

## Chapter 1 :: The Economic Environment

### Section 1.1 ~ Market Economies

#### Jump Start

Hunter is a tailor in an economy where a Central Committee determines the supply and demand for the suits that he makes. In a certain year, the Committee tells Hunter that he can make and sell 500 suits. Brandon is a tailor in an economy where he makes his own decisions about how many suits to make, and he has to predict how many suits his customers will buy in a year. If he is to be successful, Brandon has to make many important decisions. In which of the two economies could a businessperson become more prosperous? In which economy are the risks greater? In which economy would you prefer to do business? Explain your answers.

#### Economic Systems

Our businesses operate in a global marketplace and deal with a variety of economic systems that influence each other. Countries take different approaches in how their economies operate, but each must provide answers to the same basic economic questions.

#### Economic Problem

All types of economic systems face similar problems. The most basic economic problem is referred to as scarcity. **Scarcity** is the conflict between unlimited wants and limited resources. In order to decide how to use its scarce resources, a country must answer three key economic questions. The answers to these questions depend in large part on the society's economic system.

1. **What to produce?** Should resources be used to provide consumer goods, industrial goods, or military goods?
2. **How should things be produced?** What kinds of industries and equipment should be used?
3. **For whom should they be produced?** Which of its citizens should benefit most from what is produced?

#### Types of Economic Systems

An economic system refers to the way in which a society provides things that are desired by its citizens. Economic systems can be classified into traditional, command, or market economies. Today, the market economy is the most common; however, most economies tend to be mixed and have elements of both traditional and command economies. Few are purely just one kind or the other.

**Traditional Economy** In a traditional economy, things are done according to tradition and progress is very slow. This type of economy may be found in developing or third-world countries. Goods are produced with techniques and processes handed down from generation to generation. Goods typically are produced by hand with simple tools. Change and growth occur slowly, and people generally are poor in material goods.

**Command Economy** In a command economy, the government owns the businesses and controls the economy. Officials, usually through central committees, make decisions on what and how goods are produced and how they will be shared. They decide how much resources will be spent on the military and how much will be spent on consumer goods. Government officials plan all phases of the economy and command that the plans be carried out. Citizens have little say on how the three key economic questions are answered, and people have limited freedoms.



Who decides what products to make in a command economy?

**Market Economy** In a **market economy**, businesses and individuals are free to make their own decisions as they buy and sell in the marketplace. Market economies generally are found

in countries that have a democratic form of government. Market economies, such as the U.S. economy, often are said to be practicing capitalism or free enterprise. **Capitalism** means that economic resources are privately owned by individuals rather than by the government. Individual owners of businesses are free to decide what they will produce, which is the basis for the term *free enterprise*. In a market economy, decisions about production and distribution are largely made by voluntary exchange in the *marketplace* where sellers and buyers do business.

## Characteristics of Market Economies

There are a number of important characteristics that help us identify a market economy. Four of these are private enterprise, private property, profit, and competition.

### Private Enterprise

Businesses supply you with products and services in exchange for a payment of some kind. An individual's right to own a business, select a market to enter, and produce with limited government direction is called *private enterprise*. The private enterprise economy is based on freedom of choice. As the owner of a business in private enterprise, you are free to succeed or fail. Private enterprise gives you the right to start any business you wish and operate it as you want as long as you obey the laws that regulate the business. Some regulations are necessary even in a market economy to protect people from harm. For instance, if your company deals with hazardous waste materials, you must obey laws about how to dispose of those materials.

### Private Property

Your right to *private property* means that you can own, use, and dispose of things of value. If you listen to music on a laptop that you own, you are enjoying the right of private property. You can own any item and do what you want with it as long as you do not violate a law that has been enacted to protect others' rights. You also can own, use, and sell whatever you create. Businesses also have the right to own property. This property can include land, buildings, tools, and the goods the business produces.

## Profit

In economies like ours, an important characteristic is your right to earn a profit. **Profit** is the amount of money left over when subtracting the

expenses of operating a business from its income—it is a reward for taking risks. Profit is important to business owners because it pays them for the time and money they have invested in their businesses. The desire to work hard, to be creative, and to satisfy customers in order to earn a profit is called the *profit motive*. The profit motive has helped market economies outperform the other types of economies.



What does the right to private property mean to you?

## Competition

Earning a profit in a market economy is not easy. A good business will always have competition. **Competition** is the rivalry among businesses to sell their products and services to consumers.

Governments with market economies enact laws to help assure that competition exists in the marketplace. Competition gives consumers the opportunity to choose from a variety of products and services. These choices are made by comparing the quality, price, appearance, usefulness, and general appeal of products and services. Competition encourages business owners to improve their products and services and provide a superior product or service at a competitive price.

## Think Critically

1. Why have market economies been adopted in many countries throughout the world that formerly had command economies?
2. If you were a citizen in a country that converted from a traditional economy to a market economy, what are some of the changes that you would find in your life compared to life under the former system?
3. What do you think are the positive and negative aspects of the profit motive in a market economy?
4. What are some things that a government can do to help assure that there is fair competition in the marketplace?