of each item. Scan copies of *Consumer Reports* tests to get an idea of what categories to use in your tests—cost per unit, durability, flavor, aftertaste, ease of use, reliability, overall score, and so on.
5. Within your group, perform the product-comparison tests. You may want to include the rest of the class in a blind test to get a larger response.



STEP D Lab Report Analysis

Study the graph that you created in step C, then answer the questions below.

1. How wide was the price difference among competing brands of resources?
2. What other factors influenced your choice of items to use in your product?
3. Were you surprised by the results of your tests? Explain.