

CHAPTER

2

Economic Systems

SECTION 1
Introduction
to Economic
Systems

SECTION 2
Command
Economies

SECTION 3
Market
Economies

SECTION 4
Modern
Economies in a
Global Age

CASE STUDY
Contrasting
Economies:
North Korea and
South Korea

CONCEPT REVIEW

Scarcity is the situation that exists when there are not enough resources to meet human wants.

CHAPTER 2 KEY CONCEPT

An **economic system** is the way in which a society uses its scarce resources to satisfy its people's unlimited wants.

WHY THE CONCEPT MATTERS

How does a society decide the ways to use scarce resources to meet unlimited wants? Its economic system determines what to produce, how to produce, and for whom to produce. Although every country today uses a mixture of economic systems, some mixed systems provide more economic and political freedom and create more wealth than others.

Online Highlights

More at ClassZone.com

Economics Update

Go to **ECONOMICS UPDATE** for chapter updates and current news on the economies of North Korea and South Korea. (See Case Study, pp. 64–65.) ▶

Animated Economics

Go to **ANIMATED ECONOMICS** for interactive lessons on the graphs and tables in this chapter.

Interactive Review

Go to **INTERACTIVE REVIEW** for concept review and activities.

FIGURE 2.7 PER CAPITA GDP



Source: United Nations Statistics Division

How do the economies of North Korea and South Korea compare? See the Case Study on pages 64–65.

Introduction to Economic Systems

OBJECTIVES

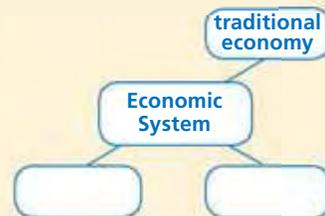
- In Section 1, you will
- identify the three main types of economic systems
 - understand how a traditional economy operates, including its advantages and disadvantages
 - analyze how modern forces are changing traditional economies

KEY TERMS

economic system, p. 38
 traditional economy, p. 38
 command economy, p. 39
 market economy, p. 39

TAKING NOTES

As you read Section 1, complete a cluster diagram that provides information on the different kinds of economic systems. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Types of Economic Systems

KEY CONCEPTS

QUICK REFERENCE

An **economic system** is the way a society uses resources to satisfy its people's wants.

A **traditional economy** is an economic system in which people produce and distribute goods according to customs handed down from generation to generation.

In his book *Utopia*, 16th-century writer Thomas More describes a society without scarcity, where wants are limited and easily fulfilled. It is no accident, however, that the word *utopia* means “no place” in Greek. In the real world, scarcity is a fact of life. To address scarcity, societies must answer three questions:

- What should be produced?
- How should it be produced?
- For whom will it be produced?

The answers to these questions shape the economic system a society has. An **economic system** is the way a society uses its scarce resources to satisfy its people's unlimited wants. There are three basic types of economic systems: traditional economies, command economies, and market economies. In this chapter you will learn about these economic systems, as well as “mixed” economies that have features of more than one type.

TYPE 1 Traditional Economy

A **traditional economy** is an economic system in which families, clans, or tribes make economic decisions based on customs and beliefs that have been handed down from generation to generation. The one goal of these societies is survival. Everyone has a set role in this task. Men often are hunters and herders. Women tend the crops and raise children. The youngest help with everyday chores while learning the skills they will need for their adult roles. There is no chance of deviating from this pattern. The good of the group always takes precedence over individual desires.



Traditional The Kavango people of Namibia use fishing techniques passed down from generation to generation.



Command Food was scarce and expensive in this store in the former Soviet Union, a command economy.



Market Advertisements, like these billboards in New York City, are a common sight in a market economy.

TYPE 2 Command Economy

In the second type of economic system, a **command economy**, the government decides what goods and services will be produced, how they will be produced, and how they will be distributed. In a command economy, government officials consider the resources and needs of the country and allocate those resources according to their judgment. The wants of individual consumers are rarely considered. The government also usually owns the means of production—all the resources and factories. North Korea and Cuba are current examples of command economies. Before the collapse of communism in Europe, countries such as the Soviet Union, Poland, and East Germany also were command economies.

TYPE 3 Market Economy

The third type of economic system, a **market economy**, is based on individual choice, not government directives. In other words, in this system consumers and producers drive the economy. Consumers are free to spend their money as they wish, to enter into business, or to sell their labor to whomever they want. Producers decide what goods or services they will offer. They make choices about how to use their limited resources to earn the most money possible.

In a market economy, then, individuals act in their own self-interest when they make economic choices. However, as they seek to serve their own interests, they benefit others. As a consumer, you choose to buy the products that best meet your wants. However, this benefits the producers who make those products, because they earn money from your purchases. As Adam Smith noted in *The Wealth of Nations* (1776), when you make economic decisions you act in your self-interest, but you are “led by an invisible hand” to promote the interests of others.

QUICK REFERENCE

A **command economy** is an economic system in which the government makes all economic decisions.

A **market economy** is an economic system in which individual choice and voluntary exchange direct economic decisions.

APPLICATION Applying Economic Concepts

A. How might economic activities within a family with adults, teenagers, and young children represent aspects of traditional, command, and market economies?

Economics Update

Find an update on issues in a market economy at ClassZone.com

Characteristics of Traditional Economies

KEY CONCEPTS

In the earliest times, all societies had traditional economies. Such systems serve the main purpose of traditional societies—survival—very well. The traditional economic system, however, tends to be inefficient and does not adapt to change.

TRAIT 1 Advantages and Disadvantages

The one great advantage of a traditional economy is that it so clearly answers the three economic questions. A traditional society produces what best ensures its survival. The methods of production are the same as they have always been. Systems of distribution are also determined by custom and tradition. In a traditional economy, then, there is little disagreement over economic goals and roles.

Traditional economies have several major disadvantages, too. Because they are based on ritual and custom, traditional economies resist change. Therefore, they are less productive than they might be if they adopted new approaches. Further, while traditionally defined roles eliminate conflict, they also prevent people from doing the jobs they want to do or are best suited to do. People who are in the “wrong” jobs are less productive. The lower productivity in traditional economies means that people do not acquire the material wealth that people in other societies do. As a result, people in traditional economies have a much lower standard of living.

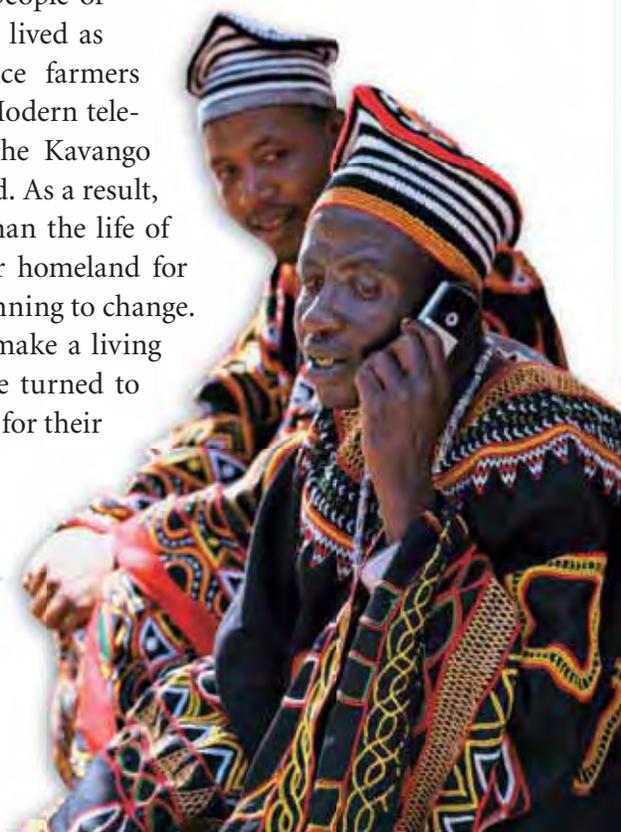
TRAIT 2 Under Pressure to Change

Around the world, traditional economies are under pressure from the forces of change. The Kavango people of Namibia in southern Africa, for example, have lived as subsistence farmers for centuries. (Subsistence farmers grow just enough to feed their own families.) Modern telecommunications, however, have bombarded the Kavango with images of the world beyond their homeland. As a result, many young Kavango want something more than the life of subsistence farming. Thousands have left their homeland for the cities. Even the old ways of farming are beginning to change. The vast majority of the Kavango people still make a living from subsistence farming. However, a few have turned to commercial farming, where they grow crops not for their own use, but for sale.

Forces of Change The use of the cell phone has brought changes to many traditional African societies.

APPLICATION Making Inferences

- B. There are no pure traditional economies today. Why do you think this is so?



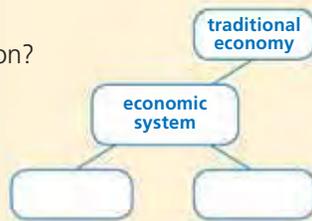
SECTION 1 Assessment

REVIEWING KEY CONCEPTS

- Demonstrate your understanding of the following terms by using each one in a sentence.
 - traditional economy*
 - command economy*
 - market economy*
- Which is more important in a traditional economy, accumulating individual wealth or honoring tradition? Explain your answer.
- How are economic decisions made in a command economy?
- What drives the choices of consumers and producers in a market economy?
- Does Adam Smith's "invisible hand" also function in traditional and command economies? Explain your answer.

6. Using Your Notes What do the three kinds of economic systems have in common? Refer to your completed cluster diagram.

Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



CRITICAL THINKING

- 7. Drawing Conclusions** How might strongly defined economic roles and goals be both a strength and a weakness of traditional economies?
- 8. Analyzing Cause and Effect** What effect might mass media have on the erosion of traditional economies in today's world?
- 9. Generalizing from Economic Information** You have the following information about an economy: 1) People have little choice in the kinds of jobs they do. 2) Producers are not free to use resources as they wish. 3) People have little, if any, say in how the basic economic questions are answered. What kind of economy might this be? Explain your answer.
- 10. Challenge** Most modern economies are a mixture of the three economic systems described in Section 1. Identify elements of traditional, command, and market economic systems in the American economy. (You will learn more about mixed economies in Section 4.)

ECONOMICS IN PRACTICE



Market economy in action in Mexico

Identifying Economic Systems

The three economic systems may be identified by the way they answer the basic economic questions: What to produce? How to produce? For whom to produce?

Complete a Table Copy the table below. Complete it by noting how each of the three economic systems answers the basic economic questions.

| Economic System | Answers to the Basic Economic Questions |
|---------------------|---|
| Traditional economy | |
| Command economy | |
| Market economy | |

Challenge Identify modern countries that have economies that closely resemble each of the three economic systems. Explain each of your choices.

Command Economies

OBJECTIVES

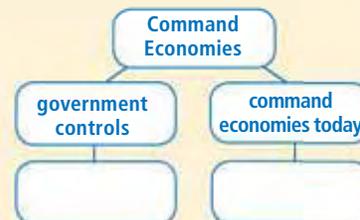
- In Section 2, you will
- describe the main features of a command economy
 - note how socialism and communism differ
 - identify modern examples of command economies
 - explain the advantages and disadvantages of a command economy

KEY TERMS

- centrally planned economy, p. 42
 socialism, p. 43
 communism, p. 43
 authoritarian, p. 43

TAKING NOTES

As you read Section 2, complete a hierarchy chart to categorize information about command economic systems. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Government Controls

KEY CONCEPTS

QUICK REFERENCE

A **centrally planned economy** is a system in which central government officials make all economic decisions.

In command economies, leaders decide what should be produced and how it should be produced. They also decide for whom it should be produced, in part by setting wages. By determining who earns the highest wages and who the lowest, these leaders decide who has the money to buy available products. A system in which the society's leaders, usually members of the central government, make all economic decisions is called a **centrally planned economy**.

EXAMPLE Government Planning

Think for a moment about how the federal government affects you. If you work, you have to pay taxes. If you're 18 years old and male, you have to register with the Selective Service System. State and local governments exert somewhat more control over your day-to-day life. State laws set both speed limits and the age at which people can drive. Local laws set standards for cleanliness in food stores and restaurants and for honest business practices. And state and local taxes are collected to support such services as police and fire departments and public education.

However, what if the government went further? Suppose that bureaucrats in a government office in Washington, D.C., had the power to decide which businesses could operate in your city. Further, these bureaucrats decided not only what these businesses should produce, but also how much each business should produce each month. Finally, they also decided who could have jobs and set work hours and pay scales for workers. Government controls of this type are a feature of a command, or centrally planned, economy.

EXAMPLE Socialism and Communism

Modern societies that have adopted command economies have done so largely because of the influence of Karl Marx, a 19th-century German philosopher, historian, and economist. According to Marx's analysis, all of history is a struggle between classes. In his own time, the struggle was between the owners of the great industrial factories and the workers who exchanged their labor for wages. While the industrialists grew rich, the workers remained relatively poor. Marx predicted that in time the workers would overthrow this system and transfer ownership of the factories to public hands. With the means of production owned by the government, the class struggle would be resolved and all citizens would share in the wealth.

FIGURE 2.1 Comparing Economic Systems

| | Communism | Socialism | Market System |
|---------------------------------|---|--|---|
| Who owns resources? | Government | Government owns basic resources; the rest are privately owned | All resources privately owned |
| How are resources allocated? | Government planners decide how resources are used | Government planners allocate basic resources; market forces allocate privately-owned resources | Market forces allocate resources |
| What role does government play? | Government makes all economic decisions | Government makes decisions in the basic industries | Government's role limited—mostly to ensure market forces are free to work |

ANALYZE TABLES

Government involvement varies among economic systems. How do communist systems answer the three basic economic questions?

Socialism, an economic system in which the government owns some or all of the factors of production, developed from the ideas of Marx. **Communism**, a more extreme form of socialism in which there is no private ownership of property and little or no political freedom, also grew out of Marx's thinking. Essentially, it is authoritarian socialism. An **authoritarian** system requires absolute obedience to authority. Figure 2.1 lists the major characteristics of socialism and communism.

Democratic socialism is established through the democratic political process rather than through the violent overthrow of the government. In this form of socialism, the government owns the basic industries, but other industries are privately owned. Central planners make decisions for government-owned industries. Central planners might also control other sectors—health care, for example—to ensure that everyone has access to these important services.

QUICK REFERENCE

Socialism is an economic system in which the government owns some or all of the factors of production.

Communism is an economic system in which the government owns all the factors of production and there is little or no political freedom.

Authoritarian systems require absolute obedience to those in power.

APPLICATION Comparing and Contrasting

A. How are socialism and communism similar yet different?

Karl Marx: Economic Revolutionary

Millions of lives were affected by the work of Karl Marx. Governments were toppled and new political alliances were forged on the strength of his arguments. What was it in the thousands of difficult-to-read pages he wrote that fueled revolutions?

FAST FACTS

Karl Marx

German philosopher, historian, and economist

Born: May 5, 1818

Died: March 14, 1883

Major

Accomplishment:

Detailed analysis of capitalism and foundation for socialist economic theory

Famous Quotation:

Workers of the world unite; you have nothing to lose but your chains.

Influenced:

Russian Revolution, 1917
Chinese Revolution, 1949

A New View of Economics

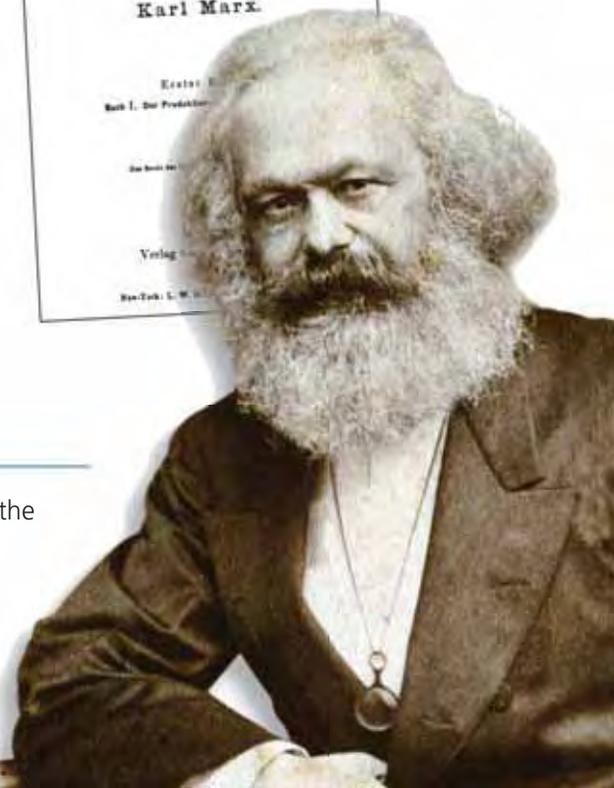
Marx was born in what is now Germany in 1818 and grew up in middle-class comfort. In college, however, he became involved in radical politics. In time, his political activism led to his exile from his homeland. He moved from country to country, eventually settling in London. During his travels, he met Friedrich Engels, the son of a factory owner. Through Engels, Marx became aware of the struggles of the working class and he undertook a deep study of economics. He concluded that the Industrial Revolution had created a system of wage slavery.

Factory owners, Marx said, looked upon labor as just another commodity that could be bought. They then used this labor to convert other productive resources into products. The factory owners made a profit by selling products at a higher price than the cost of labor and other resources. By keeping wages low, they could make ever greater profits. The whole industrial system, Marx reasoned, was based on this exploitation of workers.

To Marx, rising tension between worker and owner was an inevitable development in economic history. Over time, more and more wealth would be concentrated in fewer and fewer hands, and dissatisfied workers would revolt and create a new society without economic classes. Marx, assisted by Engels, laid out these ideas in *The Communist Manifesto* (1848). Marx discussed his economic ideas more fully in his enormous study *Das Kapital*, which was published in three volumes between 1867 and 1894.

Because of the way that communist economies worked in practice and the eventual collapse of communism in the early 1990s, Marx's theories have fallen into disfavor. Even so, few people had more impact on 20th-century economic and political thinking than Karl Marx.

Communism Marx's writings influenced revolutionary leaders such as V. I. Lenin in Russia and Mao Zedong in China.



Economics Update

Learn more about Karl Marx at ClassZone.com

APPLICATION Drawing Conclusions

- B. What did Marx think was the logical outcome of the struggle between owners and workers?

Command Economies Today

KEY CONCEPTS

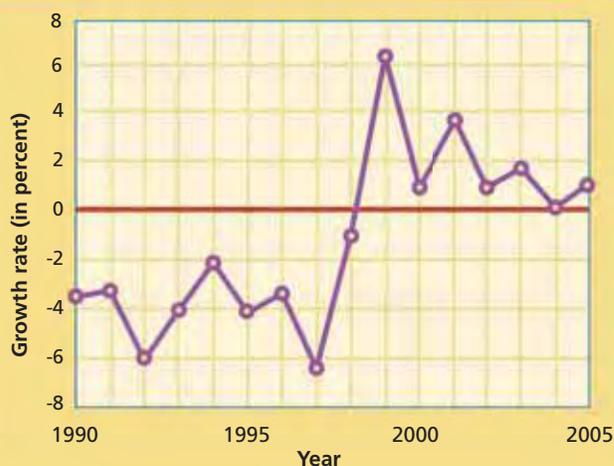
There are no examples of pure command economies today. The forces that have brought changes to traditional economies are also transforming command economies. However, some countries—North Korea, for example—still have economies with mostly command elements.

North Korea

Once under the control of China and later Japan, Korea was split into North Korea and South Korea following World War II. North Korea came under communist control. The government controlled every economic decision. For example, it diverted many of the country's resources to the military, building up an army of more than 1 million soldiers—out of a population of about 22 million. It also developed a nuclear weapons program. However, this military buildup came at the expense of necessities. During the late 1990s and early 2000s, food was so scarce that millions of North Koreans died from hunger and malnutrition. Many North Koreans survived only because of food aid from other countries, most notably South Korea.

The failure to provide food and other important products was just one result of a flawed economic plan. For much of the 1990s, North Korea produced less and less each year, and its economy actually shrank. (See Figure 2.2 below.) In 2003, however, central planners relaxed some restrictions on private ownership and market activity. North Koreans hoped that this experiment with free markets would revive the country's ailing economy. (For more information on North Korea's economy, see the Case Study on pages 64–65.)

FIGURE 2.2 NORTH KOREA: ECONOMIC GROWTH



Source: United Nations

North Korea had a negative growth rate for much of the 1990s. (The red line on the graph marks 0 percent, or no growth.) The average yearly growth rate for all economies during this time period was about 3 percent.

ANALYZE GRAPHS

1. The North Korean economy began to show positive growth after 1999. To what might this development be attributed?
2. During the 1990s, some newspaper reports noted that the North Korean economy was "shrinking." How is this shown in the graph?



Meeting Demand (Left) In communist East Germany, government planners' decisions left this butcher with just one goose to sell. (Right) In West Germany, a market economy, store shelves were laden with consumer goods.

Impact of Command Economies

In theory, command economies have some advantages. For example, they seek to provide for everyone, even the sick and the old who are no longer productive economically. Also, leaders in a command economy can use the nation's resources to produce items that may not make money in a market economy—certain medicines, for example.

In practice, however, the disadvantages of command economies are abundantly clear. To begin with, central planners often have little understanding of local conditions. Because of this, their economic decisions are frequently misguided or wrong. Also, workers often have little motive to improve their productivity, since they know they will be paid the same wages regardless of their output. And because there is no private property, there is no motivation for workers to use resources wisely.

Centrally planned economies often set prices well below those that would be established in a market system. As a result, command economies face shortages. One scene repeated in many command economies is people standing in long lines waiting to buy goods. Such shortages often lead to creative behavior. In the former Soviet Union, for example, light bulbs were almost impossible to buy for home use. However, burned-out bulbs in factories were regularly replaced. Some people took and sold these burned-out bulbs. Why? Other people would buy them and use them to switch out with working bulbs in their factories. They then took the working bulbs to light their homes.

Perhaps the greatest failing of strict command systems is the great suffering that people living under them endured. Carrying out centrally planned economic policies requires that individual rights—even the right to life—be subordinate to the needs of the state. Millions of people died in the efforts to build huge collective farms in China and the Soviet Union. Millions more were imprisoned for exercising their political or economic rights. Estimates suggest that the deeply flawed policies of command economies are responsible for more deaths than two world wars.

APPLICATION Applying Economic Concepts

C. Why are consumer goods often in short supply in a command economy?

SECTION 2 Assessment

REVIEWING KEY CONCEPTS

- Write a brief paragraph explaining the links between the following three terms.
 - centrally planned economy
 - socialism
 - communism
- Why do communist countries use authoritarian methods to maintain their economic and political system?
- List and describe some advantages of centrally planned economies.
- What are some disadvantages of centrally planned economies?
- What is the relationship between the individual and the state in a communist nation?

- 6. Using Your Notes** Write a sentence that makes a generalization about the nature of command economies. Refer to your completed hierarchy chart to complete this question.



Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

- 9. Making Inferences** Look again at the sentences about Thomas More's *Utopia* on page 38. Do you think that Karl Marx, like Thomas More, was trying to imagine a utopia in his writings? Give reasons for your answer.
- 8. Explaining an Economic Concept** How do command societies address the problem of scarcity? Illustrate your answer with examples.
- 9. Analyzing Cause and Effect** Read again the information about the North Korean economy on page 45. What factors caused North Korea's serious economic problems? What steps has the North Korean government taken to improve the dire economic situation?
- 10. Challenge** Adam Smith used the "invisible hand" as a metaphor for the forces that balance a free market. What might be a good metaphor for the forces at work in a command economy? Explain your answer.

ECONOMICS IN PRACTICE



Celebration of communism in the Soviet Union

Using Graphs

Presenting information in a graph shows economic changes more clearly.

Create a Graph Use the following data to create a line graph.

| Household Expenditures in the Soviet Union (\$) | |
|---|-----------------|
| 1979 | 825.2 million |
| 1981 | 934.7 million |
| 1983 | 966.7 million |
| 1985 | 1,017.1 million |
| 1987 | 1,064.7 million |
| 1989 | 1,152.3 million |

Source: United Nations

Challenge During the 1980s, Soviet leaders introduced market elements into the economy. How might this explain the increase in household expenditures?

Use **SMART Grapher @ClassZone.com** to complete this activity.

Market Economies

OBJECTIVES

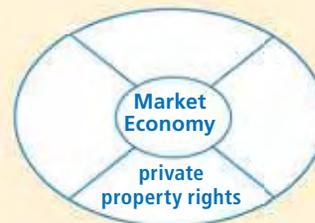
- In Section 3, you will
- describe what a market is and how it works
 - identify the main features of a market economy
 - analyze how the circular flow model represents economic activity in a market economy
 - explain the advantages and disadvantages of a market economy

KEY TERMS

private property rights, p. 48
 market, p. 48
 laissez faire, p. 49
 capitalism, p. 49
 voluntary exchange, p. 49
 profit, p. 49
 competition, p. 49
 consumer sovereignty, p. 50
 specialization, p. 50
 circular flow model, p. 52
 product market, p. 52
 factor market, p. 52

TAKING NOTES

As you read Section 3, complete a chart to identify and describe the features of a market economy. Use the Graphic Organizer at [Interactive Review @ ClassZone.com](https://www.classzone.com)



Fundamentals of a Market Economy

KEY CONCEPTS

QUICK REFERENCE

Private property rights are the rights of individuals and groups to own businesses and resources.

A **market** is any place where people buy and sell goods and services.

Market economies have several distinct characteristics. Earlier in this chapter you read about the fundamental feature of a market economy—the fact that people’s economic behavior is motivated by self-interest. Self-interested behavior is behind two other features of a market economy. One is **private property rights**, the rights of individuals and groups to own property. In economic terms, *property* means everything that an individual owns. This includes factories, offices, clothes, furniture, house, car, and other belongings; money; and even intellectual property, such as songs or ideas developed for inventions. It also includes the labor individuals provide to earn money to buy what they own.

The other feature that stems from self-interest is the **market**, any place or situation in which people buy and sell resources and goods and services. It may be the farmers’ market on Saturdays in the town square, or it may be an enormous cybermarket on the Internet, such as eBay. Large or small, real or virtual, the market is where people can exchange their private property for someone else’s.

Private Property Rights In a market economy, people are free to own and use private property—houses, for example.



FEATURE 1 Private Property and Markets

For markets to operate efficiently, private property rights need to be well defined and actively enforced by law. If you have ever bought a car, you know that an essential part of the transaction is getting possession of the title. You need proof that the person you are buying it from actually owns it and has the right to sell it. Since clear ownership is vital to any sale or exchange, private property rights are necessary to make markets work properly. If buyers could not trust that the sellers actually had the right to offer their products on the market, trade would break down. Further, suppose you are a musician but know that your songs can be downloaded for free, depriving you of your right to exchange what you own for money. In such a situation, it is doubtful that you would be motivated to record music. In protecting private property rights so that producers have motivation and consumers have trust, the government performs an important role in a market economy.

FEATURE 2 Limited Government Involvement

Sometimes the government's economic role is to stay out of the marketplace. The principle that the government should not interfere in the economy is called **laissez faire**, a French phrase meaning "leave things alone." The concept of laissez faire is often paired with **capitalism**, an economic system that is based on private ownership of the factors of production. Capitalism, the foundation of market economies, operates on the belief that, on their own, producers will create the goods and services that consumers demand. Therefore, according to laissez faire capitalism, there is no need for government involvement in the marketplace. Laissez faire capitalism is a market economy in its pure form. However, there are no pure market economies—all real-world market economies have some degree of government involvement.

FEATURE 3 Voluntary Exchange in Markets

When a buyer and seller agree to do business together, they engage in a **voluntary exchange**, a trade in which the parties involved anticipate that the benefits will outweigh the cost. Both sides in a voluntary exchange believe that what they are getting is worth more than what they are giving up. In a market economy, most trade is based on an exchange of a product for money rather than for another product.

Self-interest guides voluntary exchanges. Suppose you buy a new guitar. Even though you spend a good part of your savings, your self-interest is served because you've wanted this particular model of guitar. The seller's self-interest is likely served by **profit**, a financial gain from a business transaction. If you pay more for the guitar than the seller did, the seller earns money. In voluntary exchange, then, both sides must believe that they are gaining by trading.

FEATURE 4 Competition and Consumer Sovereignty

Market economies are also characterized by **competition**, the effort of two or more people, acting independently, to get the business of others by offering the best deal. You are able to choose today between a Macintosh and a Windows PC operating system because of the competition in the computer market. In the case of these competing systems, each has somewhat different features but mainly performs the same

QUICK REFERENCE

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

Capitalism is an economic system that is based on private ownership of the factors of production.

Voluntary exchange is a trade in which both traders believe that what they are getting is worth more than what they are giving up.

Profit is a financial gain that a seller makes from a business transaction.

Competition involves all the actions sellers, acting independently, do to get buyers to purchase their products.

YOUR ECONOMIC CHOICES

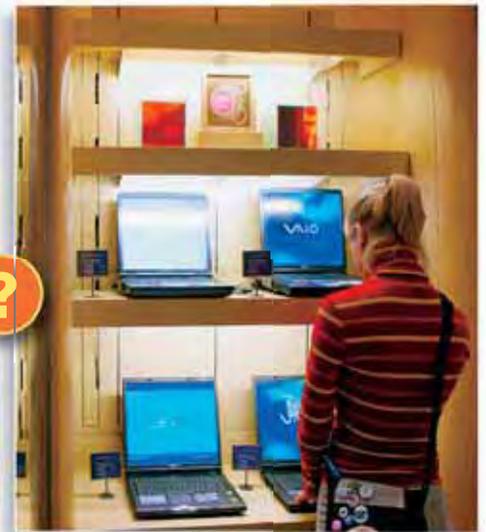
COMPETITION

Where will you buy your computer?

You want to buy a new computer. You could buy a “standard package” from the electronics discount store. The price will be very reasonable, but you won’t be able to customize the software package or the service program. Alternately, you could buy from a computer specialty store. You’ll pay more, but you can choose the extras that you want and the customer support program is excellent.



Electronics discount store



Computer specialty store

functions as the other. You are free to decide which you prefer based on whatever combination of price and value appeals to you more. When you buy over-the-counter medications, you can also clearly see the competitive aspect of the market. Often next to a well-known brand-name product you will see a product with the same ingredients, similar packaging, but a different name and lower price. The producers of the lower priced item are competing for the business established by the brand-name product. If the producers of the brand-name product want to keep your business, they must lower their prices or find a way to add some other value.

That’s because you, the consumer, hold the real power in the market place. **Consumer sovereignty** is the idea that because consumers are free to purchase what they want and to refuse products they do not want, they have the ultimate control over what is produced. Sovereignty means supreme authority, which is what consumers exercise as key economic decision-makers. Let’s look at the over-the-counter medications again. If there were no competition, the brand-name producers could charge higher prices. It would be in their self-interest to charge as much as they possibly could. Competition, however, acts as a control on self-interested behavior, guiding the market toward a balance between higher value and lower prices. Rather than lose your business, the brand-name producers will either lower their prices or raise the value of their product. Because producers must compete for the consumer’s dollar, they have to work at pleasing you, the consumer, while pleasing themselves.

QUICK REFERENCE

Consumer sovereignty

is the idea that consumers have the ultimate control over what is produced because they are free to buy what they want and to reject what they don’t want.

Specialization is a situation in which people concentrate their efforts in the activities that they do best.

FEATURE 5 Specialization and Markets

A market economy encourages efficient use of resources by allowing people and businesses to specialize in what they do best. **Specialization** is a situation in which people concentrate their efforts in the areas in which they have an advantage. This allows people to trade what they can most efficiently produce for goods and services

ECONOMICS ESSENTIALS

FIGURE 2.3 Fundamentals of a Market Economy



ANALYZE CHARTS

Identify a business in your community. Consider how the fundamentals of a market economy noted in the diagram are illustrated by the operations of that business. Record your ideas in a two-column table.

produced more efficiently by others. Specialization removes the need for households to be self-sufficient, and markets allow households to trade for what they need.

Suppose one adult in your house is a bank teller and another is a welder. Neither banking nor welding needs to happen within your household, but your household does need groceries. By specializing in what they do best—earning money in their jobs—in a market economy these adults are able to trade the dollars they earn for items and services others specialize in. If, however, they had to grow all the family's food themselves, they'd be less efficient than those who specialized in farming. Also, with each hour spent on growing food they would lose an hour's worth of wages from their jobs. Specialization, then, leads to higher-quality yet lower-priced products.

APPLICATION Applying Economic Concepts

- A. Which is more important in determining the format in which recordings are offered by the music industry, new technology or consumer sovereignty? Explain.

Circular Flow in Market Economies

KEY CONCEPTS

How do all these fundamental characteristics combine to allow a market economy to function? Economists have developed a model to help them answer this question. Called the **circular flow model**, it visualizes how all interactions occur in a market economy. The model represents the two key economic decision makers in a market economy—households, which are made up of individuals like you, and businesses. It also shows the two markets where households and businesses meet—that for goods and services, and that for resources. (See Figure 2.4 on the next page.)

QUICK REFERENCE

The **circular flow model** is a tool that economists use to understand how market economies operate.

The **product market** is the market where goods and services are bought and sold.

The **factor market** is the market for the factors of production—land, labor, capital, and entrepreneurship.

Product Markets

The market for goods and services is called the **product market**. This is the market you probably know best. The product market isn't a place as much as it is a set of activities. Whenever or wherever individuals purchase goods or services—at a local mall, a dentist's office, the phone company, or an online service selling concert tickets—they are doing so in the product market. The suppliers of the product market are businesses, which offer their goods or services for sale and use the money they earn from the sales to keep their businesses going.

Factor Markets

To run a business, firms must, in turn, purchase what they need from the **factor market**, the market for the factors of production—land, labor, capital, and entrepreneurship. Individuals own all the factors of production. They own some factors of production outright, such as their own labor and entrepreneurship. Others they own indirectly as stockholders in businesses. In the factor market, businesses are the customers and individuals are the producers. A restaurant buys your labor as a server, for example, to serve meals prepared by chefs whose labor they have also bought. The chefs make the meals from products bought from farmers who own the fields and farm equipment.

Circular Flow

This set of interactions between businesses and individuals is illustrated in Figure 2.4 on the next page. On the left and right of the model, you can see the two main economic decision makers, businesses and households. At the top and bottom are the two main markets, product and factor. The green arrows represent the flow of money. The blue arrows represent the flow of resources and products.

Circular Flow Individuals, such as restaurant servers, sell their labor to businesses in the factor market.



FIGURE 2.4 The Circular Flow Model



ANALYZE CHARTS

The circular flow model is a tool for understanding the relationships among economic decision makers and various markets. Why do you think that money always flows in one direction, while resources and products always flow in the opposite direction?



Use an interactive circular flow model at ClassZone.com

Find the “Households” box at the right side of the chart. If you follow the green arrow, you see that individuals spend money in the product market to buy goods and services. From the product market, the money goes to businesses as revenue. The businesses spend this in the factor market, paying for the land, labor, capital, and entrepreneurship needed to produce goods and services. The receivers of that money are individuals who own all the factors of production. With the money they receive, individuals can make more purchases in the product market, and so the cycle continues.

If you look at the blue arrows, you can follow the route of the resources and products in the circular flow model. Once again, start with individuals. They sell their land, capital, labor, and entrepreneurship in the factor market. Follow the arrows to see that these factors of production are bought by businesses. The businesses then use these productive resources to make goods and services. The goods and services are then sold in the product market and flow to individuals who purchase them.

APPLICATION Interpreting Economic Models

- B.** Think of a good or a service you have recently bought. Using the circular flow model as a guide, write an explanation of the impact of your purchase on the economy.

Impact of Market Economies

KEY CONCEPTS

Between the late 1940s and the early 1990s, between one-quarter and one-third of the world's population lived under command economic systems. The Soviet Union and its Eastern European neighbors, China and much of Southeast Asia, Cuba, and North Korea all had centrally planned economies. However, with the collapse of communism in the early 1990s, most of these countries have adopted some form of market economy. Also, as you read in Section 2, even those that have clung to communism and central planning have introduced market-economy measures. Why were these countries so ready to embrace the market system?

Advantages

On November 9, 1989, the Berlin Wall, a symbol of the division between the communist and democratic worlds, was finally opened. Over the next few days, hundreds of thousands of East Germans began pouring into West Germany through gates and improvised breaches in the wall. What drew these jubilant East Germans to the west? For most of them, the answer was freedom.

Economic and Political Freedom Freedom is one of the chief advantages of a market economy. A market economy requires that individuals be free to make their own economic choices, since it depends on the consumer's right to buy or refuse products to determine what will be produced. Individuals are also free to develop their interests and talents in work they find satisfying, rather than being assigned to jobs.

Also, since the government does not use a heavy hand to control the economy, the political process can be much freer, with a diversity of viewpoints and open elections. Government bureaucracy is generally less cumbersome and costly in a market economy than in a command economy, since there are fewer areas of government involvement. A market economy also can be responsive to changes in conditions and accommodate those changes quickly.

Further, individuals in local communities are free to make their own economic choices without the interference of the government. These individuals' better knowledge of the resources and potential of their area leads to better economic decisions and greater productivity.

Profit The profit motive, a key feature of a market economy, insures that resources will be allocated efficiently, since inefficiencies would result in lower profits. It also serves as a reward for hard work and innovation. Knowing you can earn money



Freedom New shopping malls, like this one in Bucharest, Romania, are a common site in many formerly communist countries.

Economics Update
Find an update about developing market economies in Eastern Europe at ClassZone.com



Competition Competition among dairy companies ensures that there is a wide variety of milk and other dairy products.

if you come up with a good idea is an incentive to do so, and the more good ideas people have, the more the economy grows. The incentive to come up with good ideas is related to another advantage of a market economy: it encourages competition, letting consumers have the final say. Competition leads to higher-quality products at lower prices. It also helps to create a diverse product market.

Disadvantages

Market economies, however, have disadvantages as well. In a pure market economy, the economic good of the individual is the primary focus. A pure market economy has no mechanism for providing public goods and services, such as national defense, because it would not be profitable from a strictly economic viewpoint to do so.

Another disadvantage is that a pure market economy cannot provide security to those who, because of sickness or age, cannot be economically productive. Nor can it prevent the unequal distribution of wealth, even though that gap may be the result of unequal opportunities.

The industrial boom in the United States in the late 1800s and early 1900s illustrates the problems that can develop in a market economy with little government regulation. During this time, a few business leaders became very rich. At the same time, most of those who worked for these leaders were paid low—but increasing—wages. Further, most business leaders did little at the time to address the negative consequences of industrialization such as pollution. Issues like these led most industrialized societies to adopt some level of government involvement in the economy. The result was economic systems that mix elements of market and command economies. In Section 4, you'll learn more about such mixed economies.

APPLICATION Analyzing Causes

- C. Why did many societies feel it necessary to adopt some level of government involvement in market economies?



Comparing and Contrasting Economic Systems

Comparing means looking at the similarities and differences between two or more things. **Contrasting** means examining only the differences between them. To understand economic systems, economists compare and contrast the ways in which societies use their limited resources to meet unlimited wants.

TIPS FOR COMPARING AND CONTRASTING Look for subjects that can be compared and contrasted.

Comparison This passage compares two economic systems that have both similarities and differences.

Contrast To contrast, look for clue words that show how two things differ. Clue words include *however, in contrast, on the other hand, and unlike.*

Similarities To find similarities, look for clue words indicating that two things are alike. Clue words include *both, similarly, and likewise.*

Economic Systems

An economic system is the way in which a society uses its resources to satisfy its people's needs and wants. Two common economic systems are the market system and the command system. Both systems provide answers to three basic economic questions: What to produce? How to produce? For whom to produce?

In a command economy, government economic planners decide what goods and services will be produced, how they will be produced, and for whom they will be produced. Individuals, then, have little or no influence on how economic decisions are made. In contrast, in a market economy the individual plays the major role in answering the basic economic questions. Consumers spend their money on the goods and services that satisfy them the most. In response, producers supply the goods and services that consumers want.

Few, if any, "pure" economic systems exist today. Most economic systems are "mixed." For example, market economies generally have some limited form of government control—a characteristic of command economies. Most command economic systems are likewise mixed in that they have some elements of market economies.

THINKING ECONOMICALLY Comparing and Contrasting

1. How are market and command economic systems similar?
2. In what ways do these two economic systems differ?
3. Read the paragraphs about North Korea under the heading "Command Economies Today" on page 45. Construct a Venn diagram showing similarities and differences between the economy of North Korea and a typical market economy.

SECTION 3 Assessment

REVIEWING KEY CONCEPTS

- Explain the relationship between the terms in each of these pairs.
 - private property rights market*
 - laissez-faire capitalism*
 - specialization profit*
 - factor market product market*
- What are the essential elements of market economies?
- What are some advantages of market economies?
- What are some disadvantages of market economies?
- How does the profit motive help lead to efficient use of productive resources?

6. Using Your Notes Make charts for a traditional economy and a command economy and compare and contrast them with your completed market economy chart.



Use the Graphic Organizer at [Interactive Review @ ClassZone.com](#)

CRITICAL THINKING

- Analyzing Cause and Effect** Review the circular flow model on page 53. Based on the model, how do businesses benefit from the wages they pay?
- Creating and Interpreting Economic Models** Return to the answer you gave for Application B on page 53. Create a circular flow model to illustrate your answer.
- Solving Economic Problems** How do you think the disadvantages of a market economy can be minimized while its advantages continue to operate?
- Challenge** On August 29, 2005, Hurricane Katrina devastated regions of the Gulf Coast states of Louisiana, Mississippi, and Alabama. Most of New Orleans, for example, was flooded after the levees protecting the city broke. How would a pure market economy respond to the devastation and loss?

ECONOMICS IN PRACTICE



Employers and employee discuss salary

Understanding the Market Economy

Market economies can be identified by certain fundamental characteristics. These include self-interested behavior, private property rights, voluntary exchange, profit, competition, consumer sovereignty, specialization, and a limited role for government.

Identify Features Each sentence in the chart illustrates one fundamental feature of a market economy. Complete the chart by identifying these features.

| Feature | Description |
|---------|--|
| | An author secures a copyright for her latest novel. |
| | Declining sales signal the end of production for a model of car. |
| | A prospective employee and a business reach an agreement on salary and benefits. |
| | Taking advantage of their beautiful natural environment, local planners approve development of new hotels and resorts. |

Challenge Write sentences illustrating two fundamental features of market economies not illustrated in the sentences above.

Modern Economies in a Global Age

OBJECTIVES

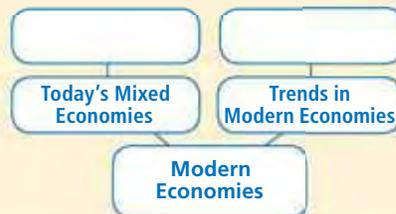
- In Section 4, you will
- identify the main characteristics of a mixed economy
 - understand why most modern economies are mixed economies
 - explain why modern economies are becoming increasingly global

KEY TERMS

- mixed economy, p. 58
 nationalize, p. 61
 privatize, p. 61
 global economy, p. 61

TAKING NOTES

As you read Section 4, complete a cluster diagram to record what you learn about modern economies in a global age. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Today's Mixed Economies

QUICK REFERENCE

A **mixed economy** is an economy that has elements of traditional, command, and market systems.

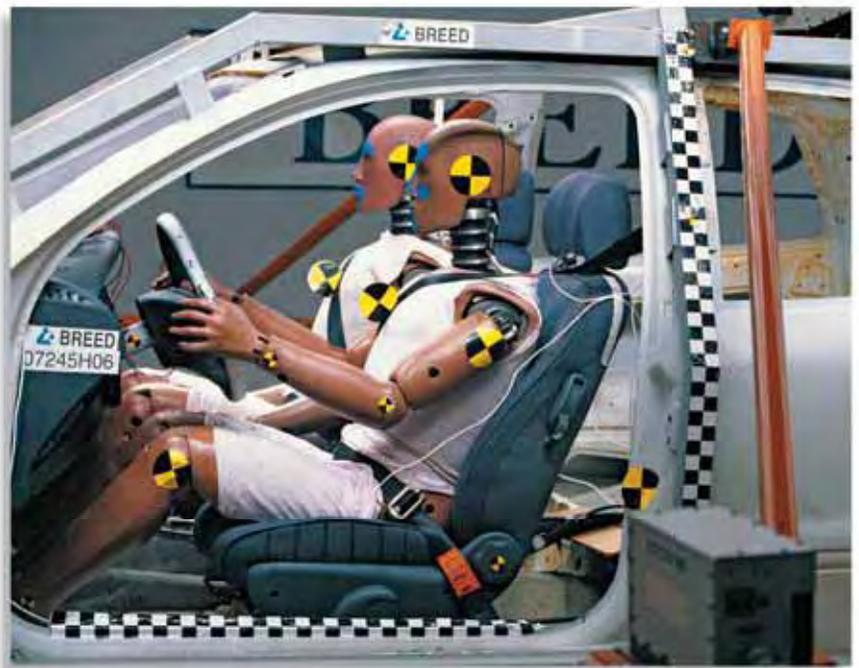
KEY CONCEPTS

Today, the **mixed economy**—an economic system that has elements of traditional, command, and market economies—is the most common type of economic system. Even the most strongly market-based modern economies have some elements of central planning. Similarly, market influences have penetrated all of today's command economies to some extent. Traditional production methods are still followed in some areas of both market and command systems. And traditional economies everywhere are experiencing greater government involvement and growing pressure from market influences.

Life in a Mixed Economy

Let's look at a farming family in the rural Midwest of the United States to see how elements of all three economic systems may be present in a mixed economy. The family has owned and operated the farm for many generations. While they use the most modern farming methods, family members still cling to some old customs. At harvest time, for example, everybody works to get in the crops. Even the youngest children have their own special tasks to do. The family's crops are sold on the market along with those of their neighbors and of farmers throughout the region. Well-maintained highways connect the farm to the various locations where the crops are sold. Two teenagers in the family attend the public high school. The oldest one works in town at a part-time job during the week, earning the minimum wage. Two grandparents who no longer work full time on the farm each receive a Social Security check every month.

In this scenario, all three types of economic system are blended. The harvest-time customs the family follows represent the influence of a traditional economy. The command aspects of the economy are reflected in the ways that government has become involved. The well-maintained roads, the public high school, the minimum wage, and the Social Security checks are all examples of government benefits and regulations at the local, state, or national level. (You'll learn more about government involvement in the economy, including the minimum wage and Social Security, in later chapters.) The market aspects of the economy are represented in the private property rights and entrepreneurship of the family members. They own their land and have figured out the best ways to use it to make a living. Other aspects of a market economy include the competitive market in which their goods are sold, and the voluntary exchange that takes place when the family sells its crops and when one of the teenagers exchanges labor for wages.



Elements of Command One way the U.S. government intervenes in the economy is to set safety standards for automobiles and other products.

Types of Mixed Economies

Although all modern economies are mixed, they often emphasize one type of system or another. In the scenario you just read, which is based on the economy of the United States, the market economy dominates. Even though there are traditional and command elements, the driving forces of the U.S. economy are such features as private ownership and markets. So, the United States essentially has a market economic system.

Many European countries have a more even mix of market and command economies. France, for example, tried to find a “middle way” between socialism and capitalism. In the years following World War II, its economy emphasized the command system with government ownership of core industries. In the 1980s, however, many people expressed dissatisfaction with the performance of government-owned industry. As a result, the French government pulled back from its ownership role in the economy, privatizing several industries, most notably banking and insurance. Even so, it still has a controlling share of ownership in a number of industries, including energy, automobiles, transportation, communications, and defense. In addition, it provides an array of social services, including health care and education, to the French people.

Sweden, while also a mixed economy, has much greater government involvement. The Swedish government and government-related organizations own about one third of all Swedish companies. In addition, Swedish citizens receive “cradle to grave” social benefits. These include childcare for children ages 1 through 5, schooling for

MATH CHALLENGE

FIGURE 2.5 Calculating Percentages

Economists often use percentages to express the level of government involvement in a country's economy.

Step 1: Read the table, which contains data on the total economy and government consumption—the value of all the goods and services government buys—for three countries.

Step 2: Using Canada as an example, calculate government consumption as a share of the total economy.

| Country | Total Economy (in billions of U.S. dollars) | Government Consumption (in billions of U.S. dollars) |
|---------|--|---|
| Canada | 789.8 | 152.4 |
| Nigeria | 48.8 | 11.4 |
| Sweden | 259.2 | 72.2 |

Source: Heritage Foundation

$$\text{Share of economy consumed by government} = \frac{\text{Government consumption}}{\text{Total economy}}$$

Step 3: Convert the answer to a percentage by multiplying by 100.

$$\frac{\$152.4}{\$789.8} = 0.192960243$$

$$0.192960243 \times 100 = 19.2960243\%$$

Step 4: Round your answer to a whole number.

$$19.2960243 \text{ rounded to a whole number} \approx 19\%$$

Comparing Economies To compare government consumption in the economies of two different countries, economists can calculate percentages for each country and compare the percents.

NEED HELP?



Math Handbook,
"Calculating and Using
Percents," page R4

children ages 6 through 16, additional years of school and college for those who choose them, health care, dental care, paid time off for raising families, and generous old-age pensions. In return, however, the Swedish pay very high tax rates, in some cases as high as 60 percent of income.

Each country has its own distinct balance of economic types. Namibia, as you read in Section 1, has a large number of people engaged in subsistence farming, following traditional production methods. Since the early 1990s, however, the Namibian government has been encouraging a more market-driven approach, including foreign investment in farming and other businesses. The country's leaders hope that these efforts will help the economy to grow and provide more economic opportunities for all Namibians.

APPLICATION Synthesizing Economic Data

- A. Look at the Math Challenge above. What level of government involvement in the economy does each country shown have?

Trends in Modern Economies

KEY CONCEPTS

Economies have changed, and are always changing, in response to changes in natural, social, and political conditions. In the early 1990s, for example, some Eastern European economies experienced abrupt change when their command systems broke down after the collapse of communism in the Soviet Union. Many of these economies have been making reforms to introduce more market elements. (You'll learn more about these economies in Chapter 18.)

TREND 1 Changes in Ownership

Economies in transition often go through predictable processes. Some of the most important relate to changes in ownership. After World War II, some European economies became more centrally planned. For example, the British government, to help the country more effectively recover from the war, nationalized several important industries, including coal, steel, and the railroads. To **nationalize** means to change from private ownership to government or public ownership.

More recently, many economies have moved away from command systems to market systems. In this process, government-owned industries have been privatized. To **privatize** means to change from government or public ownership to private ownership. Poland, for example, is undergoing a transition from a command to a market economy with an extensive privatization program. Since 1990, Poland has privatized a number of manufacturing, construction, trade, and service industries. The Polish government hoped that private ownership of economic resources would provide incentives for greater efficiency, which, in turn, would help the economy to grow.

QUICK REFERENCE

To **nationalize** means to change from private ownership to government or public ownership.

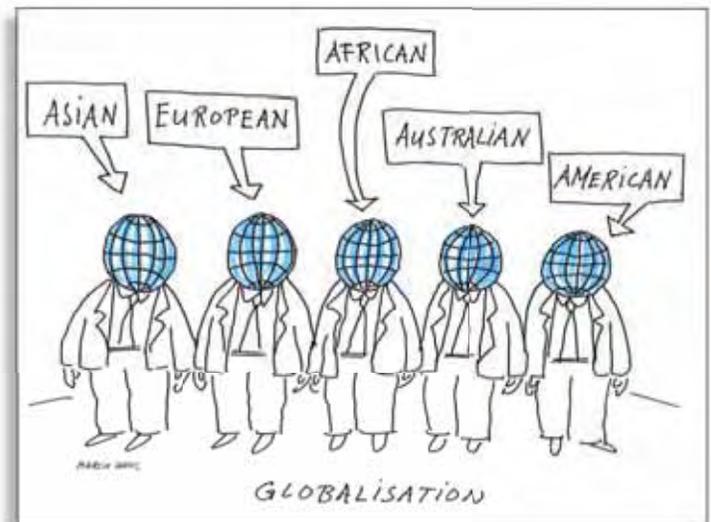
To **privatize** means to change from government or public ownership to private ownership.

The **global economy** refers to all the economic interactions that cross international boundaries.

TREND 2 Increasing Global Ties

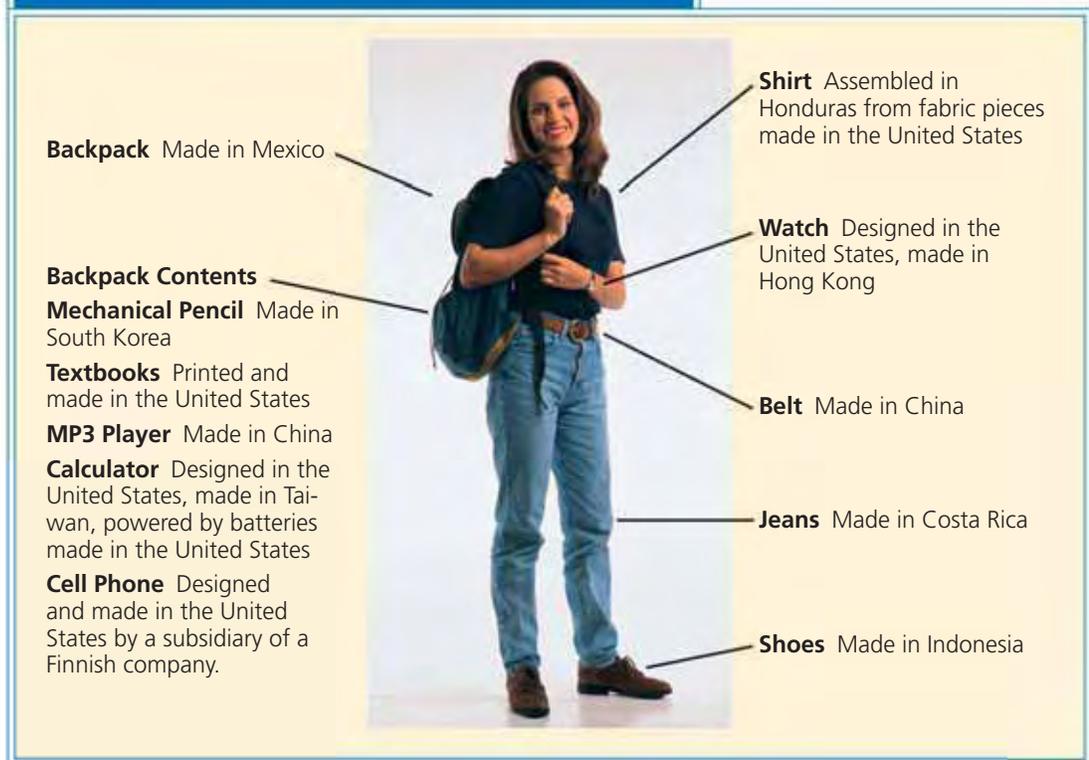
One way to help privatize an industry is to open it up to foreign investors. This kind of economic tie between nations is only one example of the global economy. The **global economy** is all the economic interactions that cross international boundaries. Today, American consumers and businesses are actors in a world economy. Businesses now engage in more foreign trade than ever before, and they depend not only on the products they buy from foreign nations, but also on the foreign markets in which they sell their products.

There are several reasons for this surge in economic globalization. One reason is the opening up of the world's markets to trade. Nations have been discussing ways to open trade for many years. The outcome of these talks has been the signing of agreements that ensure that trade among nations flows as



Globalization Some people are opposed to globalization, charging that it results in the loss of national identity.

FIGURE 2.6 The World Student



ANALYZE CHARTS

List all the things that you use in a normal day—the clothes you wear, the foods you eat, the appliances you use, and so on. Identify where each item was made—in the United States or in another country.

smoothly and freely as possible. Another reason for the growth of the global economy is the development of faster, safer, and cheaper transportation. Distribution methods have become so efficient that resources and products can be moved around the world relatively inexpensively. In addition, telephone and computer linkages have made global financial transactions quick, inexpensive, and easy.

Globalization also has been enhanced by cross-border business partnerships. For example, Ford Motor Company of the United States and Mazda Motor Corporation of Japan have long worked as partners. They design and engineer cars together, use each other's distribution systems, and share manufacturing plants. Recently, Ford and Mazda have joined with China's Changan Automotive Group to produce engines for Ford and Mazda cars. Such shared efforts lead to greater efficiency, which results in lower production costs and greater profits.

Other global partnerships have grown out of the need to share the enormous costs of researching and developing new technology. For example, Hitachi of Japan has joined with two American companies, Texas Instruments Incorporated and Integrated Device Technology, to develop smaller and more powerful computer memory chips. Such joint efforts are an illustration of today's economic reality—businesses can cooperate and learn from one another even while pursuing their own interests.

APPLICATION Analyzing Effects

B. How do global business alliances benefit the U.S. economy?

Economics Update

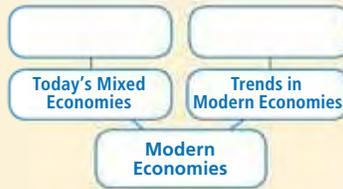
Find an update on global partnerships at ClassZone.com

SECTION 4 Assessment

REVIEWING KEY CONCEPTS

- For each of the following key terms, write a sentence that illustrates its meaning.
 - mixed economy*
 - nationalize*
 - privatize*
 - global economy*
- What is a market-driven mixed economy? Illustrate your answer with examples.
- In the transition from command to market economies, most economic resources are privatized. What is the expected impact of this action?
- What forces have contributed to the growth of the global economy?
- How are you, as an individual, affected by the global economy?

6. Using Your Notes Write a four-sentence summary of this section, using your completed cluster diagram as a reference.



Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

- 7. Explaining an Economic Concept** Explain, with examples, how the American economy includes elements of traditional, command, and market economic systems.
- 8. Analyzing Cause and Effect** Since the fall of communism in the 1990s, countries in Eastern Europe and the former Soviet Union have abandoned command economies in favor of market economies. How do you think economic life in these countries has changed?
- 9. Applying Economic Concepts** Many nations import U.S. capital and technology by purchasing equipment that U.S. businesses manufacture. Explain how this development can benefit the American people.
- 10. Challenge** How do market forces operate in the global economy? Illustrate your answer with examples.

ECONOMICS IN PRACTICE



Shopping for shoes

Illustrating the Global Economy

How do you participate in the global economy? Study Figure 2.6 opposite and then complete this exercise.

Conduct a Survey Make a survey of class members to identify the “Made in” labels in their clothes, shoes, and other items they use every day. Use a chart similar to the one below to list the items and the countries in which they were produced.

| Product | Where Made |
|------------------|------------|
| Sweaters | |
| Shirts | |
| Pants or dresses | |
| Shoes | |
| Jackets | |
| Backpacks | |

Challenge Write a short explanation of how this list illustrates the global economy.

Contrasting Economies: North Korea and South Korea

Background Korea was an independent kingdom for nearly 1,000 years. After World War II, the country was divided into two nations, North Korea and South Korea. Since then, the two countries have developed in vastly different ways. After the Korean War ended in 1953, North Korea's communist government followed an economic, political, and military policy of isolation. North Korea has a command economy, though elements of a market system are taking root.

South Korea, in contrast, is a democracy with a market economy. South Korea has achieved incredible economic growth, in part because of its *chaebols* (jeh BOLZ), huge technology conglomerates like Samsung and Hyundai that originated from a single family. Strong government support for businesses has aided the country's economic success.

What's the issue? How effective are command and market economies? Use these sources to discover how well the economies of North and South Korea function.



A. Online Article

In this article, the United States Institute of Peace (USIP) summarizes the findings of Andrew P. Natsios about the great famine in North Korea. Natsios is the author of *The Great North Korean Famine: Famine, Politics, and Foreign Policy* (2001).

North Korea Suffers Famine

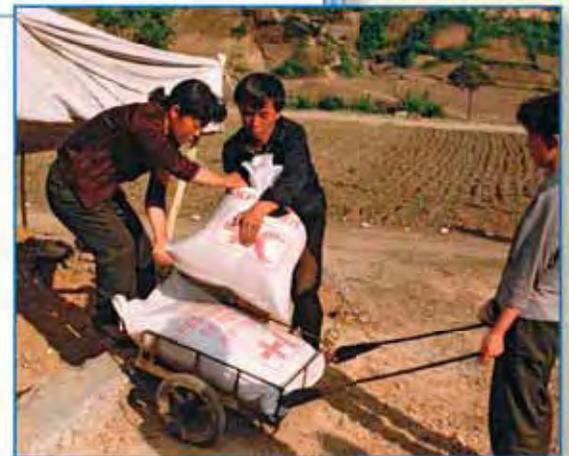
Workers in "unproductive" industries die from lack of food

According to some estimates, . . . three million people died in the North Korean famine of the mid-1990s. . . .

Faced with a massive food shortage, the North Korean government "made a choice," Natsios said. Making the regime's survival its top priority, the government decided that food would go to the country's elite and its military forces. Most citizens, especially those who lived in regions or worked in industries that the government deemed "unproductive," were considered expendable. As many as three million people may have died.

Before the famine, North Korea relied on food and oil subsidies, mostly from the former Soviet Union. When that aid declined and a series of natural disasters occurred, the North Korean government cut food rations to farmers. Many people started hoarding and stealing. The system collapsed. In Natsios' view, North Koreans lost faith in the state.

Source: "The North Korean Famine." *Peace Watch Online*, June 2002



North Koreans receive contributions of rice from an international humanitarian agency.

Thinking Economically What decision described in this document is characteristic of a command economy? Explain your answer.

FIGURE 2.7 PER CAPITA GDP



Source: United Nations Statistics Division

B. Graph

This graph compares North Korea's and South Korea's per capita GDP—each person's share of everything produced in the economy—from 1994 to 2004.

Thinking Economically What does this graph suggest about productivity in the two nations?

C. Magazine Article

This article reflects the contributions of corporations like Samsung to South Korea's growing economy.

Samsung and the "Next Great Tech Revolution"

Heading Towards a Digitized Life

Lee Jong Jin, 51, is no couch potato. But lounging in his apartment overlooking the mountains of Seoul, the international trader has little reason to leave his sofa. As he watches an interactive game show, he uses the remote to send in answers. In a corner of the 50-inch plasma screen, he can link to his online bank or control his air conditioner. Lee is one of thousands of Koreans involved in trials of Samsung Electronics' Home Network, which allows digital products to talk to each other. If Samsung has its way, millions around the world will be running their homes from the comfort of their couch within a few years.

... Over the last decade, [Samsung] has ... become the most diverse and profitable consumer-electronics company on the planet. Samsung leads the global market for color televisions, VCRs, liquid crystal displays for electronic devices and digital memory devices. ... Since 1999, revenues have doubled, and profits have risen 20 times. ...

In the digital world all these products will finally be networked to each other ... creating the sort of "smart" living space imagined only in science fiction. That's the idea, anyway. The change, says analyst Keith Woolcock of Westhall Capital in London, will be "the biggest event in technology for the next 10 years."

Source: "Digital Masters," *Newsweek* (International Edition), October 18, 2004

Thinking Economically What aspects of a market economy are illustrated by Samsung's financial success?

THINKING ECONOMICALLY Synthesizing

1. Based on documents A and C, in which country does the government appear to be more involved in controlling business and the economy?
2. Based on documents A and C, what can you infer about the effects of government activities on productivity in the two nations?
3. In today's global economy, is a command economy or a market economy more likely to succeed? Support your answer with information presented in the three documents.

Review this chapter using interactive activities at **ClassZone.com**

- Online Summary
- Quizzes
- Vocabulary Flip Cards
- Graphic Organizers
- Review and Study Notes

REVIEWING KEY CONCEPTS

Introduction to Economic Systems (pp. 38–41)

1. What are the three types of economic systems?
2. What are features of a traditional economy?

Command Economies (pp. 42–47)

3. What role does the government play in a command economy?
4. What are the advantages and disadvantages of a command economy?

Market Economies (pp. 48–57)

5. What are the features of a market economy?
6. What are the advantages and disadvantages of a market economy?

Modern Economies in a Global Age (pp. 58–65)

7. What are the features of a mixed economy?
8. What trends are shaping modern economies?

APPLYING ECONOMIC CONCEPTS

Look at the chart below showing statistics for four nations. Answer the following questions.

9. Which country appears to have the most productive economy?
10. Does a high percentage of GDP from agriculture make a country more or less productive? Support your answer with statistics from the chart.

FIGURE 2.8 GROWTH AND PRODUCTIVITY

| Country | GDP* Growth Rate | PPP** | % of GDP from Agriculture |
|-------------|------------------|--------|---------------------------|
| North Korea | 1.0 | 1,800 | 30.0 |
| Poland | 3.3 | 12,700 | 2.8 |
| Namibia | 4.2 | 7,800 | 9.3 |
| China | 9.2 | 6,200 | 14.4 |

* Gross Domestic Product (value of everything the country produced)

** Purchasing Power Parity (shows a country's productivity relative to its population)

Source: *The CIA World Factbook, 2006*

Choose the key concept that best completes the sentence. Not all key concepts will be used.

- | | | |
|---|--------------------------------|---|
| capitalism | global economy | private property rights |
| centrally planned economy | laissez faire | privatize |
| circular flow model | market | product market |
| command economy | market economy | profit |
| competition | mixed economy | socialism |
| factor market | nationalize | traditional economy |
| | | voluntary exchange |

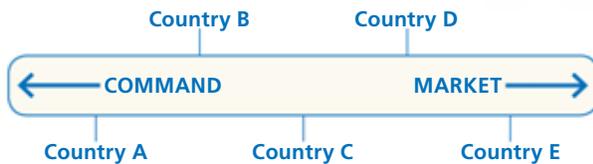
In a 1, the three basic economic questions of what to produce, how to produce, and for whom to produce are answered in the same way they have been for generations. In a 2, in contrast, the government makes most economic decisions. Two systems in which government plays a strong role are communism and 3. In the transition between types of economic systems, the government may 4 industries, taking them out of private ownership.

A 5 economy rests on private ownership, however, so 6 guaranteed by the government are vitally important. A market economy also depends on 7 to help produce the highest quality goods at the lowest price. Sellers are motivated by the chance to make a 8, so they try to use their resources as efficiently as possible. The 9 shows the flow of money as well as the flow of products and resources in the 10 that takes place between buyers and sellers in a market economy.

The most common kind of economy today is the 11 which blends elements from all three systems. Each modern economy is also part of the 12, which entails all the economic interactions that cross international borders.

CRITICAL THINKING

- 11. Creating Charts** Create a chart showing a continuum of countries with different types of economic systems. At the left will be the nations with the most command elements in their economic systems. On the right will be the nations with the most market elements in their economies. Use the chart below as a model.



Begin with the countries listed in the chart on the previous page. Then add other countries mentioned in this chapter, such as France, Sweden, and the United States. Conduct extra research if you have difficulty placing these countries on the continuum. One useful source of information is *Economic Freedom of the World Annual Report*.

- 12. Synthesizing Economic Data** Look again at Figure 2.8 on page 66. Why do you think Poland and Namibia had relatively high growth rates? In writing your answer, consider the economic changes that have taken place in these countries in recent years.
- 13. Evaluating Economic Decisions** Using information in Figure 2.8, evaluate Poland's decision to privatize a number of its industries, noting whether you think it was a wise or an unwise action. Explain your evaluation.
- 14. Explaining an Economic Concept** In most of the former command economies in Eastern Europe, one of the first economic changes instituted was establishing the right to own private property. Why do you think the leaders of these countries considered this feature of market economies so important?
- 15. Challenge** Write a brief essay explaining how a country's political system and economic system are intertwined.

SIMULATION

Privatize Your Community's Recreation Facilities

Suppose your community felt that its administration of your park district and recreation facilities—pools, gyms, and so on—had become inefficient. As an exercise to understand the issues involved in moving from a government-owned to a privately-owned enterprise, work through the decisions you would face in privatization.

- Step 1.** With your whole class, divide the recreation facilities into manageable segments. One segment might be park maintenance, another might be fitness classes at the community center, and so on. Then organize pairs or small teams and assign each pair or team one of the segments.
- Step 2.** In your pairs or teams, discuss how to use the elements of a market economy to make your segment of the project as efficient as possible—to provide the lowest priced services at the highest possible quality.
- Step 3.** Draw up a plan describing the privately-owned company you think could take over your segment.
- Step 4.** Share your plans with the teams working on the other segments to see what other ideas came up.
- Step 5.** With your whole class, discuss whether privatizing services like park district facilities is a beneficial step or not. Discuss possible advantages and possible disadvantages.

