

CHAPTER

2

Economic Systems and Decision Making

Economics & You



In Chapter 2, you will learn how economic systems differ and what makes up the major characteristics of the United States market system. To learn more about how economic systems operate, view the Chapter 3 video lesson:

Economic Systems and the American Economy

A wide range of choices is characteristic of a market economy.

ECONOMICS
Online



Chapter Overview Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on **Chapter 2—Chapter Overviews** to preview chapter information.

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CONTENTS

Economic Systems

Study Guide

Main Idea

An economic system is a set of rules that governs what goods and services to produce, how to produce them, and for whom they are produced.

Reading Strategy

Graphic Organizer As you read the section, complete a graphic organizer like the one below to identify ways in which a market economy differs from, and is similar to, a command economy.



Key Terms

economy, economic system, traditional economy, command economy, market economy

Objectives

After studying this section, you will be able to:

1. **Describe** the characteristics of the traditional, command, and market economies.
2. **Explain** the advantages and disadvantages of the traditional, command, and market economies.

Applying Economic Concepts

Tradition Tradition plays a stabilizing role in our lives. Even the U.S. economy, characterized by freedom and competition, has some elements of tradition.

Cover Story



Bombay, India

McDonald's in India


The Golden Arches finally have arrived in India, but if you get a Big Mac Attack, you're still out of luck. . . . In coming to this predominately Hindu nation, where cows are sacred and most people don't eat beef, McDonald's Corp. ditched the Big Mac for an Indian stand-in, the Maharaja Mac. That's two all-mutton patties, special sauce, lettuce, cheese, pickles and onions, all on a sesame-seed bun.

—The Wall Street Journal, October 14, 1996

The survival of any society depends on its ability to provide food, clothing, and shelter for its people. Because these societies face scarcity, decisions concerning WHAT, HOW, and FOR WHOM to produce must be made.

All societies have something else in common. They have an **economy**, or **economic system**—an organized way of providing for the wants and needs of their people. The way in which these provisions are made determines the type of economic system they have. Three major kinds of economic systems exist—traditional, command, and market. Most countries in the world can be identified with one of these systems.

Traditional Economies

 Many of our actions spring from habit and custom. Why, for example, do so many Americans eat turkey on Thanksgiving? Why does the bride toss the bouquet at a wedding? Why do most people shake hands when they meet, or leave tips in restaurants? These practices have generally been handed down from one generation to the next and have become tradition—they are a part of American culture.

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Student Web Activity Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on **Chapter 2—Student Web Activities** for an activity on the role of tradition in Inuit society.

In a society with a **traditional economy**, the allocation of scarce resources, and nearly all other economic activity, stems from ritual, habit, or custom. Habit and custom also dictate most social behavior. Individuals are not free to make decisions based on what they want or would like to have. Instead, their roles are defined by the customs of their elders and ancestors.

Examples

Many societies—such as the central African Mbuti, the Australian Aborigines, and other indigenous peoples around the world—are examples of traditional economies. The Inuits of northern Canada in the 1800s provide an especially interesting case of a traditional economy.

For generations, Inuit parents taught their children how to survive in a harsh climate, make tools, fish, and hunt. Their children, in turn,

taught these skills to the next generation. The Inuit hunted, and it was traditional to share the spoils of the hunt with other families. If a walrus or bear was taken, hunters divided the kill evenly into as many portions as there were heads of families in the hunting party. The hunter most responsible for the kill had first choice, the second hunter to help with the kill chose next, and so on.

Later, members of the hunting party shared their portions with other families, because the Inuit shared freely and generously with one another. The hunter had the honor of the kill and the respect of the village, rather than a physical claim to the entire kill. Because of this tradition of sharing, and as long as skilled hunters lived in the community, a village could survive the long harsh winters. This custom was partially responsible for the Inuit's survival for thousands of years.

Traditional Economy



Way of Life This woman uses the methods for weaving passed on by her ancestors. **What drives economic activity in a traditional economy?**

Advantages

The main strength of a traditional economy is that everyone knows which role to play. Little uncertainty exists over **WHAT** to produce. If you are born into a family of hunters, you hunt. If you are born into a family of farmers, you farm. Likewise, little uncertainty exists over **HOW** to produce, because you do everything the same way your parents did.

Finally, the **FOR WHOM** question is determined by the customs and traditions of the society. Tradition dictates how people live their lives.

Disadvantages

The main drawback of the traditional economy is that it tends to discourage new ideas and new ways of doing things. The strict roles in a traditional society have the effect of punishing people



THE GLOBAL ECONOMY

TEACHING CAPITALISM IN RUSSIA

In Nadeshda Shilyayeva's first-grade class, the words of the day are "profit" and "inventory." As the kindly teacher bounces her pointer along the curly blackboard script, her 26 students at School 139 sing the syllables in unison.

"Now what do we call the money left over in Misha's wallet after all his expenses are paid?" asked Miss Shilyayeva. "Profit!" shouted a pig-tailed 7-year-old girl named Dasha. The teacher continued, "And why does Misha need this profit?"

Silence. Then a small voice ventured, "So he can"—a pause—"expand his store?"

"Excellent, Andrushka!" boomed the teacher's voice.

Ten years ago, this kind of aggressive attempt to plant a seed of capitalism in her young students would have landed Miss Shilyayeva in the *gulag* [Soviet labor camp]. Today she is among a growing number of elementary school teachers in Russia who have seen the future and know that in order to survive, her students will need to be able to compute interest rates.

"If we don't teach children about the market economy from an early age," said Miss Shilyayeva, 57, "they will end up like us. The older generation knew nothing about economics. We never gave it a thought. As a result, we are like blind kittens, bumping into walls, looking for a way out."

—*The New York Times*, Feb. 9, 1997

Critical Thinking

1. **Analyzing Information** What topics are the first graders studying?
2. **Finding the Main Idea** Why does the teacher believe it is important for her students to learn about the market economy?

who act differently or break rules. The lack of progress leads to a lower standard of living than in other types of economic societies.

Command Economies



Other societies have a **command economy**, one in which a central authority makes most of the WHAT, HOW, and FOR WHOM decisions. Economic decisions are made by the government: the people have little, if any, influence over how the basic economic questions are answered.

Examples

There are few command economies in the world today, but they still can be found in North Korea and Cuba. Until recently, the People's Republic of China, the communist bloc countries of Eastern Europe, and the former Soviet Union also had command economies.

In the former Soviet Union, for example, the government made the major economic decisions. The State Planning Commission directed nearly every

aspect of the Soviet economy. It determined needs, decided goals, and set production quotas for major industries. If the State Planning Commission wanted growth in heavy manufacturing, it shifted resources from consumer goods to that sector. If it wanted to strengthen national defense, it directed resources to the production of military equipment and supplies.

Advantages

The main strength of a command system is that it can change direction drastically in a relatively short time. The former Soviet Union went from a rural (or primitive) agricultural society to a leading industrial nation in just a few decades. It did so by emphasizing heavy industry and industrial growth rather than the production of consumer goods.

During this period, the central planning agency shifted resources around on a massive scale. Consumer goods were virtually ignored, and when the country faced a shortage of male workers on construction projects, the government put women to work with picks and shovels.

Another advantage of command economies, especially those represented by the former Soviet Union and modern-day Cuba, is that many health and public services are available to everyone at little or no cost, regardless of income. While the quality of these services varies widely, it can be argued that access to some services is better than none.

Disadvantages

One disadvantage of a command system is that it is not designed to meet the wants of consumers, even though many basic needs are provided. In the case of Soviet industrial development, generations were forced to do without such consumer goods as cars, home appliances, and adequate housing. People often were told to sacrifice for the good of the state and the benefit of future generations.

A second disadvantage is that the system does not give people the incentive to work hard. In most command economies, workers with different skills and responsibilities receive similar wages. In addition, people seldom lose their jobs, regardless of the quality of their work. As a result, many people work just hard enough to fill the production quotas set by planners.

This can have unexpected results. At one time in the former Soviet Union, central planners set production quotas for electrical motors to be measured in tons of output per year. Workers soon discovered that the easiest way to fill the quota was to add weight to the motors. As a result, Soviet workers made some of the heaviest electrical motors in the world. They also produced some of the heaviest chandeliers in the world for the same reason. Some were so heavy that they fell from ceilings.


A third weakness is that the command economy requires a large decision-making bureaucracy. Many clerks, planners, and other administrators are needed to operate the system. Most decisions cannot be made until after consulting a number of people and processing a large amount of paperwork. These procedures slow decision making and raise the costs of production.

Yet a fourth weakness of a command economy is that it does not have the flexibility to deal with minor, day-to-day problems. Even when some change is needed, the sheer size of the bureaucracy

discourages even the smallest adjustments. As a result, command economies tend to lurch from one crisis to the next—or collapse completely as in the case of the former Soviet Union.

Finally, people with new or unique ideas find it difficult to get ahead in a command economy. Rewards for individual initiative are rare. Each person is expected to perform a job in a factory, in the bureaucracy, or on a farm, according to the economic decisions made by central planners.

Market Economies

 In a **market economy**, people and firms act in their own best interests to answer the WHAT, HOW, and FOR WHOM questions. In economic terms, a market is an arrangement that allows buyers and sellers to come together in order to exchange goods and services. A market might be in a specific location, such as a farmers' market or a flea market. A list of phone numbers for lawn-mowing services posted on a local bulletin board also acts as a market. As long as a mechanism exists for buyers and sellers to get together, a market can exist.

In a market economy, people's decisions act as votes. When consumers buy a particular product, they are casting their dollar "votes" for that product. After the "votes" are counted, producers know what people want. Because producers are always looking for goods and services that consumers will buy, the consumer plays a key role in determining WHAT to produce.

Examples

Many of the largest and most prosperous economies in the world, such as the United States, Canada, Japan, South Korea, Singapore, Germany, France, Great Britain, and other parts of Western Europe, are based on the concept of a market economy. While there are also many significant differences among these countries, the common thread of the market binds them together.

Advantages

One advantage of a market economy is that, over time, it can adjust to change. During the gasoline shortage of the 1970s, for example, consumers

reduced their demand for large, gas-guzzling automobiles and increased their demand for smaller, fuel-efficient ones. Because auto makers still wanted to sell cars, they moved resources from the production of large cars to small ones.

When gas prices finally declined in the mid-1980s, the trend slowly began to reverse. Consumers wanted to buy large cars again, so auto makers began making large, although more fuel-efficient, vehicles again. Changes in a market economy, then, tend to be gradual. Unlike the traditional economy, change is neither prohibited nor discouraged. Unlike the command economy, change is neither delayed because of bureaucracy, nor suddenly forced on people by others.

A second major strength of the market economy is its high degree of individual freedom. Producers may make whatever they think will sell. They also decide the HOW question by producing their products in the most efficient manner. Consumers,

on the other hand, spend their money on the goods and services they prefer. Meanwhile, individuals are free to choose where and when they want to work, and if they should invest further in their own education and training.

A third strength is the relatively small degree of government interference. Except for certain important concerns, such as national defense and environmental protection, the government tries to stay out of the way so that buyers and sellers can go about their business. As long as competition exists, the market economy tends to take care of itself.

A fourth advantage is that decision making is decentralized, or not concentrated in the hands of a few. Literally billions—if not trillions—of individual economic decisions are made daily. Collectively, these decisions direct scarce resources into uses that consumers favor. Because individuals make these decisions, everyone has a voice in the way the economy runs.

Command Economy



Economic Choices Consumers line up to buy scarce goods at a marketplace in the western Ukraine. In a command economy, like the former Soviet Union, many products are unavailable or in short supply, while other overproduced goods sit in warehouses. *Who is responsible for making the basic economic decisions in a command economy?*

A fifth strength of the market economy is the incredible variety of goods and services available to consumers. Almost any product can and will be produced if a buyer for it exists. Recent products include everything from Internet bookstores to 24-hour cable television cartoon and comedy networks to ultrasound devices that keep the neighbor's dog out of your yard. In short, if a product can be imagined, it can be produced in hopes that people are willing to buy it.

A sixth strength is the high degree of consumer satisfaction. In a market economy, almost everyone can satisfy his or her wants because the choice one group makes does not mean that another group cannot have what it wants. To illustrate, if 51 percent of the people want blue shirts, and 49 percent want white ones, people in both groups can still get what they want. Unlike an election, the minority does not have to live with choices the majority makes.

ECONOMICS AT A GLANCE

Figure 2.1

Comparing Economic Systems

	Traditional	Command	Market
Advantages	<ul style="list-style-type: none"> • Sets forth certain economic roles for all members of the community • Stable, predictable, and continuous life 	<ul style="list-style-type: none"> • Capable of dramatic change in a short time • Many basic education, public health, and other public services available at little or no cost 	<ul style="list-style-type: none"> • Able to adjust to change gradually • Individual freedom for everyone • Lack of government interference • Decentralized decision making • Incredible variety of goods and services • High degree of consumer satisfaction
Disadvantages	<ul style="list-style-type: none"> • Discourages new ideas and new ways of doing things • Stagnation and lack of progress • Lower standard of living 	<ul style="list-style-type: none"> • Does not meet wants and needs of consumers • Lacks effective incentives to get people to work • Requires large bureaucracy, which consumes resources • Has little flexibility to deal with small, day-to-day changes • New and different ideas discouraged, no room for individuality 	<ul style="list-style-type: none"> • Rewards only productive resources; does not provide for people too young, too old, or too sick to work • Workers and businesses face uncertainty as a result of competition and change • Does not produce enough public goods such as defense, universal education, or health care • Must guard against market failures

Using Charts Every society has an economic system. The type of system that is best for a society depends on the ability of that system to satisfy people's wants and needs, and to fulfill its economic goals. **What conditions must be met for a market economy to be effective?**

Disadvantages

One of the disadvantages of the market economy is that it does not provide for the basic needs of everyone in the society—some members of the society may be too young, too old, or too sick to care for themselves. These people would have difficulty surviving in a pure market economy without assistance from government or private groups.

Another disadvantage of a market economy is that it does not provide enough of the services that people value highly. For example, private markets cannot adequately supply a system of justice, national defense, universal education, or comprehensive health care. This is because private producers concentrate on providing products they can sell. Therefore, government must provide these services, paid for with tax dollars.

A third disadvantage of a market economy is the relatively high degree of uncertainty that workers and businesses face as the result of change. Workers, for example, worry that their company will move to another city or country in order to lower the cost of production. Employers worry that another company will produce a better and less expensive product, thereby taking their customers.

Finally, market economies can fail if three conditions are not met. First, markets must be reasonably

competitive, allowing producers to compete with one another to offer the best value for the price. Second, resources must be reasonably free to move from one activity to another. Workers, for example, need the freedom to change jobs if they have a better opportunity elsewhere. Producers need the freedom to produce goods and services in the best way they know how. Third, consumers need access to adequate information so that they can weigh the alternatives and make wise choices.

When markets fail, some businesses become too powerful and some individuals receive incomes much larger than that justified by their productivity. Because of this, we often have to rely on government to ensure that sufficient competition, freedom of resource movement, and adequate information exist.

Did you know?

Worth Its Weight Many currencies get their names from words meaning “weight” because merchants in ancient times would weigh coins made from precious metals to assess their value. Among these currencies are the Spanish *peseta*, the Mexican *peso*, and the Italian *lira*.

Section 1 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 33, explain how a market economy determines who will receive the benefits from what is produced and sold.
- 2. Key Terms** Define economy, economic system, traditional economy, command economy, market economy.
- 3. Describe** the characteristics of a traditional economy.
- 4. Identify** the advantages and disadvantages of a command economy.
- 5. Identify** the advantages and disadvantages of a market economy.

Applying Economic Concepts

- 6. Tradition** Give an example of an economic activity from a traditional economy that is seen in today's market economy. Describe how important this activity is for the economy.

Critical Thinking

- 7. Analyzing Information** How are roles defined in a traditional economy?
- 8. Making Comparisons** How are the WHAT, HOW, and FOR WHOM questions answered in the command and market economies?



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CRITICAL THINKING

Skill

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.

Learning the Skill

Follow these steps to make comparisons:

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

Practicing the Skill

Read the passages below, then answer the questions that follow.

Viewpoint A

Russians are readily embracing the middle-class lifestyle of Western democracies. Nothing better symbolizes the changes sweeping this nation than the flea market that has taken over Moscow's Exhibition of Economic Achievements park. Built as a shrine to the Soviet system, it is now the center of free enterprise in the city. Muscovites swarm here to get deals on all sorts of goods. A park pavilion once housed an exhibit celebrating the Soviet space program. It has now become an auto showroom. A few space capsules remain, scattered among the used cars. But the crowds are here to see the new Fords and Jeeps.

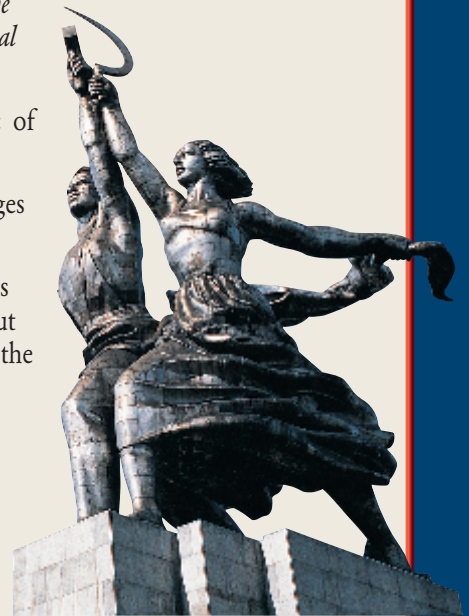
Viewpoint B

Besides the inefficiency of many Russian factories, capitalism there is not yet the same as it is in the United States. Private capital apparently is steered into projects controlled by small groups in power. There is a strong criminal organization in Russia that imposes serious costs on anybody wishing to do business.

"The West supports Russia, despite the corruption there, because of the former Soviet state's economic and military stature on the world stage," said a World Bank spokesperson. "The reason we need to help is that the whole of the former Soviet Union represents not only an economic threat or economic opportunity, but politically it does have a somewhat different weight than some other countries because of its defense and offensive capabilities."

The spokesperson also noted, "I don't doubt that there has been corrupt practice . . . but the overall question of global stability is also an issue."

1. What is the topic of these passages?
2. How are the passages similar? Different?
3. What conclusions can you draw about the opinions of the writers?



Statue of farm workers at the Exhibition of Economic Achievement

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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Evaluating Economic Performance

Study Guide

Main Idea

The social and economic goals of the United States include economic freedom, economic security, and economic equity.

Reading Strategy

Graphic Organizer As you read the section, identify seven major economic and social goals by completing a graphic organizer like the one below.



Key Terms

Social Security, inflation, fixed income

Objectives

After studying this section, you will be able to:

1. **Describe** the basic economic and social goals used to evaluate economic performance.
2. **Evaluate** the trade-offs among economic and social goals.

Applying Economic Concepts

Freedom and Equity Read to find out how freedom and equity are related to the level of satisfaction people have with their economic system.

Cover Story

Minimum Wage Revisited on the Hill

It happens every seven years or so, the last time in 1997. So look for a hike in the minimum wage before too long. Sen. Tom Daschle, D-S.D., the Senate's new majority leader, has already said it's a Democratic priority. He wants to raise the rate \$1.50 over a year and a half, to \$6.65 an hour. He's likely to get it, too, even if now may not be the best time....

Critics say hiking the minimum wage cuts down on the number of new jobs employers can add. It may also force employers to cut back on the hours workers work.




Minimum-wage workers might get a raise.

- *Investor's Business Daily*, June 6, 2001

Every economic system has goals such as financial security and freedom to carry out economic choices. Goals are important because they serve as benchmarks that help us determine if the system meets most—if not all—of our needs. If the system falls short, then we may demand laws to change the system until the needs are met.

Economic and Social Goals

 In the United States, people share many broad social and economic goals. While it might be difficult to find them listed in any one place, they are repeated many times in the statements that friends, relatives, community leaders, and elected officials make. We can categorize those statements into seven major economic and social goals.

Economic Freedom

In the United States, people place a high value on the freedom to make their own economic decisions. People like to choose their

Economic and Social Goals



Economic Equity Our nation values the ideal of equal pay for equal work. **What legislation safeguards economic equity?**

own occupations, employers, and uses for their money. Business owners like the freedom to choose where and how they produce. The belief in economic freedom, like political freedom, is one of the cornerstones of American society.

Economic Efficiency

Most people recognize that resources are scarce and that factors of production must be used wisely. If resources are wasted, fewer goods and services can be produced and fewer wants and needs can be satisfied. Economic decision making must be efficient so that benefits gained are greater than costs incurred.

Economic Equity

Americans have a strong sense of justice, impartiality, and fairness. Many people, for example, believe in equal pay for equal work. As a result, it is illegal to discriminate on the basis of age, sex, race, religion, or disability in employment. When it comes to selling products, most people feel that advertisers should not be allowed to make false claims about their products. Many states even have “lemon laws” that allow new car buyers to return their cars if they have too many repairs.

Economic Security

Americans desire protection from such adverse economic events as layoffs and illnesses. States have set up funds to help workers who lose their jobs. Many employers have insurance plans to cover the injuries and illnesses of their workers. On the national level, Congress has set up **Social Security**—a federal program of disability and retirement benefits that covers most working people.

More than 90 percent of American workers participate in the Social Security system. Retirees, survivors, disabled persons, and medicare recipients are eligible for benefits. Survivors are spouses and children of deceased persons covered by Social Security. Medicare provides health insurance for persons 65 or older.

Full Employment

When people work, they earn income for themselves while they produce goods and services for others. If people do not have jobs, however, they cannot support themselves or their families, nor can they produce output for others. As a result, people want their economic system to provide as many jobs as possible.

STANDARD & POOR'S

INFOBYTE

Economic Indicators Economic indicators are economic statistics reflecting the general direction of the economy. Some indicators are termed *leading* indicators because they tend to lead or forecast the direction of the economy or business cycle; the stock market is known as a leading indicator. Another important indicator is the U.S. Department of Labor's quarterly Employment Cost Index, which measures the rate of change in employee compensation. Like the average hourly earnings data, it allows economists to keep a beat on wage inflation, which is often seen as a catalyst to overall inflation.

Price Stability

Another goal is to have stable prices. If **inflation**—a rise in the general level of prices—occurs, workers need more money to pay for food, clothing, and shelter. People who live on a **fixed income**—an income that does not increase even though prices go up—find that bills are harder to pay and that planning for the future is more difficult. High rates of inflation can discourage business activity. When there is inflation, interest rates tend to increase. High interest rates discourage businesses both from borrowing and spending. Price stability makes budgeting easier and adds a degree of certainty to the future.

Economic Growth

The last major goal of most Americans is economic growth. Most people hope to have a better job, a newer car, better clothes, their own home, and a number of other things in the future. Growth is needed so that people can have more goods and services. Because the nation's population is likely to grow, economic growth is necessary to meet everyone's needs.

Future Goals

These goals are ones on which most people seem to agree. As our society evolves, however, it is entirely possible that new goals will be added. Do people feel that a cleaner environment is important enough to be added to the list of goals? Should we add the preservation of an endangered species, such as the timber wolf and the wild tiger, to the list? In the end, Americans must decide on the goals important to them.

Other countries and their leaders and citizens must also make important choices regarding their goals. For example, an economic goal for many developing nations from the 1950s through the mid-1970s was to increase the goods and services they produced. The idea was that big gains in production would “trickle down” to the poorest people.

By the mid-1990s, many developing nations had achieved regular increases in their production. Living conditions for the poor in most countries, however, did not improve much. Today, basic human needs have become a focus of development policies. These needs include food, shelter, health, protection, and the freedom to make choices about one's life.

Economic and Social Goals

Economic Security One aspect of economic security is protecting people against the economic loss of natural disasters. *What federal program protects economic security for working people?*



CYBERNOMICS SPOTLIGHT

Job Outlook

The freedom to make our own economic decisions—including choosing our occupations and where to work—is a cherished right for many people. Information available on the World Wide Web can provide help with making those decisions. One useful online source is the Occupational Outlook Handbook from the U.S. Bureau of Labor Statistics. It provides job descriptions, earnings, job outlooks, and educational requirements about hundreds of occupations—from “able seamen” to “zoologists.”

Trade-Offs Among Goals



People sometimes have different ideas about how to reach a goal. At other times, the goals themselves might conflict with one another because even economic policies have opportunity costs. For example, a policy that keeps foreign-made shoes out of the United States could help the goal of full employment in the local shoe industry. This policy might work against individual freedom, however, if people ended up with fewer choices of shoes to buy. Or, a new shopping center built near

a highway may stimulate economic growth in one area of a community. At the same time, it could threaten the stability and security of merchants who run stores in the downtown area.

Even an increase in the minimum wage involves a conflict of goals. On one hand, supporters of the increase might argue that an increase is the equitable, or “right,” thing to do. Opponents might argue that increasing the minimum wage would do more harm than good. A higher minimum wage increases costs of production for firms that pay this wage. In addition, it restricts the freedom of employers to pay wages that they think are fair.

So, how are trade-offs among goals resolved? In the case of the minimum wage, people compare their estimates of the costs against their estimates of benefits—and then exercise their right to vote for political candidates that support their position. If the majority of people feel that it is too low, then it will be raised. The minimum wage then tends to stay at a higher level for a while until the majority of people feel that it again needs changed.

For the most part, people, businesses, and government usually are able to resolve conflicts among goals. Fortunately, the economic system of the United States is flexible enough to allow choices, accommodate compromises, and still satisfy the majority of Americans most of the time.

Section 2 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer activity on page 41, explain why it is important to set economic goals.
- 2. Key Terms** Define Social Security, inflation, fixed income.
- 3. Describe** the seven major goals of the United States economy.
- 4. Explain** how an increase in the minimum wage might involve a conflict of goals.
- 5. Describe** some of the economic choices people and producers in the United States are free to make.

Applying Economic Concepts

- 6. Freedom and Equity** How do laws against false advertising promote the goal of economic equity?

Critical Thinking

- 7. Analyzing Information** Why is economic growth an important goal?
- 8. Making Generalizations** What characteristics does the United States economy have that allow it to resolve conflicts among goals?



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BusinessWeek

APRIL 5, 1999

Newsclip

The Internet provides millions with quick access to information. There are trade-offs, however. One is privacy. Powerful database technologies have made it possible to quickly gather personal information on millions of Americans who cruise the Web.

The Internet and the Right of Privacy

Like all new technologies, the Internet is creating undreamed-of conflicts. Case in point: The very nature of the Web makes it easy to collect and collate information about people who shop at or even simply visit a Web site, without their knowledge. Indeed, using such information is an important part of the business model of many Net companies.

But Net companies are discovering that consumers also care about their privacy. Examples of a growing concern are [evident] everywhere. GeoCities had to settle with the Federal Trade Commission when it sold personal data collected from children without parents' consent. Microsoft Corp. was red-faced and apologetic when it was discovered that the Windows 98 operating system could be used to create a giant database of information about Microsoft customers. Perhaps most notable was the response to Intel Corp.'s plans to ship its new Pentium III microprocessor with a component that could transmit a serial

number whenever the user visits a Web site. The idea of consumers unknowingly leaving behind an ID number when on-line set off howls of protest, and Intel promised to ship the Pentium III with the identifier in the "off" position.

What's happening is that people are worried that their essential democratic right to privacy is being surreptitiously eroded. The idea of the Net building "dossiers" without customers' knowledge conjures up images of secret files, police states, and the loss of freedom. That will create a backlash that can only injure Internet commerce. . . .

Equally germane is a truism of the Information Age: Information is a hugely valuable good in its own right. From that perspective, Net companies have been appropriating information that rightfully does not belong to them. It is akin to stealing for Net companies to gather, use, and resell information on consumers without asking permission.

Net companies have to realize that individuals have the right of first refusal on the information of their lives. For companies to use it, they have to say "please" and exchange something for the information. The Net marketplace has made progress in posting privacy policies on Web sites and curbing intrusions. But time is running out for companies to agree on rules of the game to protect privacy before the backlash does permanent damage to the future of E-commerce.

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Examining the Newsclip

- 1. Analyzing Information** What issue is the article addressing?
- 2. Drawing Conclusions** What solution to protecting the right of privacy does the article present? In your opinion is this a good solution, or should others be suggested?



Capitalism and Economic Freedom

Study Guide

Main Idea

Under capitalism, the basic economic decisions are made through the free interaction of individuals looking out for their own best interests.

Reading Strategy

Graphic Organizer As you read the section, complete a graphic organizer like the one below to identify the five characteristics of a free enterprise economy. Then provide an example of each.

Characteristic	Example

Key Terms

capitalism, free enterprise, voluntary exchange, private property rights, profit, profit motive, competition, consumer sovereignty, mixed economy, modified private enterprise economy

Objectives

After studying this section, you will be able to:

1. **Explore** the characteristics of a free enterprise system.
2. **Describe** the role of the entrepreneur, the consumer, and government in a free enterprise economy.

Applying Economic Concepts

Voluntary Exchange Read to find out why voluntary exchange is one of the most popular features of a market economy.

Cover Story

Madame C.J. Walker

Madame C.J. Walker—Sarah Breedlove—was a highly successful entrepreneur, widely considered to be the first African-American millionairess. Walker was known and respected not only for her business acumen but for her inspirational political and social advocacy and her philanthropy.



Madame C.J. Walker

The daughter of former slaves, Walker worked initially as a washerwoman until she devised a hair care and grooming system to meet the needs of African-American women in 1905. Supervising the manufacture of a variety of products, she also developed an enormous marketing network, headquartered in Indianapolis, that employed thousands of African-American women and was the largest African-American owned business in the nation. Walker encouraged women's independence by training others and by serving as a powerful role model.

—National Women's Hall of Fame, ©1998

A market economy is normally based on a system of **capitalism**, where private citizens, many of whom are entrepreneurs, own the factors of production. **Free enterprise** is another term used to describe the American economy. In a free enterprise economy, competition is allowed to flourish with a minimum of government interference.

Competition and Free Enterprise



A free enterprise economy has five important characteristics—economic freedom, voluntary exchange, private property rights, the profit motive, and competition.

Economic Freedom

Individuals as well as businesses enjoy economic freedom, the first characteristic of capitalism. People, for example, have the freedom to choose their occupation and their employer. To a lesser extent, they can choose to work where and when they want. They may work on the west coast, east coast, or in Alaska. They may work days, nights, indoors, outdoors, in offices, or in their homes.

With economic freedom, people can choose to have their own business or to work for someone else. They can apply for jobs, and they have the right to accept or reject employment if offered. Economic freedom also means that people can leave jobs and move on to others that offer greater opportunity.

Businesses also enjoy economic freedom. They are free to hire the best workers, and they have the freedom to produce the goods and services they feel will be the most profitable. Businesses can make as many or as few goods and services as they want, and they can sell them wherever they please. They have the right to charge whatever price they feel is profitable, and they are free to risk success or failure.

Voluntary Exchange

A second characteristic of capitalism is **voluntary exchange**—the act of buyers and sellers freely and willingly engaging in market transactions. Moreover, transactions are made in such a way that both the buyer and the seller are better off after the exchange than before it occurred. Buyers, for example, can do many things with their money. They

can deposit it in the bank, hide it under a mattress, or exchange it for goods or services. If they spend their money on a product, they must believe that the item being purchased is of greater value to them than the money they gave up.

With voluntary exchange, sellers also have many opportunities to sell their products. If they exchange their goods and services for cash, they must feel that the money received is more valuable than the product being sold, or they would not sell in the first place. In the end, the transaction benefits both buyer and seller or it would not have taken place. Both the buyer and the seller obtained something they believed had more value than the money or products they gave up.

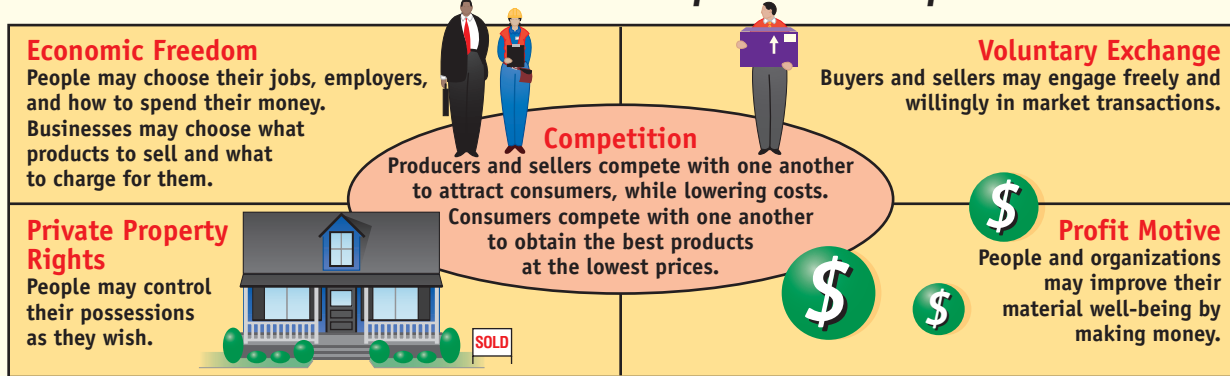
Private Property Rights

Another major feature of capitalism is the concept of **private property rights**, the privilege that entitles people to own and control their possessions as they wish. Private property includes both tangible items such as houses and cars, and intangible items such as skills and talents. People are free to make decisions about their property and their own abilities.

ECONOMICS AT A GLANCE

Figure 2.2

Characteristics of Free Enterprise and Capitalism



Using Charts The terms “free enterprise” and “capitalism” describe a market system in which the factors of production are owned by private citizens, and businesses are allowed to compete for profits with minimal governmental interference. **What items are included under the category of private property?**

Free Enterprise



Economic Freedom The freedom to own a business is a hallmark of free enterprise. *What other characteristics does a free enterprise economy have?*

They have the right to use or abuse their property as long as they do not interfere with the rights of others.

Private property gives people the incentive to work, save, and invest. When people are free to do as they wish with their property, they are not afraid to use, accumulate, or lend it. Private property gives people the incentive to be successful; they know that if they succeed they will be able to keep any rewards they might earn.

Profit Motive

Under free enterprise and capitalism, people are free to risk their savings or any part of their wealth in a business venture. If the venture goes well for them, they will earn rewards for their efforts. If things go poorly, they could lose part or all of their investment. The very possibility of financial gain, however, encourages many people to become *entrepreneurs*, or those who risk entering business in hopes of earning a profit.

What, however, is profit? Consider the earlier case of voluntary exchange. Remember that the buyer gives up money to obtain a product, and the seller gives up the product to obtain money. Unless both parties believe they will be better off afterward than before, neither will make the exchange. When exchange takes place, it does so only because both parties feel they will make a profit.


Profit, then, is the extent to which persons or organizations are better off at the end of a period than they were at the beginning. The **profit motive**—the driving force that encourages people and organizations to improve their material well-being—is largely responsible for the growth of a free enterprise system based on capitalism.

Competition

Finally, capitalism thrives on **competition**—the struggle among sellers to attract consumers while lowering costs. Competition is possible because private individuals, acting as entrepreneurs, own the factors of production and have the freedom to produce the products they think will be the most profitable.

Because capitalism is based on freedom and voluntary exchange, buyers compete to find the best products at the lowest prices. The result is that goods and services are produced at the lowest cost and are allocated to those who are willing and able to pay for them.

The Role of the Entrepreneur

 The entrepreneur is one of the most important people in the economy. The entrepreneur organizes and manages land, capital, and labor in order to seek the reward called profit.

Entrepreneurs are the ones who start up new businesses such as restaurants, automobile repair shops, Internet stores, and video arcades. They include people who may have worked for others at one time, but have decided to quit and start their own businesses. Entrepreneurs want to “be their own boss” and are willing to risk everything to make their dreams come true.

Many entrepreneurs fail. Of course, others survive and manage to stay in business with varying degrees of success. A few, and only a very few, manage to become fantastically wealthy and famous.


Well-known entrepreneurs include Bill Gates, who founded Microsoft, John Johnson of Johnson Publishing Co., and Mary Kay Ash, who founded Mary Kay Cosmetics.

Despite the high rate of failure among entrepreneurs, the dream of success is often too great to resist. The entrepreneur is both the sparkplug and the catalyst of the free enterprise economy. When an entrepreneur is successful, everybody benefits. The entrepreneur is rewarded with profits, a growing business, and the satisfaction of a job well done. Workers are rewarded with more and better-paying jobs. Consumers are rewarded with new and better products. The government is rewarded with a higher level of economic activity and larger tax receipts. These receipts can be used to build roads, schools, and libraries for people not even connected with the original entrepreneur.

Nor does it stop there. Successful entrepreneurs attract other firms to the industry who rush in to “grab a share” of the profits. To remain competitive

and stay in business, the original entrepreneur may have to improve the quality or cut prices, which means that customers can buy more for less. In the end, the entrepreneur’s search for profits can lead to a chain of events that involves new products, greater competition, more production, higher quality, and lower prices for consumers.

The Role of the Consumer

 In the United States, consumers often are thought of as having power in the economy because they determine which products are ultimately produced. For example, a company may try to sell a certain item to the public. If consumers like the product, it will sell and the producer will be rewarded for his or her efforts. If consumers reject the product and refuse to purchase it, the firm may

The Role of the Entrepreneur



Building a Business John Johnson started his publishing business in 1942 with a \$500 loan on his mother’s furniture. Today, Johnson Publishing is the world’s largest African American-owned publishing company. *What aspects of the economy benefit when an entrepreneur succeeds?*

Careers

Law Enforcement Officer

Law enforcement work can range from keeping order in public places and investigating crimes to controlling traffic and lecturing the public on safety.

The Work

Every level of government needs law enforcement officers. In small communities, officers may be called on to do many tasks. In larger cities, work may be highly specialized, including chemical and firearms analysis, fingerprint identification, and harbor and border patrol. The challenges of the work are numerous. Working long hours, risking injury, and taking the chances involved in pursuing and apprehending law-breakers demands dedication to the job.

Qualifications

Most law enforcement jobs are covered by civil service regulations. Usually candidates must be at least 21 years old and must be U.S. citizens. Most jobs require a high school education or more. The more specialized jobs require college training.



The Role of the Consumer



Consumer Sovereignty The principle of consumer sovereignty says that in a competitive economy, customers determine what is produced by choosing what they will buy. *Why do firms have to sell products customers want in order to earn a profit?*

go out of business. **Consumer sovereignty** describes the role of the consumer as sovereign, or ruler, of the market. More commonly, this is expressed in a different way by saying that “the customer is always right.”


In recent years, producers have had outstanding successes with various products, including home video games, sport utility vehicles, and personal computers. Many other products—including “New” Coke, celery flavored Jell-O, chewable toothpaste in tablet form, and bacon you cook in your toaster—were promptly rejected by consumers.

Consumers’ wants change constantly as modern communications and travel expose people to new ideas and products. Today, Americans purchase more home computers every year than TV sets,

even though computers were barely known just 20 years ago. Consumers buy products from all over the world, and more and more often they use the Internet to find product reviews and other information about the goods before they purchase.

Consumers, then, play an important role in the American free enterprise economy. They have a say in what is—and what is not—produced when they express their wants in the form of purchases in the marketplace. The dollars they spend are the “votes” used to select the most popular products.

The Role of Government

 Government—whether national, state, or local—has an economic role to play that reflects the desires, goals, and aspirations of its citizens. Government has become involved in the economy because Americans want its involvement. Consequently, it has become a protector, provider of goods and services, consumer, regulator, and promoter of national goals. The role of government is normally justified whenever its benefits outweigh its costs.

Protector

As protector, the United States government enforces laws such as those against false and misleading advertising, unsafe food and drugs, environmental hazards, and unsafe automobiles. It also enforces laws against abuses of individual freedoms. Employers, for example, cannot discriminate against workers because of their age, gender, race, or religion. In short, the government protects property rights, enforces contracts, and generally tries to make sure that everyone follows the “rules of the game” to ensure an efficient and fair economy.

Provider and Consumer

All levels of government provide goods and services for citizens. The national government, for example, supplies defense services. State governments provide education and public welfare. Local governments provide, among other things, parks, libraries, and bus services.

In the process of providing, government consumes factors of production just like any other form of business. In recent years the government has grown so large that it is now the second largest consuming unit in the economy, trailing only the consumer sector.

Regulator

In its role as a regulator, the national government is charged with preserving competition in the marketplace. It also oversees interstate commerce, communications, and even entire industries such as banking and nuclear power. Many state governments regulate insurance rates and automobile registrations. Local governments even regulate business activity with building and zoning permits.

The regulatory role of government is often controversial. Most businesses do not like to be told how to run their affairs, and they argue that consumers can always sue in court if there are problems. On the other hand, many consumers feel that they do not always know when they are at risk—as in the case of potential food poisoning from unsafe food preparation practices. As a result,

consumers usually think that the government is in a better position to monitor and regulate such activities.

Promoter of National Goals

Government reflects the will of a majority of its people. As a result, many government functions reflect people's desire to modify the economic system to achieve the economic goals of freedom, efficiency, equity, security, full employment, price stability, and economic growth. A government program such as Social Security, as well as laws dealing with child labor and the minimum wage, reveal how Americans have modified their free enterprise economy.

Because of these modifications, and because there are some elements of tradition in our economy, the United States is said to have a **mixed economy**, or a **modified private enterprise economy**. In a mixed economy people carry on their economic affairs freely, but are subject to some government intervention and regulation. This system most likely will undergo further change as the goals and objectives of the American people change.

Section 3 Assessment

Checking for Understanding

- 1. Main Idea** Using your notes from the graphic organizer on page 46, explain how basic economic decisions are made under capitalism.
- 2. Key Terms** Define capitalism, free enterprise, voluntary exchange, private property rights, profit, profit motive, competition, consumer sovereignty, mixed economy, modified private enterprise economy.
- 3. List** the five major characteristics of a free enterprise system.
- 4. Describe** the role of the entrepreneur.
- 5. Analyze** the consequences of consumer economic decisions in a free enterprise economy.

- 6. Identify** the role of the government in a free enterprise economy.

Applying Economic Concepts

- 7. Voluntary Exchange** Cite at least three examples of voluntary exchanges you made this week. How are you better off by having made the exchanges? Did the person with whom you exchanged gain too? How?

Critical Thinking

- 8. Understanding Cause and Effect** Americans have varying economic goals. How have these often-competing goals modified our free enterprise economy?



Practice and assess key social studies skills with the *Glencoe Skillbuilder Interactive Workbook, Level 2*.

Profiles IN Economics



More Than Star Wars: George Lucas (1944–)

“The crossroad in my career,” filmmaker giant George Lucas recalls, “happened very early on. I was in an automobile accident. Before that I wasn’t really a very good student. I wasn’t really focused in my life. I came through an automobile accident that I should never have survived. And, in the process of that, I realized that there must be some purpose for me to be here and I’d better figure out what it is. . . . That really motivated me in a very direct way which sent me off, ultimately, searching for the things I loved and winding up in the film business.”

George Lucas did more than just “wind up” in the film business: he conquered it. Lucas, as a writer, director, producer, and film business owner, has had a hand in more than half of the top 20 box office hits of all time. His credits

include many of the world’s best-known films, including the *Indiana Jones* series, and, his most famous work, the *Star Wars* series.

Lucas has won many awards, the most prestigious of which is the Irving G. Thalberg Award, given by the Academy of Motion Pictures. Lucas seems, indeed, to have found his purpose.

A Household Name: Walt Disney (1901–1966)

The name Disney is known around the world. Yet as a young man, Walt Disney was a failed filmmaker operating out of a makeshift studio in a garage in Los Angeles. Disney had moved there from Kansas City, where he had helped create cartoon advertisements for showings in movie theaters. Dreaming of making full-scale movies, he headed to Los Angeles—then, as now, the film industry capital—to pursue his dream. For five years, he struggled to make ends meet. Then he released an animated film featuring a character that would soon become a household name: Mickey Mouse.

The year was 1928, and the film industry was about to explode: the ability to add sound to movies had just been developed; color movies would emerge in just a few years.

Disney and his workers made full use of . . . new technologies.

Today, Walt Disney Company is a business giant. With income from four motion-picture units (Walt Disney Pictures, Touchstone Pictures, Hollywood Pictures, and Miramax Films), television (Disney owns ABC), videocassettes, recordings, theme parks, resorts, publications, and merchandise based on Disney characters, “Disney” is practically an industry unto itself. This huge media presence has brought Disney characters to millions of people around the world. Walt Disney combined economic success with a cultural impact that few, if any, others have achieved.



Examining the Profiles

- 1. Making Comparisons** What similarities are there in the early lives of Lucas and Disney?
- 2. Evaluating Information** Both Lucas and Disney have influenced millions of people through their films. Do you view this as something positive or something negative? Explain your answer.

Chapter 2 Summary

Section 1

Economic Systems (pages 33–39)

- Every society has an **economy** or **economic system**, a way of allocating goods and services to satisfy the WHAT, HOW, and FOR WHOM questions.
- In a **traditional economy**, the major economic decisions are made according to custom and habit. Life in these economies tends to be stable, predictable, and continuous.
- In a **command economy**, government makes the major economic decisions. Command economies can change direction drastically in a short time, focusing on whatever the government chooses to promote.
- Command economies tend to have little economic freedom and few consumer goods.
- A **market economy** features decentralized decision making with people and firms operating in their own self-interests.
- A market economy adjusts gradually to change, has a high degree of individual freedom and little government interference, is highly decentralized, and offers a wide variety of goods and services that help to satisfy consumers' wants and needs.

Section 2

Evaluating Economic Performance

(pages 41–44)

- The social and economic goals of U.S. society include economic freedom, economic efficiency, economic equity, economic security, full employment, price stability, and economic growth.



- When goals conflict, society evaluates the costs and benefits of each in order to promote one goal over another; many election issues reflect these conflicts and choices.
- People's goals are likely to change in the future, as our economy evolves.



Section 3

Capitalism and Economic Freedom (pages 46–51)

- **Capitalism** is a competitive economic system in which private citizens own the factors of production.
- The five characteristics of capitalism are **economic freedom, voluntary exchange, private property rights, profit motive, and competition.**
- The entrepreneur is the individual who organizes land, capital, and labor for production in hopes of earning a **profit**; the profit motive is the driving force in capitalism.
- In capitalism, firms are in business to make a profit. To do this they must offer products consumers want at competitive prices.
- **Consumer sovereignty** states that the consumer is the one who decides WHAT goods and services to produce.
- The national government plays the role of protector, provider and consumer, regulator, and promoter of economic goals.
- The United States has a **mixed economy**, or a **modified private enterprise economy**, in which its citizens carry on their economic affairs freely but are subject to some government intervention and regulation.

Chapter 2 Assessment and Activities

ECONOMICS Online



Self-Check Quiz Visit the *Economics: Principles and Practices* Web site at epp.glencoe.com and click on **Chapter 2—Self-Check Quizzes** to prepare for the chapter test.

CLICK HERE

Identifying Key Terms

On a separate sheet of paper, write the letter of the key term that best matches each statement below.

- | | |
|-------------------------|----------------------------|
| a. capitalism | f. inflation |
| b. command economy | g. private property rights |
| c. consumer sovereignty | h. profit motive |
| d. economic system | i. traditional economy |
| e. fixed income | j. voluntary exchange |

- the idea that people rule the market
- a society's organized way of providing for its people's wants and needs
- the driving force that encourages people and organizations to try to improve their material well-being
- a rise in the general level of prices
- a system in which the factors of production are owned by private citizens
- the right and privilege to control one's own possessions
- an economic system in which ritual, habit, and custom dictate most economic and social behavior
- an economic system in which a central authority makes economic decisions
- the situation in which the money an individual receives does not increase even though prices go up
- the act of buyers and sellers freely conducting business in a market

Reviewing the Facts

Section 1 (pages 33–39)

- Describe** the main strength and weakness of a traditional economy.
- List** the five major weaknesses of the command economy.
- Describe** how a market economy, a traditional economy, and a command economy adapt to change.

Section 2 (pages 41–44)

- Describe** the seven major economic goals which most Americans agree on.
- Explain** how society resolves the conflict among goals which conflict.

Section 3 (pages 46–51)

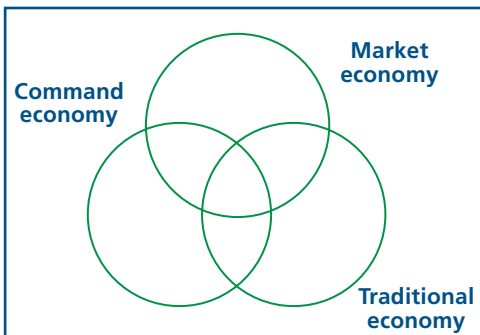
- State** how people and businesses benefit from economic freedom.
- Explain** the importance of the entrepreneur in a free enterprise economy.
- Provide** examples of how the government acts as protector, provider and consumer of goods and services, regulator, and promoter of national goals.

Thinking Critically

- Drawing Conclusions** Some people believe the profit motive conflicts with the goals of economic security and equity. Do you agree or disagree? Why or why not?
- Understanding Cause and Effect** How has the development of transportation and communication systems affected the type of economy that exists in the United States?
- Making Inferences** What incentive does owning private property give people?

Chapter 2 Assessment and Activities

4. **Making Comparisons** Reproduce the following diagram on a separate sheet of paper. Then, in the spaces indicated, identify several elements of command and tradition in the U.S. economy that make it a mixed, or modified private enterprise, economy.



Applying Economic Concepts

1. **Tradition** Most people tip for service in restaurants, but not for service at clothing stores or gas stations. Explain how this illustrates economic behavior by tradition rather than by market or command.
2. **Freedom and Equity** Explain the role you as a consumer must play in obtaining economic equity for yourself.
3. **Voluntary Exchange** How does the principle of voluntary exchange operate in a market economy?

Math Practice

If the typical minimum-wage employee works 40 hours a week and takes two weeks off for vacation, how much will that person earn annually if the minimum wage is \$5.15/hour? How much extra will that person earn for every \$0.25 increase per hour in the wage?

Thinking Like an Economist

Not all societies have market economies. Some have command or traditional economies. Use the discussion

of incremental reasoning and cost-benefit analysis in Chapter 1 on pages 22 and 23 to explain why you would or would not like to live in a society with a different economic system.

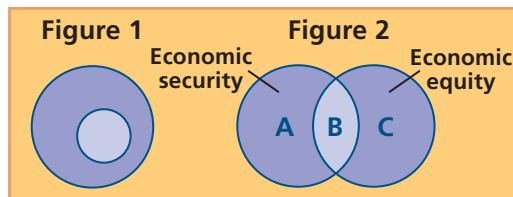
Technology Skill

Using the Internet Search for information on the Internet about the Russian economy. Use a search engine. Type in the word *Russia*. After typing in *Russia*, enter words like the following to focus your search: *goods and services*, *government controls*, *competition*, *economic freedom*, and *transition economy*.

As you analyze the information that you find, answer these questions: What progress has Russia achieved in its transition to a market economy? What problems remain? Write a one-page paper that describes your findings.

Building Skills

Making Comparisons Compare the figures below and then answer the questions that follow.



1. If the diagram in Figure 1 represents "needs" and "wants," how would you label the two diagrams in the figure? Explain your choice.
2. If the two circles in Figure 2 represent the goals of economic security and economic equity, where would you place a federal policy such as the minimum wage law—in area A, B, or C? Explain your choice.
3. If you were to change economic security to economic efficiency in Figure 2, how would this change your placement of the minimum wage policy? Or, would it?



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