Economic systems and the American economy

- This chapter discusses;
- how economic systems answer basic questions about production and distribution of goods and services
- How economic systems differ

What constitutes the major characteristics of the U.S. market economy?
Chapter 2 standards

• E.1.7 Describe and compare the various economic systems (traditional, market, command, mixed); explain their strengths and weaknesses.

• E.1.8 Describe how clearly defined and enforced property rights are essential to a market economy.

• E.1.9 Diagram and explain the circular flow model of a market economy.
Economic systems

A. ) Three Basic questions

1. ) Although countries have three different economic systems, each system is faced answering the same 3 basic questions

What should be produced?

How should it be produced?

For whom should it be produced?
Model of an Economic System

- Consumer demand
- Resources

Society must make choices:
- What to produce?
- How to produce?
- For whom to produce?
- Choices must make the best use of resources
a.) What should be produced?

• 1.) Society can’t have everything the people want, so it must decide what to produce.
  – a.) ex = auto makers must decide whether to produce cars, trucks, minivans, etc & how many
  – b.) ex = military spending vs. civilian goods
The example below shows how the Consumer Goods Industry breaks down into Supersectors, Sectors and Subsectors:
b. How should it be produced?

• 1.) Should a factory use assembly-line methods that require little labor or should they use less equipment and hire more workers?

• 2.) A decision must be made as to how the combination of available inputs will get the job done for the least cost.
...so we asked ourselves, where can we find cheap overseas labor that will actually improve our corporate image?...
c. For whom should it be produced?

- 1.) After goods and services are produced, the type of economic system under which the people live determines how the goods and services will be distributed among the people.
  
  - a.) ex = through a price system, majority rule, a lottery or on a 1\textsuperscript{st} come 1\textsuperscript{st} served basis, by sharing equally, by military rule, etc.

\textbf{The 3 choices; What, How & For whom are not easy for any society to make}
Written response

• If you were the leader of a country, how would you decide who gets what & how much they get?
Which is not a basic question of economic markets?

A. How should it be produced
B. What should be produced
C. How much should be produced
D. For whom should it be produced

[Default]
[MC Any]
[MC All]
B. Types of economic systems

- Economists have identified 4 types of economic systems but no “pure” systems exist – they are all mixed economies to some degree
- Traditional
- Command (controlled)
- Market (capitalist)
- Mixed
1. Traditional system

a.) based on customs and beliefs passed down for generations

b.) things are done “the way they have always been done”

c.) people’s roles are defined – they know what goods and services will be produced, how to produce them, and how they will be distributed
d.) Advantages
   1.) You know what is expected of you
   2.) Family & community ties are usually very strong

e.) Disadvantages
   1.) Change is discouraged and maybe even punished
   2.) Methods of production are usually inefficient, so choices among consumer goods are rare
   3.) The economy tends to be stagnant and this leads to a lower standard of living

f.) Very few traditional economies exist today – Inuit (eskimos) the Kalahari area in Africa and the Aborigines of Australia
<table>
<thead>
<tr>
<th>Traditional economy</th>
<th>Knowledge-based economy</th>
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<tbody>
<tr>
<td>Manufacture</td>
<td>Service</td>
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<tr>
<td>Labor</td>
<td>Brainpower</td>
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<td>Hardware</td>
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<td>Tangible</td>
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<tr>
<td>Efficiency</td>
<td>Innovation</td>
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<tr>
<td>Management</td>
<td>Leadership</td>
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2. Command (controlled) system

a.) Government leaders control the factors of production and make most of the what, how, and for whom decisions

b.) Economic decisions are made at the top (by the leaders) and people are expected to go along with their decisions

c.) Advantages

1.) The speed with which resources can be rerouted – if war is expected the gov’t can stop the production of civilian goods and put all their efforts and resources into making only military goods
d.) Disadvantages:
1.) Doesn’t always meet consumer needs and wants (black market may develop)
2.) Requires a large bureaucracy – this slows down decision making, especially day-to-day decisions regarding problems
3.) Lack of incentives that encourage people to work hard – the gov’t sets salaries, so there’s no need to work efficiently or smartly
4.) Doesn’t encourage new ideas – little opportunity for individuality or for getting ahead
5.) Lack of consumer choices
6.) North Korea and Cuba are the 2 main countries that practice a gov’t controlled economy
Command economy

- **WHAT TO PRODUCE**: Determined by government preferences
- **HOW TO PRODUCE**: Determined by government and their employees
- **FOR WHOM TO PRODUCE**: Determined by government preferences
Command Economy

What is it? - System in which is controlled by the government and industries are publicly owned.

The government has complete control.

The Soviet Union is an example of command economy because there goods and supplies were run by the government. The people didn't have much control over anything.

Other countries that have Command economy: Cuba, North Korea,
3.) Market (capitalist) system

a.) Question of what, how, for whom to produce are made by businesses and individuals looking out for their best interest.

b.) **Market** – any arrangement that allows buyers and sellers to come together to do business.
   1.) ex= flea market, yard sale, farmer’s stand, ad in newspaper, internet

c.) Market allows buyers and sellers to exchange goods not necessarily at an even rate, but one agreed to by both parties
Circular flow of economic activity – illustrates how the market system works
e.) Advantages-

People have the freedom to:

1. Choose a career
2. Spend or not spend their money as they wish
3. Own private property
4. Take risks and earn profits
5. Competition creates a variety of goods and services to choose from
6. Creates an efficient system to help determine what things cost
f. Disadvantages:

1.) Concern about those too young, too old, or too sick to work

2.) Many people may suffer unless others (gov’t, churches, family members or other organizations) step in to help out

The Characteristics of a Free Market

- Free to Set Prices
- Free, Cooperative, and Peaceful Process
- Free to Choose Your Work
- Free to Be an Investor
- Free to Be an Entrepreneur
- Free to Buy, Own, Use, and Sell Private Property
- Free to Compete
- Free to Earn Profits
- Free to Create Capital Formation
4. Mixed system

a.) It is a combination of market and command economies – private ownership of property and individual decision making are combined with government intervention and regulations.

b.) Most countries of the world have a mixed system.
Which economic system most closely resembles what we use in the United States?

- A. Command
- B. Market  ✔
- C. Traditional  ✗
Which country uses a command economy?

A. Japan
B. India
C. North Korea
D. South Korea
Characteristics of the American Economy

• A pure market economy has 6 major characteristics that are interrelated and all are present in the American economy to some degree.

1. Limited role of government
2. Freedom of enterprise
3. Freedom of choice
4. Profit incentive
5. Private property
6. Competition
1.) Limited role of government

a.) In 1776, economist Adam Smith wrote the book “An inquiry into the nature and causes of the wealth of nations” that described a system in which government has little to do with a nation’s economic activity. He said that people left on their own would work for their own best interest – being guided by an “invisible hand” – to use resources efficiently and thus achieve the maximum good for society.

b.) Smith described an economic system called capitalism.

c.) Pure capitalism can be called a laissez faire system (it means “let people do as they choose, hands off from the government” people and businesses make decisions without gov’t restraint
There, there it is...
---the invisible hand of the marketplace
giving us the finger.
d.) Smith’s ideas greatly influenced the U.S.’s basic economic system

e.) Capitalism, as practiced in the U.S. today, is an economic system in which private individuals own the factors of production but decide how to use them within legislated limits
WE BELIEVE IN LIMITED GOVERNMENT...

...THAT IS WHY WE ONLY REPRESENT...

...1% OF THE POPULATION!
The invisible hand refers to

- A. Government
- B. Markets
- C. Ghosts
- D. Adam Smith

B. Markets
Laissez faire means that government should be involved in the economy

A. True
B. False
f.) Since the 1880’s the role of gov’t – federal, state, and local has increased greatly
1. ex = the federal government:
   a.) regulates food & drugs
   b.) regulates our banking system (not very well)
   c.) inspects our workplaces for hazardous conditions
   d.) protects the environment
   e.) Use tax monies to provide social programs like social security and Medicare
   f.) State and local gov’ts play a role in such areas as education, job training, care for the elderly etc.
2. Freedom of enterprise

a.) Capitalism is a free enterprise system – individuals can own and control the factors of production

b.) Anyone can start their own business and you may become rich or you may lose your money. There is no guarantee for success.

c.) Govt’s place some restrictions on businesses to protect the individual – such as zoning regulations, child-labor laws, hazardous waste disposal laws, minimum wages, etc.
3. Freedom of Choice

a.) Consumers can buy what they want and this creates demand which will determine what is produced.

b.) Gov’t does set safety standards to protect consumers – such as safety standards for toys, electric appliances, cars etc

c.) Government regulates prices in some industries where just a few companies dominate – like electricity and natural gas – the gov’t regulates the prices they can charge
MONSTROMART
WHERE SHOPPING IS A BAFFLING ORDEAL
4. Profit Incentive

a.) People produce goods to make a profit – money left after costs of production are paid

b.) The desire to make money is called profit incentive

c.) There is also a risk of losing money

d.) The interaction of both profits and losses leads to an economy that is more efficient, adaptable to change and continuously growing
5. Private property

a.) Property held by individuals or groups rather than the fed, state or local govt’s

b.) Individuals control how, when and by whom their property is used

c.) Private property is protected by the U.S. Constitution
6. Competition

a. Different people can produce similar products and services

b. Competing businesses try to “win” costumers with lower prices or better quality goods and services

c. Businesses must use resources efficiently to stay competitive

d. In the U.S. most industries allow anyone to start a new business:
   1) Ex = Some industries are extremely difficult to enter into and others require a license from the state government (medicine, law, education)
Which is not a characteristic of the American economy?

A. Competition

B. Freedom of choice

C. Private property

D. Equality of outcome
Written response

• Which characteristic is the most important in your opinion?
The goals of the nation

The American economy strives to “promote the general welfare”

A. Goals of Free enterprise

1. Economic freedom
   a. to allow individuals to make choices
      1. Ex = Start own business, own private property, work night or work part-time or several jobs, and to move from place to place in search of a job
2. Economic efficiency
   a.) to use limited resources wisely
   b.) because of scarcity, wasted resources means fewer goods and services are produced and fewer wants and needs are satisfied

3. Economic equity
   a.) to exhibit fairness – protected by laws
   1.) ex = equal pay for equal work – no discrimination because of race, sex, religion or disability
   2.) ex = no false advertising, unfair prices, or dangerous products
THE DISTRIBUTION OF WEALTH IN THE UNITED STATES

1% → 4% → 15% → 80% → 7%

43% → 29% → 21%

Chart: Michael DeGusta, TheUnderstatement.com - March 2011
4.) Economic security
   a.) to provide protection for risks we can’t control
      1) ex = accidents on the job, natural disasters, business and bank failures, poverty in old age, etc
   b.) there are a number of gov’t programs to help out – social security, insurance plans, etc

5.) Economic stability
   a.) to reach a stable economy – so there aren’t extreme ups and downs in our standard of living
6.) Economic growth
   a.) to grow and expand the economy - it’s necessary to keep the American way of life
   b.) It’s necessary to meet everyone’s future needs

7.) Trade-offs among goals
   a.) Satisfaction for everyone is impossible - people have different ideas about how to reach a goal
   b.) Understanding scarcity will help us realize that not all political desire can be turned into economic reality
THE BIRTH OF FREE MARKET ECONOMICS

I wish I had a rock.

I wish I had a stick.
B.) Rights & responsibilities

1.) People have the right to do what they want within the law

2.) People have to behave responsibly in order for the system to work:
   ex= people should use their education in a reasonable manner that helps them become a productive member of society.

3.) People are responsible for understanding how gov’t policies affect the economy and to elect responsible gov’t officials
Written response

• What, if any, role should the federal government play in bringing about economic equality? Would it work?