

Presentation Pro

Economics: Principles in Action

CHAPTER 2 *Economic Systems*

Economic Systems

SECTION 1 Answering the Three Economic Questions

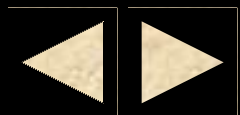
SECTION 2 The Free Market

SECTION 3 Centrally Planned Economies

SECTION 4 Modern Economies

Answering the Three Economic Questions

- What key economic questions must every society answer?
- What basic economic goals do societies have?
- What types of economic systems exist today?



The Three Economic Questions

Every society must answer three questions:

- What goods and services should be produced?
- How should these goods and services be produced?
- Who consumes these goods and services?

Economic Goals

Societies answer the three economic questions based on their values.

Economic Goals	
Economic efficiency	Making the most of resources
Economic freedom	Freedom from government intervention in the production and distribution of goods and services
Economic security and predictability	Assurance that goods and services will be available, payments will be made on time, and a safety net will protect individuals in times of economic disaster
Economic equity	Fair distribution of wealth
Economic growth and innovation	Innovation leads to economic growth, and economic growth leads to a higher standard of living.
Other goals	Societies pursue additional goals, such as environmental protection.

Four Economic Systems

An **economic system** is the method used by a society to produce and distribute goods and services.

Traditional economies rely on habit, custom, or ritual to decide what to produce, how to produce it, and to whom to distribute it.

In a **market economy** economic decisions are made by individuals and are based on exchange, or trade.

In a **centrally planned economy** the central government makes all decisions about the production and consumption of goods and services.

Mixed economies are systems that combine tradition and the free market with limited government intervention.

Since all resources of goods and services are limited, all societies must make choices?



A. Yes

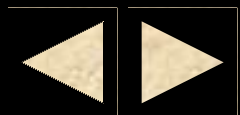
B. No

Section 1 Review

1. Each society determines who will consume what is produced based on
 - (a) its unique combination of social values and goals.
 - (b) the amount of factor payments.
 - (c) its needs and wants.
 - (d) economic equity.

2. To improve its standard of living, a nation's economy must
 - (a) remain stable.
 - (b) grow through innovation.
 - (c) reach economic equity.
 - (d) allow the central government to make economic decisions.

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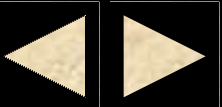
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Chapter 2, Section 1

The Free Market

- How do free markets operate?
- How can markets regulate themselves?
- What are the advantages of a free market economy?



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Chapter 2, Section 2

Why Do Markets Exist?

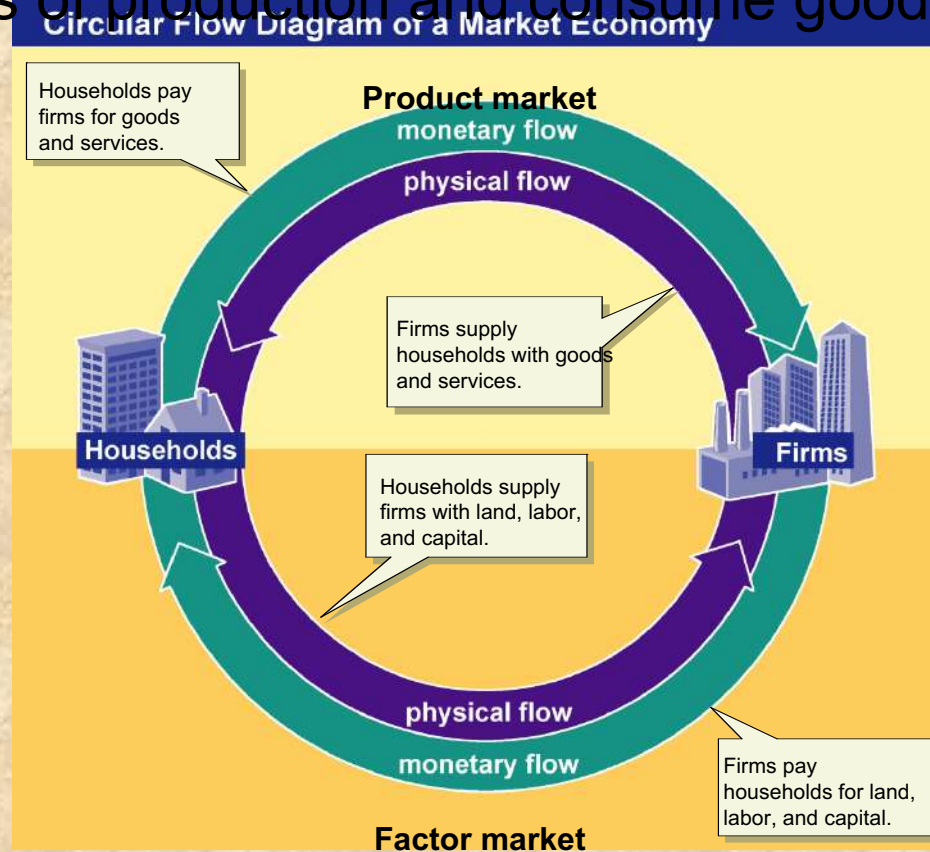
Markets exist because none of us produces all the goods and services we require to satisfy our needs and wants.

A **market** is an arrangement that allows buyers and sellers to exchange goods and services.

Specialization is the concentration of the productive efforts of individuals and firms on a limited number of activities.

The Free Market Economy

In a free market economy, households and business firms use markets to exchange money and products. Households own the factors of production and consume goods and services.



The Market's Self-Regulating Nature

- In every transaction, the buyer and seller consider only their **self-interest**, or their own personal gain. Self-interest is the motivating force in the free market.
- Producers in a free market struggle for the dollars of consumers. This is known as **competition**, and is the regulating force of the free market.
- <http://www.youtube.com/watch?v=ulyVXa-u4wE> [Milton](#)
- The interaction of buyers and sellers, motivated by self-interest and regulated by competition, all happens without a central plan. This phenomenon is called “the **invisible hand** of the marketplace.” -Adam Smith-

Advantages of the Free Market

Economic Efficiency

As a self-regulating system, a free market economy is efficient.
The market responds to rapidly changing conditions on its own.

Economic Freedom

Free market economies have the highest degree of economic freedom of any economic system.
Consumers and producers answer the 3 economic questions.

Economic Growth

Because competition encourages innovation, free markets encourage growth.
Entrepreneurs are always seeking profit.

Additional Goals

Free markets offer a wider variety of goods and services than any other economic system.
Producers have incentive to meet consumers desires = consumer sovereignty/choice

- In general, in the free market, on its own, meets many economic goals without the aid of government planners.

Why do people need to buy and sell goods/services?



(a) People need to buy and sell goods to make a profit.



(b) People buy and sell to maintain a competitive society.



(c) No one is self-sufficient.



(d) People need to provide the market with goods and services.

•[Default]

•[MC Any]

•[MC All]

Competition is producers in a free market struggle for the dollars of consumers



X A. True

B. False

What is the regulating force of the free market.

- X** A. Consumer Products
- X** B. Profits
- ✓ C. Competition
- X** D. Consumer Interest

- [Default]
- [MC Any]
- [MC All]

Competition leads to

- ✓
✗ A. Lower prices and more choices
- ✗ B. Lower prices and less choices
- ✗ C. Lower quality goods and more choices
- D. Lower quality goods and less choices

- [Default]
- [MC Any]
- [MC All]

When goods and services are produced and sold efficiently without any central plan or direction, this is called the invisible hand of the marketplace.



A. True

B. False

What factors create the phenomenon of the “invisible hand”?



(a) specialization and efficiency

(b) competition between firms



(c) competition and self-interest

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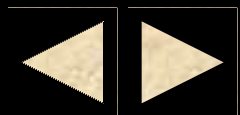
•[MC All]

Section 2 Review

1. Why do people need to buy and sell goods or services?
 - (a) People need to buy and sell goods to make a profit.
 - (b) People buy and sell to maintain a competitive society.
 - (c) No one is self-sufficient.
 - (d) People need to provide the market with goods and services.

2. What factors create the phenomenon of the “invisible hand”?
 - (a) incentives and efficiency
 - (b) specialization and efficiency
 - (c) competition between firms
 - (d) competition and self-interest

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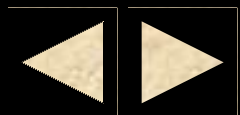
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Centrally Planned Economies

- How are centrally planned economies organized?
- How did the centrally planned economy of the former Soviet Union function?
- What problems exist within centrally planned economies?



Organization of Centrally Planned Economies

In a **centrally planned economy**, the government owns both land and capital. The government decides what to produce, how much to produce, and how much to charge.

Socialism is a social and political philosophy based on the belief that democratic means should be used to distribute wealth evenly throughout a society.

Communism is a political system characterized by a centrally planned economy with all economic and political power resting in the hands of the government.

The Former Soviet Union

Soviet Agriculture

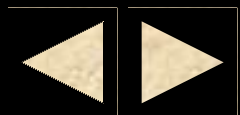
In the Soviet Union, the government created large state-owned farms and collectives for most of the country's agricultural production.

Soviet Industry

Soviet planners favored **heavy-industry** production (such as steel and machinery), over the production of consumer goods.

Soviet Consumers

Consumer goods in the Soviet Union were scarce and usually of poor quality.



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Problems of a Centrally Planned Economy



Centrally planned economies face problems of poor-quality goods, shortages, and diminishing production.

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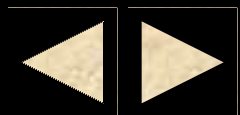
Chapter 2, Section 3

Section 3 Review

1. In a socialist country,
 - (a) central planning is unnecessary.
 - (b) the government often owns major industries, such as utilities.
 - (c) an authoritarian government controls the economy.
 - (d) economic equality is not important.

2. Which of the following is an advantage of a centrally planned economy?
 - (a) The system's bureaucracies are small and flexible.
 - (b) The system can work quickly to accomplish specific goals.
 - (c) Innovation is well rewarded.
 - (d) Consumers' needs are well met.

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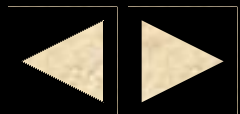
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Modern Economies

- Why are many modern economies mixed economies?
- What role does the government play in a mixed economy?
- How do mixed economies in different countries compare?
- What role does free enterprise play in the United States economy?



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The Rise of Mixed Economies

Market economies, with all their advantages, have certain drawbacks.

Limits of Laissez Faire

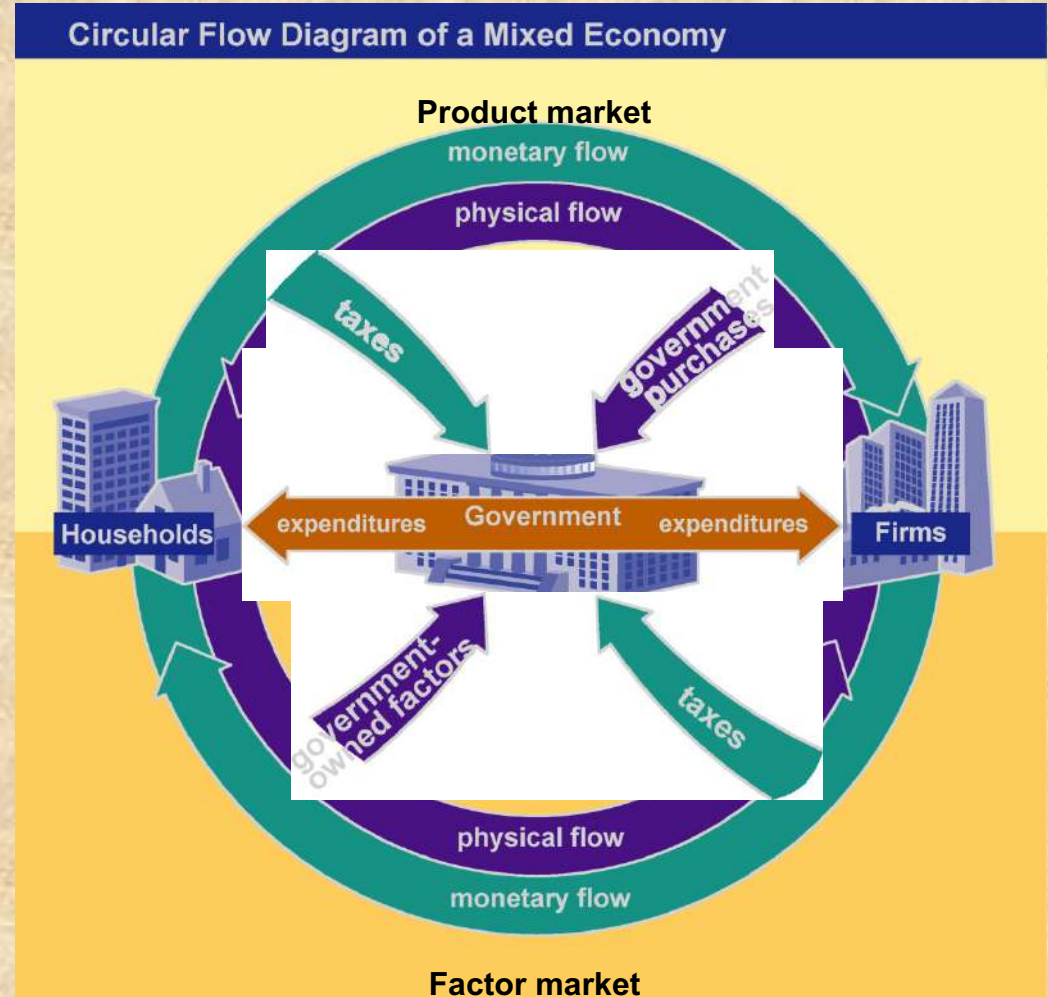
Laissez faire is the doctrine that government generally should not interfere in the marketplace.

Governments create laws protecting property rights and enforcing contracts. They also encourage innovation through patent laws.

Government's Role in a Mixed Economy

In a mixed economy,

- the government purchases goods and services in the product market, and
- purchases land, labor, and capital from households in the factor market.



Comparing Mixed Economies

An economic system that permits the conduct of business with minimal government intervention is called **free enterprise**. The degree of government involvement in the economy varies among nations.

Continuum of Mixed Economies

Centrally planned

Free market

Iran

South Africa

France

United Kingdom

Hong Kong

North Korea

China

Botswana

Canada

Singapore

Cuba

Russia

Greece

Peru

United States

Source: 1999 *Index of Economic Freedom*, Bryan T. Johnson, Kim R. Holmes, and Melanie Kirkpatrick

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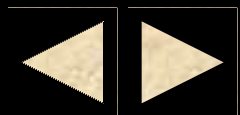
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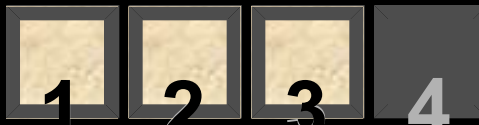
Section 4 Review

1. The United States economy is a mixed economy
 - (a) based on the principle of a traditional economy, but allows some government intervention.
 - (b) based on the principles of a centrally planned economy, with limited government intervention.
 - (c) based on the principles of the free market, and allows no government intervention.
 - (d) based on the principles of the free market, but allows some government intervention.
2. Government intervention in a modern economy is useful because
 - (a) the needs and wants of modern society are always met by the marketplace.
 - (b) the marketplace has many incentives to create public goods such as parks and libraries.
 - (c) governments are able to provide some goods and services that the marketplace has no incentive to produce.
 - (d) the marketplace provides all of its own laws.

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