

ECON: Chapter 2.2

The Free Market

Market (DEF = an arrangement that allows buyers and sellers to exchange things.)

I. Why Markets Exist (because no one is self-sufficient)

A. Specialization

1. Each of us produces one or a few products

Example: A nurse specializes in caring for the sick. A baker specializes in making bread, cakes, and cookies.

2. Specialization: (DEF = the concentration of the productive efforts of individuals and firms on a limited number of activities.)

- a. Leads to an efficient use of resources (land, labor, and capital)

3. Buying and Selling

- a. Because each of us specializes in one or a few things, we need markets to sell what we have and buy what we need.

- b. Most people earn an income and use that income (\$) to buy what they want.

II. Free Market Economy

DEF = economic system based on voluntary exchanges in markets

- -individuals and private owned businesses own the factors of production (i.e. individuals answer the 3 economic questions)
- -FIG. 2.3 (show) = how individuals and businesses exchange money, resources, and products in the marketplace

A. Households and Firms

1. The players in the free market economy

2. Household = person or group of people living in the same residence

- a. Own the factors of production- land, labor, and capital.

- b. Also the consumers of goods and services.

3. Firm = an organization that uses resources to produce a product, which it then sells.

- a. Firms transform “inputs” (factors of production) into “outputs” (products)

B. Factor Market = arena of exchange

1. **Profit** = financial gain made in a transaction.

2. **Idea:** companies (businesses, firms) purchase or rent land, hire workers, pay wages, borrow money, pay back with interest or profit.

C. Product Market = the goods and services that firms produce are purchased by households in the “product market”.

III. The Self-regulating Nature of the Marketplace

- Adam Smith: “It is the competition and our own self-interest that keep the marketplace functioning.”

A. **Self-interest** = personal gain, motivating force in the free market.

B. **Competition** = the struggle among producers for the dollars of consumers.

IV. Advantages of the Free Market

1. Economic efficiency
2. Economic freedom
3. Economic growth
4. Wider variety of goods and services