



CHAPTER

## 2

# Economic Systems and Decision Making

## Why It Matters

Take a closer look at the way your high school is organized. Who makes the decisions on lesson plans? Who plans out events that take place during the year? Who makes financial decisions, and how? Are parents and voters involved in the educational system? Obtain information from your school district office or the library to create a chart that lists the rights and responsibilities of people in your school district to meet the needs of education. Read Chapter 2 to learn about the different economic systems that societies set up to meet their specific economic needs.

### The BIG Idea

Every society has an economic system to allocate goods and services.

In a market economy, individuals can freely make all economic choices, including opening a store.



**Economics ONLINE** **Chapter Overview** Visit the *Economics: Principles and Practices* Web site at [glencoe.com](http://glencoe.com) and click on *Chapter 2—Chapter Overviews* to preview chapter information.



SECTION

## 1

# Economic Systems

## GUIDE TO READING

### Section Preview

In this section, you will learn about the different types of economic systems that govern **WHAT** goods and services to produce, **HOW** to produce them, and **FOR WHOM** to produce them.

### Content Vocabulary

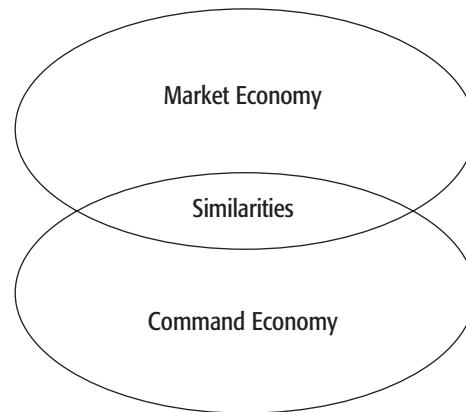
- economic system (p. 33)
- traditional economy (p. 34)
- command economy (p. 35)
- market economy (p. 37)
- market (p. 37)
- capitalism (p. 38)
- mixed economy (p. 39)
- socialism (p. 39)
- communism (p. 39)

### Academic Vocabulary

- stagnation (p. 35)
- allocate (p. 36)
- emphasizing (p. 36)

### Reading Strategy

**Comparing and Contrasting** 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.



## COMPANIES IN THE NEWS

*-Global Business Today*

### McDonald's and Hindu Culture

For thousands of years, India's Hindu culture has revered the cow. Hindu scriptures state that the cow is a gift of the gods to the human race. . . . [The cows] are everywhere, ambling down roads, grazing in rubbish dumps and resting in temples—everywhere, that is, except on your plate, for Hindus do not eat the meat of the sacred cow.

. . . McDonald's responded to this cultural food dilemma by creating an Indian version of its Big Mac—the "Maharaja Mac"—which is made from mutton. . . . According to the head of McDonald's Indian operations, "We had to reinvent ourselves for the Indian palate." ■



**W**hen companies want to do business in other countries, they need to adjust their business plans to meet local customs. This is what McDonald's corporation had to do when it expanded to India. While India's economy shares many characteristics with the United States, many of its business practices are based on a more traditional economic system.

All societies use an **economic system**—an organized way of providing for the wants and needs of their people. The way societies organize themselves determines the type of economic system they have. Three major kinds of economic systems exist—traditional, command, and market economies. In practice, however, almost all economies, like that of India, combine elements of all three.

**economic system**  
organized way in  
which a society  
provides for the wants  
and needs of its people



## Economics ONLINE

**Student Web Activity** Visit the *Economics: Principles and Practices* Web site at [glencoe.com](http://glencoe.com) and click on Chapter 2—Student Web Activities for an activity on the economies of traditional societies.

**traditional economy** economic system in which the allocation of scarce resources and other economic activities are based on ritual, habit, or custom

# Traditional Economies

**MAIN Idea** Traditional societies use ritual, habit, or customs to answer the basic questions of **WHAT**, **HOW**, and **FOR WHOM** to produce.

**Economics & You** Does your family have a tradition that has been passed down from generation to generation? Read on to learn how traditions govern the economies of some societies.

Many of our actions spring from habit and custom. Why, for example, does the bride toss the bouquet at a wedding? Such practices have become part of our traditional culture.

## Characteristics

In a society with a **traditional economy**, the use 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 generally 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—have traditional economies. The Inuit 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. When the Inuit hunted, 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. Because the Inuit shared freely and generously with one another, members of the hunting party later shared their portions with other families who had not participated.

The result was that the hunter had the honor of the kill and the respect of the village, rather than a physical claim to the entire animal. Because of this tradition of sharing, a village could survive the long, harsh winters as long as skilled hunters lived in the community. This custom was partially responsible for the Inuit's survival for thousands of years.

## Advantages

The main advantage of a traditional economy is that everyone knows which role to play. Little uncertainty exists over

**Traditions** This woman in Botswana weaves a basket based on methods handed down by her ancestors. **What are the main characteristics of a traditional economy?**



# The Global Economy & YOU



## The Great Wal [Mart] of China

What do you and 1 billion Chinese consumers have in common? Access to a Wal-Mart store. China's membership in the World Trade Organization has opened the door for capitalist companies to do business in this communist country. Now a growing number of Wal-Marts—48 and counting—cater to China's upper-middle class. Chinese consumers are pleased with the cleanliness and convenience Wal-Mart has to offer. Joe Hatfield, president and CEO of Wal-Mart Asia, explains that while Chinese grocers use fans to scatter flies, "They hold us to a higher standard than others and to set the expectations for others to follow."

While each new store creates roughly 500 new jobs, the retailer's presence in China does not come without

controversy. Opponents deride the company's low wages—between \$84 and \$96 per month—and argue that Wal-Mart encourages exploitation of Chinese workers. Headlines detailing the power struggle between the All-China Federation of Trade Unions (ACFTUS) and Wal-Mart have drawn attention to the retailer's anti-union stance in a Communist country. Meanwhile, the world watches as China seeks to balance modern and traditional ways, as well as capitalist and communist ideologies.



**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 things much the same way your parents did. Finally, the **FOR WHOM** question is determined by the customs and traditions of the society. In some societies, you would provide for your immediate family. In others, such as the Inuit, you would share what you have hunted with all families of the village. In other words, tradition dictates how people live their lives.

### Disadvantages

The main drawback of a 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 who act differently or break the rules. The lack of progress leads to economic **stagnation** and a lower standard of living than in other economic systems.

**✓ Reading Check Describing** What are the advantages and disadvantages of a traditional economy?

## Command Economies

**MAIN Idea** Command economies rely on a central authority to make most of the economic decisions.

**Economics & You** As you make career decisions, does the government or other authority tell you what to do? Read on to find out how decisions are made in a command economy.

In a **command economy**, a central authority makes the major decisions about **WHAT**, **HOW**, and **FOR WHOM** to produce. A command economy can be headed by a king, a dictator, a president, or anyone else who makes the major economic decisions.

### Characteristics

In a pure command economy, the government makes the major economic decisions. This means that the government decides if houses or apartments will be built. It also decides on the best way to build them, as well as who will receive them.

Most command economies severely limit private property rights. People are not allowed to own their homes, businesses, and

**command economy** economic system with a central authority that makes the major economic decisions



### Consumer Goods

Command economies often limit the production of consumer goods.

The result is sparsely stocked shelves, such as in this store in Pyongyang, North Korea.

***Why might command economies lack consumer goods?***

other productive resources, although they may have some personal items and tools.

Individual freedom also is limited. For example, if the government wants engineers rather than social workers, then its universities will train more engineers. This limits individual choices because people have to live within the government's restrictions.

Finally, government officials tend to favor themselves when making economic decisions. The result is that some of the country's money often goes to luxury goods like houses, cars, and extravagant vacations for these officials.

### Examples

Because they tend to be unproductive, few pure command economies exist today. North Korea and Cuba are modern examples, but in the 1970s and 1980s, the

communist bloc countries of the former Soviet Union had command economies.

In the former Soviet Union, for example, the State Planning Commission determined needs, set goals, and established production quotas for major industries. If it wanted growth in heavy manufacturing, it would **allocate** resources to that sector. If it wanted to strengthen national defense, it directed resources to military production.

### Advantages

The main strength of a command system is that it can change direction drastically. The former Soviet Union went from a rural agricultural society to an industrial nation in a few decades by **emphasizing** the growth of heavy industry. During this period, the central planning agency shifted resources on a massive scale.



Another advantage of command economies, especially those represented by the former Soviet Union, is that many health and public services are available to everyone at little or no cost.

## Disadvantages

Pure command economies have their disadvantages. One is that they ignore the basic wants and needs of consumers. In the Soviet Union, for example, generations of people were forced to do without consumer goods and adequate housing. Similarly, the current North Korean government has put a strong emphasis on defense. In the meantime, the North Korean people have been suffering years of hunger. At times, the government even had to accept aid from international sources.

A second disadvantage is that the system gives people the incentive to fill their quotas instead of producing a good product. At one time in the former Soviet Union, quotas for electrical motors were measured in tons of output. Soviet workers then filled their quotas by producing the world's heaviest electrical motors.

A third weakness is that a command economy requires a large decision-making bureaucracy. In the former Soviet Union, an army of clerks, planners, and other administrators was needed to operate the system. This structure slowed decision making and raised the cost of production.

Yet a fourth weakness is that the planning bureaucracy lacks the flexibility to deal with minor day-to-day problems. As a result, command economies tend to lurch from one crisis to the next—or collapse completely, as did the former Soviet Union.

Finally, rewards for individual initiative are rare in a command economy. Each person is expected to perform a job in a factory or on a farm according to the decisions made by central planners.

**Reading Check Analyzing** What are the major problems with a command economy?

## Market Economies

**MAIN Idea** In a market economy, consumers and businesses jointly answer the questions of WHAT, HOW, and FOR WHOM to produce.

**Economics & You** Name one or two things you like about the economic system in the United States. Read on to learn about the advantages of a market economy.

In a **market economy**, people make decisions in their own best interest. In economic terms, a **market** is an arrangement that allows buyers and sellers to come together to exchange goods and services. A market might be in a physical location, such as a farmers' market, or on an Internet site, such as eBay. Regardless of its form, a market can exist as long as a mechanism is in place for buyers and sellers to meet.

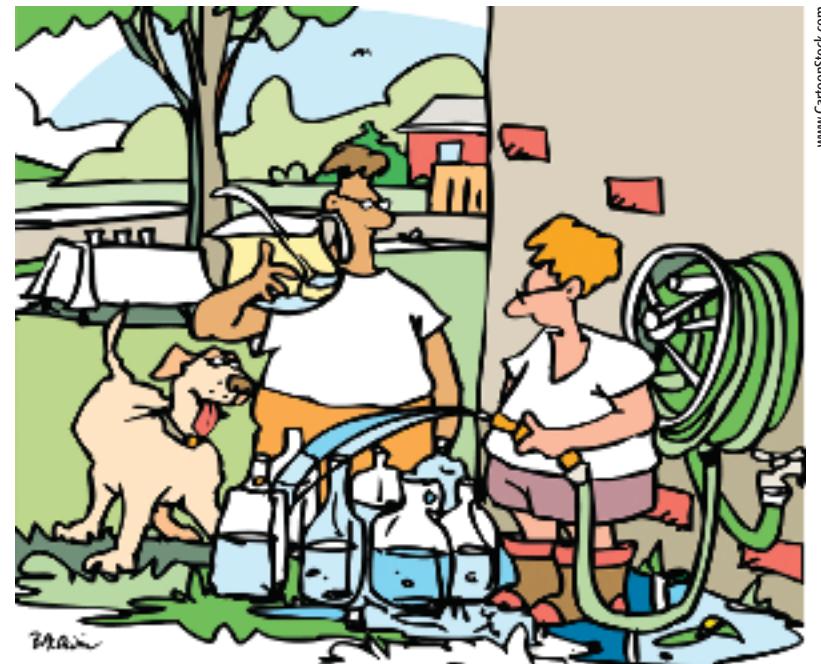
## Characteristics

A market economy is characterized by a great deal of freedom. People can spend their money on the products they want most, which is like casting dollar "votes" for those products. This tells producers which products people want, thus helping them answer the question of WHAT to

**market economy**  
economic system in which supply, demand, and the price system help people make economic decisions and allocate resources

**market** meeting place or mechanism that allows buyers and sellers to come together (also see page 15)

**Market Economies** In a market economy, people have the freedom to start any business they wish. **How do the two entrepreneurs in the cartoon reflect this freedom of choice?**



"Forget lemonade. The real money's in bottled water."



## capitalism

economic system in which private citizens own and use the factors of production in order to generate profits

produce. Businesses are free to find the best production methods when deciding HOW to produce. Finally, the income that consumers earn and spend in the market determines FOR WHOM to produce.

Market economies also feature the private ownership of resources. A market economy is often described as being based on **capitalism**—an economic system where private citizens own the factors of production. The term *capitalism* draws attention to the private ownership of resources, while the term *market economy* focuses on where the goods and services are exchanged. As a result, the two terms focus on different features of the same economy.

## Examples

Many of the most prosperous economies in the world, such as the United States, Japan, South Korea, Singapore, Australia, Great Britain, and parts of Western Europe, are based on markets and capitalism. While there are significant differences among them, these economies share the common elements of markets and the private ownership of resources to seek profits.

## Advantages

The first advantage of a market economy is its high degree of individual freedom. People are free to spend their money on almost any good or service they choose. They also are free to decide where and when they want to work, or if they want to invest further in their own education and training. At the same time, producers are free to decide whom they want to hire, which inputs they want to use, as well as the way they want to produce.

The second advantage of a market economy is that it adjusts gradually to change over time. Prior to 2005, for example, gasoline prices were low, so people tended to buy large gas-guzzling SUVs. When the price of gas rose sharply in that year, SUV sales fell, and smaller, more fuel-efficient vehicles became popular.

A third advantage is the relatively small degree of government interference. Except for certain concerns such as national defense, environmental protection, and some care for the elderly, the government normally tries to stay out of the way of buyers and sellers.

## Skills Handbook

See page R45 to learn about **Comparing and Contrasting**.

**Figure 2.1 ►**

## Comparing Economic Systems

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

► Every society has an economic system. The type of system that is best for a society depends on its ability to satisfy people's wants and needs and to fulfill its economic goals.

**Economic Analysis** *Which economic system do you think is best able to provide for the wants and needs of individuals, and why?*



A fourth advantage is that decision making is decentralized. Billions, if not trillions, of individual economic decisions are made daily. Collectively, people make the decisions that direct scarce resources into the uses consumers favor most, so everyone has a voice in the way the economy runs.

A fifth advantage of the market economy is the variety of goods and services. You can find ultrasound devices to keep the neighbor's dog out of your yard, or you can download music and video to your cell phone. In short, if a product can be imagined, it is likely to be produced in hopes that people will buy it.

A sixth advantage is the high degree of consumer satisfaction. In a market economy, the choice one group makes does not affect the choices of other groups. If 51 percent of the people want to buy classical music, and 49 percent want to buy rap music, people in both groups can still get what they want.

## Disadvantages

The market economy does not provide for everyone. Some people may be too young, too old, or too sick to earn a living or to care for themselves. These people would have difficulty surviving in a pure market economy without assistance from family, government, or charitable groups.

A market economy also may not provide enough of some basic goods and services. For example, private markets do not adequately supply all of the roads, universal education, or comprehensive health care people would like to have. This is because private producers concentrate on providing products they can sell for a profit.

Finally, a market economy has a high degree of uncertainty. Workers might worry that their company will move to another country in search of lower labor costs. Employers may worry that someone else will produce a better or less expensive product, thereby taking their customers.

**Reading Check** **Identifying** What are the main characteristics of a market economy?

## Mixed Economies

**MAIN Idea** Most economies in the world today feature some mix of traditional, command, and market economies.

**Economics & You** You just learned about traditional, command, and market economies. Read on to learn how most societies combine elements of each.

While textbooks identify neat categories like traditional, command, and market economies, the real world is not so orderly. Most countries have **mixed economies**—systems that combine elements of all three types. When we consider political systems as well as economic systems, the picture gets even more complicated.

For example, **socialism** is a mixed economic and political system in which the government owns and controls some, but not all, of the basic productive resources. In socialistic countries, the government also provides some of the basic needs of its people, such as education and health care.

An extreme form of socialism is **communism**—a political and economic system where all property is collectively—not privately—owned. In a communist system, labor is organized for the common advantage of the community, and everyone consumes according to their needs. In practice, however, communist governments have become so involved in economic decisions that they are often called command economies.

## Characteristics

If government or tradition, as well as markets, answer *some* of the questions of **WHAT**, **HOW**, and **FOR WHOM** to produce, then a society has a mixed economy. The type of political system in a mixed economy is less important than the way basic economic decisions are made.

For example, some mixed economies have a political system based on democracy, and others do not. The state's involvement in economic decisions also can vary. Some governments provide only for basic needs such as defense, a justice system, and

**mixed economy** economic system that has some combination of traditional, command, and market economies

**socialism** political and economic system in which the government owns and controls some factors of production

**communism** economic and political system in which all factors of production are collectively owned and controlled by the state



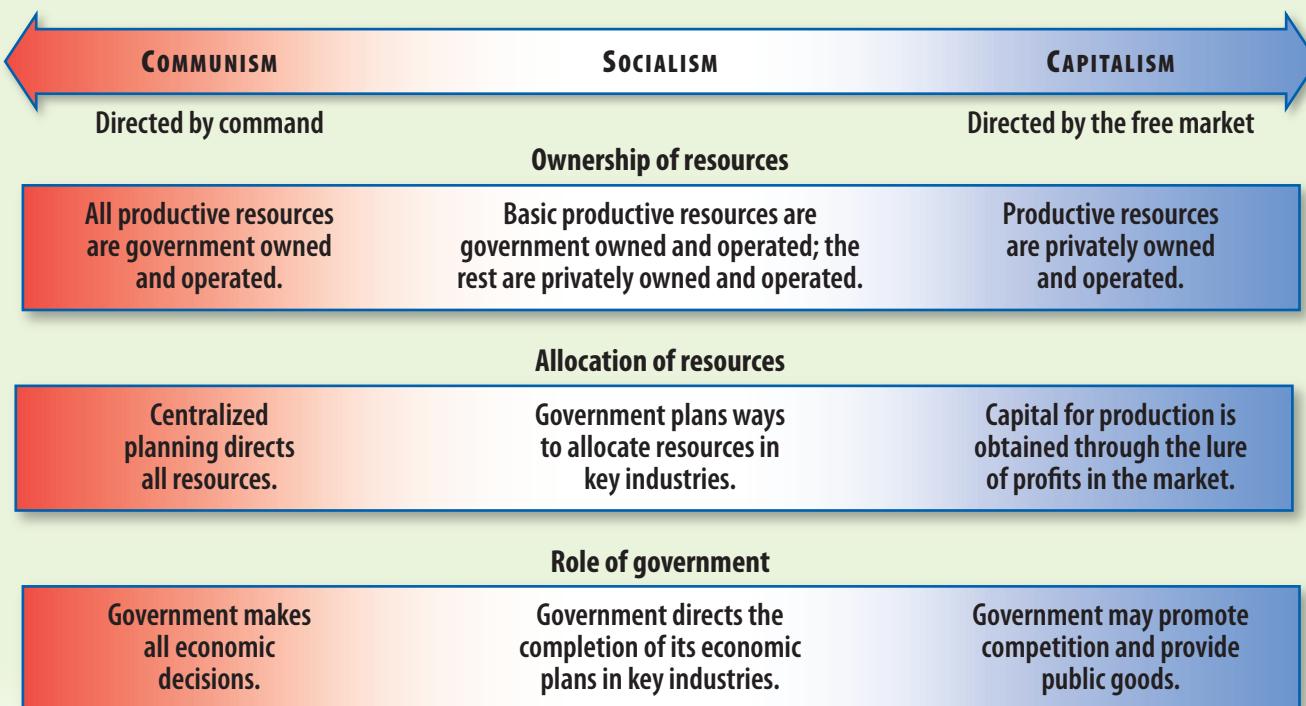
## Figure 2.2 ► The Spectrum of Mixed Economies

- In mixed economies, government involvement can range from providing basic public goods to making most economic decisions.

### Economic Analysis *What distinguishes socialism from communism?*

### Charts In Motion

See StudentWorks™ Plus or [glencoe.com](http://glencoe.com).



universal education. The more socialistic a country is, the more it will make major economic decisions, often with the claim that this is done for the betterment of the people. Some governments intervene only in certain key sectors or industries and leave the rest to markets. If the government intervenes too much, a mixed economy can turn into a command economy.

### Examples

There is a wide range of mixed economies. China has a mixture of traditional, command, and market economies. While tradition has a strong influence in rural areas, the government makes many of the major economic decisions and owns many of the factors of production. China is changing, however. In recent years the government has allowed some private ownership of resources, and capitalism is beginning to flourish.

In Norway, the government owns the basic petroleum industry. It uses the revenue from the sale of oil to other nations to keep its domestic gas prices low, finance education, maintain roads, and provide social welfare for its citizens. Because the government controls just one industry, the mixed economy is based on capitalism and markets with some elements of socialism.

Cuba and North Korea today are very similar to the former Soviet Union, where a socialist government controlled resources to provide for all the people. However, the ownership and control of resources were so extensive that many economists thought of the country as a command economy.

### Advantages

One advantage of a mixed economy is that it provides assistance for some people who might otherwise be left out. All societies



include some people who are too young, too old, or too sick to provide for themselves, for example, and most societies have traditions that address some of these concerns.

If the society has a democracy, voters can use their electoral power to affect the WHAT, HOW, and FOR WHOM decisions even if the government owns no productive resources. For example, the government can pass laws to provide aid for those most in need or to fund road construction.

Under socialism, the FOR WHOM question is addressed more directly. Ideally, those who are not fortunate or productive enough to take care of themselves still share certain benefits, such as free or low-cost public housing, transportation, medical care, and education.

## Disadvantages

While mixed economies tend to provide more services, the costs for these benefits can mean higher costs for citizens overall. Germany, for example, offers a wide range of benefits, but it also has a high tax rate. During economic downturns, when the government collects fewer taxes, less

money is available for these programs. The German government has discussed placing limits on benefits, such as unemployment and welfare, because of lower revenues.

In some socialist countries, the availability of services may be limited or the quality may deteriorate over time. Today, for example, Cuba claims that it has free health care for everyone, but the care is substandard for everyone except high-ranking members of the Communist Party and those willing to pay for services in dollars.

Historically, both socialism and communism have proved to be less efficient than capitalism. For example, if workers receive government guarantees of jobs, more workers may be hired in a plant than are necessary, driving up production costs.

Because socialism has proved to be so inefficient, many socialistic countries today allow more capitalist development. This is especially true in China, where the emergence of capitalism has helped the country to become one of the major economic powers in the world today.

✓ **Reading Check Explaining** How can you explain the range of mixed economies in the world?

### SECTION

# 1

## Review

### Vocabulary

1. **Explain** the significance of economic system, traditional economy, command economy, market economy, market, capitalism, mixed economy, socialism, and communism.

### Main Ideas

2. **Describing** Use a graphic organizer like the one below to describe how economic systems answer the basic economic questions.

WHAT, HOW, and FOR WHOM?	
Traditional economy	
Command economy	
Market economy	
Mixed economy	

3. **Explain** how a command economy differs from the other economic systems.

### Critical Thinking

4. **The BIG Idea** Why do market economies tend to be more efficient than traditional or command economies?

5. **Analyzing Visuals** Look at the chart on page 40. Why does the top row show arrows on the left and right?

6. **Inferring** Why are market economies more innovative than either traditional or command economies?

7. **Analyzing** How does a traditional economy differ from a mixed economy like that of the United States today?

### Applying Economics

8. **Mixed Economy** List specific examples to illustrate why the U.S. economy is categorized as a mixed economy.



# CASE STUDY

## The Home Depot®

### Fast Rise to Riches

In 1978, co-founders Bernie Marcus and Arthur Blank tapped into America's love of "big" and bargains when they started a chain of retail warehouses stacked floor to ceiling with everything a builder or homeowner could want or need. Thus The Home Depot® was born.

### NEWS FLASH

#### Rethinking Pink

Other predominantly "male" markets are also reaching out to women, and not just by changing a product's color to pink. Harley-Davidson has created a section on its Web site for its growing female base. When Apple introduced its multicolored iPod Mini, it experienced a 74 percent jump in sales.

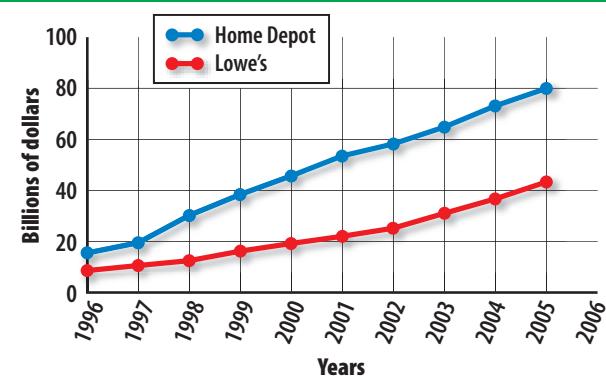
### Lagging Sales

In the early 2000s, however, Home Depot's largest competitor, Lowe's, gained sales faster. Its secret? Focusing on women customers. The home-improvement market is huge, estimated

at a quarter of a trillion dollars. Roughly one-fourth of that (over \$50 billion) consists of purchases made by women. Hardware retailers big and small began courting women—with features such as brighter lighting, wider aisles, and easy-to-reach shelves.



NET SALES FOR THE HOME DEPOT AND LOWE'S, 1996–2005



Source: [www.homedepot.com](http://www.homedepot.com) and [www.morningstar.com](http://www.morningstar.com).

### "Do It Herself"

The Home Depot decided to jump on the bandwagon, but it took this courtship one step further. It set up nationwide Do-It-Herself Workshops, taught by experienced Home Depot associates who offer hands-on demonstrations and step-by-step instructions for completing a project. The first workshop took place in May 2003. A little over a year later, more than 200,000 women had attended one of the Do-It-Herself remodeling workshops.

Today The Home Depot is the world's second-largest retailer, after Wal-Mart. As of spring 2006, the company operated 2,054 stores in 50 states, the District of Columbia, Puerto Rico, U.S. Virgin Islands, 10 Canadian provinces, and Mexico.

### Analyzing the Impact

- 1. Summarizing** How did The Home Depot market its stores toward women?
- 2. Making Inferences** Think about recent television and magazine advertisements. Which gender do you feel marketers were targeting? Describe five products and the "hook" used to capture the consumer's attention.

SECTION  
**2**

# Evaluating Economic Performance

## GUIDE TO READING

### Section Preview

In this section, you will learn how economic freedom, economic security, and economic equity are related to the level of satisfaction people have with their economic systems.

### Content Vocabulary

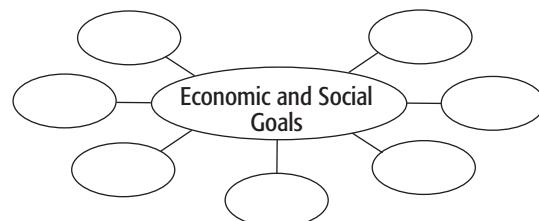
- minimum wage (p. 44)
- inflation (p. 45)
- Social Security (p. 45)
- fixed income (p. 45)

### Academic Vocabulary

- adverse (p. 45)
- accommodate (p. 46)

### Reading Strategy

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



## COMPANIES IN THE NEWS

—Newsweek

### Fruits That Go Fizz

Schoolkids in Oregon are trying something new at lunch: carbonated fruit that the Fizzy Fruit Co. hopes will lead to effervescent profits. Founder Galen Kaufman discovered his product when he ate a pear that had been stored in dry ice, which is made of carbon dioxide. The pear was fizzy and sweet, and ever since, Kaufman's been trying to commercialize the idea.

Not a few exploded kitchen experiments later, Kaufman has found his market. School-lunch supplier Sodexho has been serving the fruit in a pilot project at 14 Oregon schools, and it is expected to be in about 500 schools nationally by next month. Fizzy Fruit will also soon be sold in vending machines and at convenience stores. The trick is in the packaging. Because the fruit loses its fizz within about 20 minutes of being exposed to air (think of a soda bottle left uncapped), it's got to be wrapped tight. ■



**W**hen Galen Kaufman discovered that fruit could fizz, he made it his goal to market the idea. Economic systems also have goals. These goals provide a way to guide economic decisions. They can also help people measure how well the system is working to meet its goals.

If our economic system fails to achieve our goals, we may decide to seek changes. We could demand laws to modify the system until our needs are met. In the United States, efforts to meet our economic and social goals have caused the economy to evolve slowly over time.



**minimum wage**  
lowest legal wage that can be paid to most workers

## Economic and Social Goals

**MAIN Idea** Americans share several major economic and social goals.

**Economics & You** As you approach graduation, what kinds of goals have you set for your future? Read on to learn about the economic goals of the nation.

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

### Economic Freedom

Americans traditionally place a high value on the freedom to make their own economic decisions. They like to choose their 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 the belief in 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. Because economic decision making must be efficient, economic efficiency is also one of our major goals.

### Economic Equity

Americans have a strong tradition 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. At the national level, we have established the **minimum wage**—the lowest legal wage that can be paid to most workers. While not everyone supports it, the minimum wage does put a floor on the amount of income that some workers earn.

#### Economic Freedom

Americans are free to open any business they choose, such as this music store.

**How might the goal of economic freedom conflict with other goals?**





Most people believe 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 cars with too many defects.

## Economic Security

Americans desire protection from such **adverse** economic events as layoffs and illnesses. As a result, many states have set up programs to help workers who lose their jobs through no fault of their own, and many employers have insurance plans to cover the injuries and illnesses of their workers. At 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 all 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 also provides health insurance for persons 65 or older.

## Full Employment

When people work, they earn income by producing goods and services for others. Without jobs, people cannot support themselves or their families, nor can they produce output for others. As a result, most people want their economic system to provide as many jobs as possible. The goal of full employment even became law when Congress passed the Employment Act of 1946 in an effort to avoid the widespread joblessness before World War II.

## 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 planning for the future is more difficult.

# DID YOU KNOW?

► **On Easy Street?** The earliest reported recipient of Social Security was Ernest Ackerman, a retired Cleveland motorman. Ackerman retired one day after the Social Security program began. In return for the nickel withheld from his pay for this one day, he received a lump-sum payment of 17 cents, barely higher than the smallest payment ever of 5 cents. Such lump sum payments were made until 1942, with an average payment of \$58.06. Ida May Fuller from Ludlow, Vermont, became the first recipient of monthly Social Security benefits.

### Social Security

federal program of disability and retirement benefits that covers most working people

**inflation** rise in the general level of prices

### fixed income

income that does not increase even though prices go up

## Economic Growth

The last major goal of most Americans is economic growth. Most people hope to have a better job, a newer car, their own home, and a number of other things in the future. Overall growth enables more people to have more goods and services. Because the nation’s population is likely to increase, economic growth is necessary to meet everyone’s needs.

## Future Goals

The seven goals we have discussed so far are the ones on which most people seem to agree. As our society evolves, however, it is possible for new goals to develop. Do people feel that a cleaner environment is important enough to be added to the list of goals? Should we add the preservation of endangered species such as the California Channel Islands fox? In the end, we are the ones who decide on the goals that are most important to us, and it is entirely possible that our goals could change in the future.

✓ **Reading Check** **Interpreting** What major themes can you identify in the list of seven economic goals?



## Skills Handbook

See page R48 to learn about **Problems and Solutions.**

# Resolving Trade-Offs Among Goals

**MAIN Idea** Conflicts among goals can be solved by comparing the cost of a goal to its benefit.

**Economics & You** You learned earlier about trade-offs when deciding how to spend a monetary gift of \$100. Read on to find out how trade-offs also apply to economics goals.

People often have different ideas about how to reach a goal, or the goals themselves might conflict. Even our economic policies have opportunity costs.

For example, a policy that keeps foreign-made shoes out of the United States could help achieve the goal of full employment in the domestic shoe industry, but it could work against individual freedom if people have fewer choices of shoes to buy.

Even an increase in the minimum wage involves a conflict of goals. On one hand, supporters of the increase argue that an increase is the equitable, or “right,” thing to do. Opponents argue that an increase may cause fewer workers to be hired. In addition, it restricts the freedom of employers to pay wages that they think are fair.

How are trade-offs among goals resolved? In most cases, people compare their estimate of the costs to their estimate of the benefits, and then vote for political candidates who back their position. If the majority of voters feel that the minimum wage is too low, then it will be raised. The minimum wage then tends to stay at this new level until the majority of people feel that it needs to be changed again.

People, businesses, and government are usually 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.

In a democratic society, 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 their economic goals. A 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. This system most likely will undergo further change as the goals and objectives of the American people change.

**Reading Check Explaining** Why do trade-offs among goals exist?

## SECTION

# 2

## Review

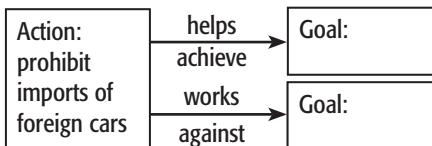
### Vocabulary

- Explain the significance of minimum wage, Social Security, inflation, and fixed income.

### Main Ideas

- Explain why it is important for a nation to set economic and social goals.

- Determining Cause and Effect** Use a graphic organizer like the one below to illustrate how economic and social goals may conflict with one another.



### Critical Thinking

- The BIG Idea** How does an increase in the minimum wage involve a conflict of goals?
- Inferring** What can Americans do to influence the economic goals of the nation?
- Applying** How do laws against false or misleading advertising promote the goal of economic equity?

### Applying Economics

- Economic Security** Interview a friend or relative who is retired or approaching retirement to find out if he or she believes the government has achieved the goal of economic security for its senior citizens, and why. Write a paragraph to describe these views and explain why you agree or disagree with them.



# BusinessWeek NEWSCLIP

We do not usually associate economic efficiency with fun. In the past few years, though, some companies have found a new and unusual tool to make job training more efficient—and more fun.

## On-the-Job Video Gaming

Laura Holshouser's favorite video games include *Halo*, *Tetris*, and an online training game developed by her employer. A training game? That's right. The 24-year-old graduate student, who manages a Cold Stone Creamery ice-cream store in Riverside, Calif., stumbled across the game on the corporate Web site in October.

It teaches portion control and customer service in a cartoon-like simulation of a Cold Stone store. Players scoop cones against the clock and try to avoid serving too much ice cream. The company says more than 8,000 employees, or about 30% of the total, voluntarily downloaded the game in the first week. . . .

The military has used video games as a training tool since the 1980s. Now the practice is catching on with companies, too. . . . Corporate trainers are betting that games' interactivity and fun will hook young, media-savvy employees like Holshouser and help them grasp and retain sales, technical, and management skills. . . .



Companies like video games because they are cost-effective. Why pay for someone to fly to a central training campus when you can just plunk them down in front of a computer? Even better, employees often play the games at home on their own time. . . .

Games are especially well-suited to training technicians. . . . Last year, Cisco rolled out six new training games—some of them designed to teach technicians how to build a computer network. It's hard to imagine a drier subject. Not so in the virtual world. In one Cisco game, players must put the network together on Mars. In a sandstorm. . . . Sounds suspiciously like fun.

—Reprinted from *BusinessWeek*

\$736	Cost of traditional training per employee
8,000	Number of employees who download the game in the first week
\$5,888,000	Cost of traditional training for 8,000 employees
\$500,000	Average cost of corporate training game

### Examining the Newsclip

- 1. Summarizing** How has on-the-job video gaming made workers and companies more efficient?
- 2. Analyzing** How do companies make video training games appealing for their employees?



SECTION

## 3

# American Free Enterprise

## GUIDE TO READING

### Section Preview

In this section, you will learn how under capitalism the basic economic decisions of **WHAT**, **HOW**, and **FOR WHOM** to produce are made through the free interaction of individuals looking out for their own best interests.

### Content Vocabulary

- free enterprise (p. 48)
- voluntary exchange (p. 49)
- private property rights (p. 50)
- profit (p. 50)
- profit motive (p. 50)
- competition (p. 50)
- consumer sovereignty (p. 51)
- mixed or modified free enterprise economy (p. 53)

### Academic Vocabulary

- incentive (p. 50)
- catalyst (p. 51)
- regulator (p. 52)

### Reading Strategy

**Listing** 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

## COMPANIES IN THE NEWS

—adapted from *BusinessWeek*

### Hot Growth at Claire's

When Bonnie and Marla Schaefer became vice-CEOs of Claire's Stores Inc., they had much to prove to the company's board. Within a few years they did just that: profits nearly doubled, earning Claire's a slot on *BusinessWeek's* 2005 list of Hot Growth companies.

How did the sisters do it? One way was to focus on a troubled recent acquisition they renamed Icings. The new store appeals to the 17-to-27 crowd. Unlike their father, Rowland Schaefer, founder and former CEO of Claire's, the sisters use market research to identify teen trends. They also licensed popular celebrities such as Mariah Carey to provide cosmetics and jewelry lines.

The sisters won't stop there. The company already has stores in Europe and Japan, and franchises are now expanding into other continents. ■



**free enterprise**  
capitalistic economy  
in which competition  
is allowed to flourish  
with a minimum of  
government  
interference

**C**apitalism has become the economic system of choice in many parts of the world because of its ability to generate wealth, just as it has for Claire's. Capitalism, as you have learned, is an economic system in which private citizens own and use the factors of production to generate profits.

The U.S. economy is based on free enterprise. Under **free enterprise**, resources are

privately owned, and competition is allowed to flourish with a minimum of government interference. We often use the terms *capitalism* and *free enterprise* interchangeably, but they have different meanings. While capitalism stands for the private ownership of resources, free enterprise is the unhindered use of privately owned resources to earn profits.



# Characteristics of Free Enterprise Capitalism

**MAIN Idea** The American economy incorporates the main characteristics of a free enterprise economy.

**Economics & You** How much freedom do you have to make your own economic choices? Read on to learn how this freedom characterizes our own market economy.

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

## Economic Freedom

Economic freedom means more than being able to buy the things you want. It means that you have the freedom to choose your occupation, your employer, and your job location. You can even leave your current

job and move on to another job that offers greater opportunity.

Businesses also enjoy considerable economic freedom. They are free to hire the best workers, and they are free to produce the products they feel will be the most profitable. Businesses can make as many items as they want, sell them wherever they please, and normally charge whatever price they choose. In short, they are free to risk success or failure.

**voluntary exchange** act of buyers and sellers freely and willingly engaging in market transactions

## Voluntary Exchange

A second characteristic of capitalism is **voluntary exchange**—the act of buyers and sellers freely and willingly engaging in market transactions. Voluntary transactions benefit both the buyer and the seller, or the exchange would never occur.

For example, when buyers spend their money on a product, they act on a belief that the item they purchase is of greater

## Figure 2.3 ► Characteristics of Free Enterprise Capitalism



► “Free enterprise capitalism” describes a market economy in which private citizens own the factors of production and businesses compete with minimal government interference.

**Economic Analysis** *What items are included in the category of private property?*



**private property rights** fundamental feature of capitalism that allows individuals to own and control their possessions as they wish

**profit** extent to which persons or organizations are better off financially at the end of a period than they were at the beginning

**profit motive** incentive that encourages people and organizations to improve their financial and material well-being

**competition** the struggle among sellers to attract consumers

#### Personal Finance Handbook

See pages R6–R9  
for more information  
on saving and  
investing.

value than the money they give up—or they would not make the purchase. When sellers exchange their products for cash, they believe that the money they receive is more valuable than the product they sell—otherwise they would not make the sale.

### Private Property Rights

Another major feature of capitalism is **private property rights**, which allow people to own and control their possessions as they wish. People have the right to use or even 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 accumulate, improve, use, or lend it. They also know they can keep any rewards they might earn.

### Profit Motive

Under free enterprise capitalism, people are free to risk any part of their wealth in a business venture. If it goes well, they will earn rewards for their efforts. If it goes poorly, however, they could lose part or all of their investment.

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

### Competition

Capitalism thrives on **competition**—the struggle among sellers to attract consumers. Competition is possible because individual entrepreneurs have the freedom to produce the products they think will be the most profitable. Free enterprise capitalism allows competition to flourish, benefiting both producers and consumers alike.

 **Reading Check Summarizing** How does voluntary exchange work in the free enterprise economy?

## The Role of the Entrepreneur

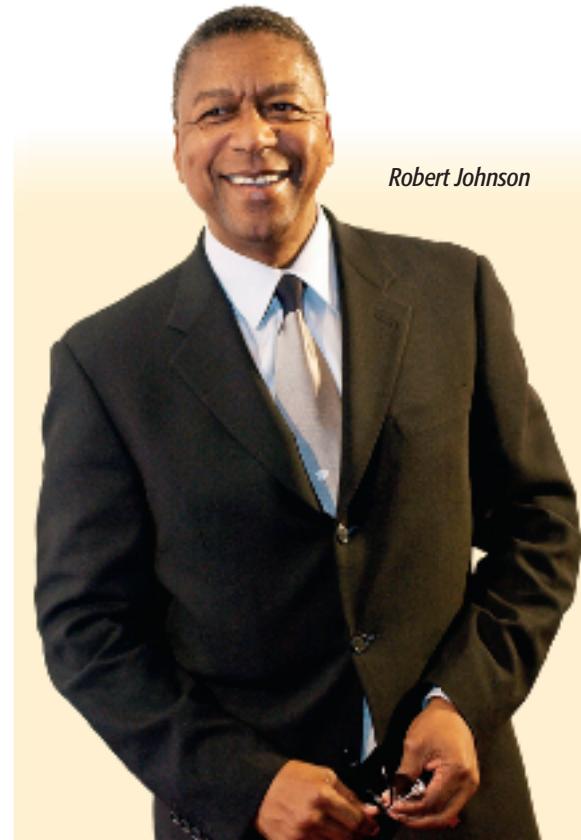
**MAIN Idea** Entrepreneurs are the driving force of the free enterprise system.

**Economics & You** Can you think of a successful entrepreneur and the business he or she runs? Read on to learn why entrepreneurs are important in a free enterprise economy.

The entrepreneur plays one of the most important roles in the free enterprise economy. The entrepreneur organizes and manages land, capital, and labor in order to seek the reward called profit.

Entrepreneurs are the people 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 who decided to quit and start their own businesses. Entrepreneurs want to “be their own boss” and are willing to take risks to make their dreams come true.

Many entrepreneurs fail. 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. Well-known entrepreneurs include Robert Johnson, founder of BET,



Robert Johnson



Bill Gates, who founded Microsoft, 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 spark plug 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 that can be used to build roads, schools, and libraries for people not even connected with the original entrepreneur.

It does not 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 of the product 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 brings new products, greater competition, more production, higher quality, and lower prices for consumers.

**Reading Check** **Analyzing** Why are entrepreneurs considered both spark plugs and catalysts of the free enterprise economy?

Evan Hurd/Corbis

## The Role of the Consumer

**MAIN Idea** The economy in the United States adapts to consumers’ wants.

**Economics & You** When you go shopping and cast your dollar “votes,” do you realize that you are helping to answer the question of **WHAT** to produce? Read on to learn how consumers help decide what products are offered in a free market economy.

Consumers have power in the economy because ultimately they determine which products are produced. If consumers like a new product, the producer will be rewarded with profits. If consumers do not buy it, the firm may lose money or even go out of business. The term **consumer sovereignty** recognizes the role of the consumer as sovereign, or ruler, of the market. The phrase “the customer is always right” reflects this power.

In recent years, producers have had outstanding successes with products ranging from video games to Internet search engines such as Google. Other products—including “Crystal” Pepsi, celery-flavored Jell-O, and Dr. Care’s aerosol toothpaste (which kids discovered they could spray around the bathroom)—were rejected.

In addition, consumers’ wants change constantly as people are exposed to new ideas and products. Today, Americans purchase more home computers every year than TV sets, even though computers were

**consumer sovereignty** role of consumer as ruler of the market when determining the types of goods and services produced

### Skills Handbook

See page R40 to learn about **Analyzing Information**.



### Entrepreneurs and Consumers

Some entrepreneurs, like Robert Johnson, develop corporations for consumers nationwide, while others serve local customers. **How do consumers influence the economy?**

*photo: Hot dog stand in Los Angeles*



barely known just 25 years ago. They buy products all over the world and frequently use the Internet to research products and make purchases.

The dollars consumers spend in the marketplace are the “votes” that give them a say in what is, and what is not, produced. Because of this, consumers play an important role in the American free enterprise economy.

 **Reading Check** **Summarizing** What role do consumers play in a free enterprise system?

## CAREERS

### Construction and Building Inspector (Zoning Officer)

#### The Work

- \* Examine the construction or repair of buildings, sewer and water systems, dams, bridges, highways, and streets to ensure compliance with building codes, zoning regulations, and contract specifications
- \* Review blueprints, write reports and detailed logs, and schedule inspections



#### Qualifications

- \* Profound knowledge of construction materials and practices
- \* Experience with survey instruments, metering devices, and test equipment
- \* Degree or certificate in building inspection with an emphasis on blueprint reading, construction technology, drafting, mathematics, and English and Spanish
- \* Background in engineering or architecture or a degree from a community college

#### Earnings

- \* Median annual earnings: \$43,670

#### Job Growth Outlook

- \* Faster than average

Source: *Occupational Outlook Handbook, 2006–2007*

## The Role of Government

**MAIN Idea** The economic role of the U.S. government is decided by its citizens.

**Economics & You** What economic roles do you think federal, state, and local governments play in your life? Read on to learn how the government has modified our country’s economic system.

The role of government—whether national, state, or local—stems from the desires, goals, and aspirations of its citizens. Government has become involved in the economy because the citizens want it that way. Consequently, government has become a protector, provider, **regulator**, and consumer. In general, the role of government in the economy is justified whenever the benefits outweigh the 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.

#### Provider

All levels of government provide goods and services for citizens. The national government supplies a system of justice and national defense. It provides subsidies to parts of the economy, such as agriculture. In addition, it gives funding to state and local governments for some programs such as road construction. State governments provide education, highways, and public welfare. Local governments provide parks, libraries, sanitation, and bus services.

#### Regulator

In its role as a regulator, the national government is charged with preserving competition in the marketplace. It also oversees communications, interstate commerce, and



even entire industries, such as banking and nuclear power. Many state governments oversee insurance rates, while local governments regulate economic activity with building and zoning permits.

The regulatory role of government is controversial. Most businesses do not like to be told how to run their affairs. Consumers, however, do not always know when they are at risk from hazards, such as potential poisoning from unsafe food preparation or false and misleading advertising from some companies. As a result, they want the government to monitor and regulate such activities.

## Consumer

The tasks of protecting, providing, and regulating are expensive. All levels of government, like any business, consume scarce resources to fulfill their role. Government has grown so much in recent years that it is now the second-largest consuming unit in the economy, after the consumer sector, eclipsing spending by all private businesses combined. You will learn later

in this textbook how the government collects and spends the money required to accomplish these tasks.

## Modified Free Enterprise

Perhaps an unintended consequence of government's role as protector, provider, regulator, and consumer is the emergence of the **mixed, or modified free enterprise economy**. In this economy, people and businesses carry on their economic affairs freely, but they are subject to some government intervention and regulation.

Some people prefer to have no government involvement in the economy, but this is not possible. After all, some services, such as national defense and a system of laws and justice, cannot be supplied by the private sector alone. Unfortunately there is no clear answer to the question of how much government involvement is necessary, but if it changes, it will be because the voting public wants it that way.

**✓Reading Check** **Explaining** Why do Americans want government to play a role in the economy? Use specific examples.

**mixed or modified free enterprise economy** economy where people carry on their economic affairs freely but are subject to some government intervention and regulation

## SECTION 3

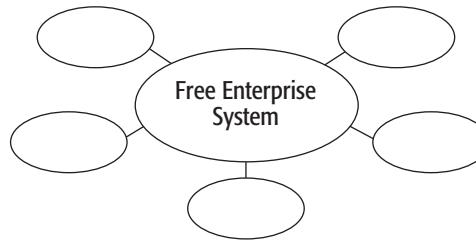
## Review

### Vocabulary

- Explain** the significance of free enterprise, voluntary exchange, private property rights, profit, profit motive, competition, consumer sovereignty, and mixed or modified free enterprise economy.

### Main Ideas

- Describe** the five major characteristics of a free enterprise system by completing a graphic organizer like the one below.



- Explain** the differences in the roles of entrepreneurs, consumers, and the government.

### Critical Thinking

- The BIG Idea** When consumers cast their "votes" in a free enterprise economy, how do they influence what is and is not produced?
- Analyzing Visuals** Look at the photo on page 51. How are the consumers demonstrating their sovereignty?
- Drawing Conclusions** How is the protection of private property rights necessary to the other characteristics of free enterprise?
- Analyzing** Explain why entrepreneurs are the driving force of the free enterprise system.

### Applying Economics

- 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?



# Profiles in Economics



When Tony Hawk first started skateboarding, he saw it as a fun way to spend some time. Just three years later, he signed with his first sponsor, and today he has turned it into a multi-million-dollar business.

## Tony Hawk (1968– )

- professional athlete at age 14 and best skateboarder in the world by age 16
- owner of a successful business empire based on resurgence of skateboarding and name recognition

### Making a Name

Tony Hawk did not set out to become a businessman. When his brother gave him his first skateboard at age nine, all he wanted to do was have some fun. But he was determined that he would learn how to ride it. This determination—and 6 hours of skateboarding a day—led to success. By age 16, Hawk was the best skateboarder in the world. He also opened a skateboarding company, Birdhouse Projects, that brought him his first big financial success.

### The Hawk Takes Off

While Hawk had made a name for himself, skateboarding itself faded in popularity, and with it Hawk's company. Then ESPN decided to broadcast the X Games in 1995. The show's immense success revitalized the skateboarding phenomenon and brought Hawk's name into the mainstream. At the end of his competitive career in 1999, Hawk had won 73 first-place competition titles, created some 80 new tricks, and pioneered a new form of vertical skateboarding.

Hawk's skills piqued the interest of software developer Activision. In 1998 the company approached him with an idea for his own skateboarding video game. Hawk wanted to "make sure that the skating aspect is authentic." He met weekly with the game developers, nixing unrealistic moves and refining aerial stunts. The next year, "Tony Hawk's Pro Skater" flew off the shelves. The Pro Skater games eventually sold 20 million copies and gave Hawk over \$6 million a year in royalties.

In 2002 Hawk launched the Boom Boom HuckJam tour, an extreme sports event that brings the world's best skateboarders, BMX bikers, and motocross racers to arenas around the country. On top of that, his combined brands, which today include skateboards, clothes, shoes, video games, and action figures, generate about \$300 million a year in retail sales.

### Examining the Profile

1. **Drawing Conclusions** How has Tony Hawk used his sport to develop into an entrepreneur?
2. **Making Inferences** How do you know that Hawk is careful about which products he brands? Explain.

# Visual Summary



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- **Economic Systems** Most countries have a mix of three different types of economic systems.

Traditional	Command	Market	Mixed
<ul style="list-style-type: none"> <li>Most economic activities based on ritual, habit, or customs</li> <li>Everyone knows which role to play</li> <li>Little innovation</li> </ul>	<ul style="list-style-type: none"> <li>Government makes all major economic decisions</li> <li>Private property severely limited</li> <li>Can be adjusted quickly to meet a country's demands</li> <li>Does not meet all of consumers' wants and needs</li> <li>Is inefficient and discourages innovation</li> </ul>	<ul style="list-style-type: none"> <li>People make economic decisions based on supply, demand, and the price system</li> <li>High degree of individual freedom and innovation</li> <li>Does not provide for the basic needs of everyone</li> </ul>	<ul style="list-style-type: none"> <li>Provides a mix of all three economic systems</li> <li>Government involvement varies</li> <li>Government provides help to some people who might otherwise be left out</li> <li>Systems like socialism and communism are less efficient than capitalism</li> </ul>

- **Economic and Social Goals** In the United States, we share several economic and social goals.



- **Free Enterprise** The U.S. economic system is based on the free enterprise system and is characterized by competition and private ownership of resources.

Characteristics	Role of Entrepreneurs	Role of Consumers	Role of Government
<ul style="list-style-type: none"> <li>Economic freedom</li> <li>Voluntary exchange</li> <li>Private property rights</li> <li>Profit motive</li> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Organize land, capital, and labor in order to seek profit</li> <li>Accept the risk of loss</li> <li>Decide HOW to produce</li> <li>Are innovators and catalysts</li> </ul>	<ul style="list-style-type: none"> <li>Decide WHAT is produced by how they spend their money</li> <li>Spur development of new products by changing their wants</li> </ul>	<ul style="list-style-type: none"> <li>As protector, provider, and regulator, ensures and enforces that economic and social goals are carried out</li> <li>Is a large consumer in the economy</li> </ul>

# Assessment & Activities

## Review Content Vocabulary

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

- |                         |                            |
|-------------------------|----------------------------|
| a. capitalism           | e. private property rights |
| b. command economy      | f. profit motive           |
| c. consumer sovereignty | g. traditional economy     |
| d. economic system      | h. voluntary exchange      |
1. the idea that buyers and sellers rule the market
  2. a society's organized way of providing for its people's wants and needs
  3. the incentive that encourages people and organizations to try to improve their material well-being
  4. an economic system in which the factors of production are owned by private citizens
  5. the right and privilege to control one's own possessions
  6. an economic system in which ritual, habit, and custom dictate most economic and social behavior
  7. an economic system in which a central authority makes economic decisions
  8. the act of buyers and sellers freely conducting business in a market

## Review Academic Vocabulary

On a separate sheet of paper, define and illustrate each of the following terms. See the sample below.

Term	Definition	Illustration
• Incentive	• Something that encourages or motivates	

- |                |                 |
|----------------|-----------------|
| 9. allocate    | 13. catalyst    |
| 10. emphasize  | 14. regulator   |
| 11. stagnation | 15. accommodate |
| 12. adverse    | 16. incentive   |

## Review the Main Ideas

### Section 1 (pages 33–41)

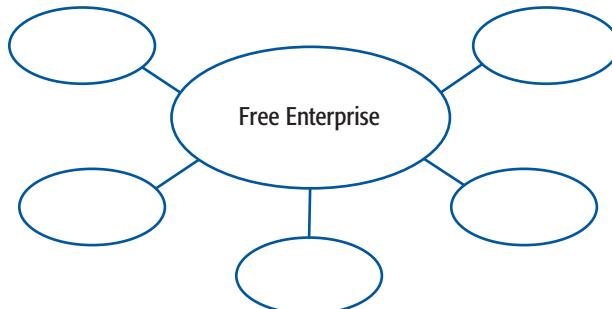
17. **Describe** the main characteristics of a traditional economy.
18. **Identify** the five major weaknesses of a command economy.
19. **Explain** who makes economic decisions in a market economy.
20. **Describe** the advantages and disadvantages of a mixed economy.

### Section 2 (pages 43–46)

21. **Describe** how individuals and businesspeople benefit from economic freedom.
22. **Discuss** who benefits from economic security.
23. **Explain** how a society resolves conflicts between economic and social goals.

### Section 3 (pages 48–53)

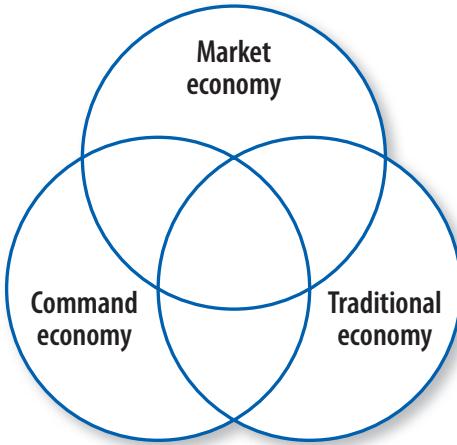
24. **Describe** the five major characteristics of free enterprise.



25. **Explain** why entrepreneurs are thought to have important roles in the economy.
26. **Describe** how consumers have influenced the success of products in recent years.
27. **List** the five major roles that the government plays in the economy.

## Critical Thinking

- 28. The BIG Idea** Some people believe that the profit motive conflicts with the goals of economic security and equity. Do you agree? Why or why not?
- 29. Understanding Cause and Effect** How has the development of modern transportation and communication systems affected the type of economy that exists in the United States?
- 30. Making Inferences** What incentive does owning private property give people?
- 31. 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.



## Analyzing Visuals

- 32. Critical Thinking** Look at the chart on page 40. Explain how government involvement differs under communism, socialism, and capitalism. Where on the spectrum does the economy of the United States fit, and why?

## Math Practice

- 33.** If the typical minimum-wage employee works 40 hours a week and has two weeks' unpaid vacation, how much will that person earn in a year 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

- 34. Critical Thinking** Not all societies have market economies. Some have command or traditional economies. Use the discussion of opportunity cost and cost-benefit analysis in Chapter 1 on pages 20 and 24 to explain why you would or would not like to live in a society with a different economic system. Prepare a decision grid similar to the one on page 20 to help you with your analysis. Write a paragraph that summarizes your conclusion.

## Applying Economic Concepts

- 35. 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.

- 36. Economic and Social Goals** Compare the figures below and then answer the questions that follow.

- If the diagram in Figure 1 represents “needs” and “wants,” how would you label the two diagrams in the figure? Explain your choice.
- 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.
- If you were to change “Economic security” to “Economic efficiency” in Figure 2, would this change your placement of the minimum wage policy? How?

Figure 1

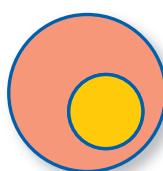
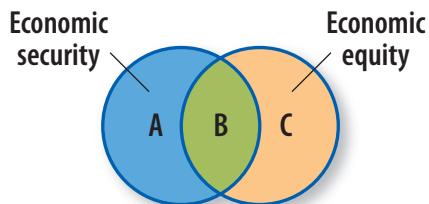


Figure 2





# The Global Economy & YOU



## Pirating Intellectual Property

A major feature of capitalism is the concept of private property rights—the freedom to own and control your possessions as you wish. Another major feature is the profit motive—taking a risk with your labor, property, or money in order to reap financial gains. Unfortunately, in our global economy the risks you take don't always result in rewards—at least for you.

### Stolen Profits

Pirates of intellectual property reduce profits in some industries by as much as 50 percent. The term *intellectual property* (IP) refers to creations of the mind: inventions, literary and artistic works, symbols, names, images, and designs. Piracy of CDs, software, and clothing designs has expanded in recent years, along with counterfeit money and prescription medications. The illegal trade in pirated and counterfeit goods costs the legal world economy an estimated \$630 billion per year.

Software Piracy*		
Highest piracy rates	Lowest piracy rates	
Vietnam	92%	Germany
Ukraine	91%	Finland
China	90%	Japan
Zimbabwe	90%	Switzerland
Indonesia	87%	Denmark
Russia	87%	United Kingdom
Nigeria	84%	Sweden
Tunisia	84%	Austria
Algeria	83%	New Zealand
Kenya	83%	United States

\*Percentage of software pirated versus paid for

Source: Second Annual BSA and IDC Global Software Piracy Study, 2005

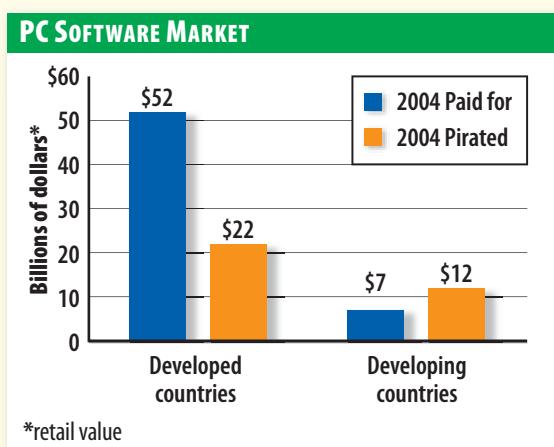
### Case Study: China

In Silk Alley, a street in Beijing, bargain hunters can find just about anything on the cheap, including inexpensive knockoffs of Gucci, Chanel, Prada, and

North Face products. Chinese piracy has made a significant dent in American music, movie, and software profits. In 2004 alone, U.S. companies lost an estimated \$40 billion to IP piracy, the majority of which allegedly took place in China.

In the past, China blamed its flourishing culture of piracy on a myriad of issues. Yet the Chinese government also fostered a culture of piracy by maintaining that intellectual property was not an individual right, but a benefit to the state.

Now that the country is a member of the World Trade Organization, China must follow market-economy rules. It did a remarkable job of cracking down on its own domestic pirates, who have attempted to profit from the 2008 Beijing Olympics. U.S. officials now want to see similar efforts to protect U.S. intellectual property.



Source: Second Annual BSA and IDC Global Software Piracy Study, 2005



## Worldwide Problem

Piracy has become a worldwide problem and affects the bottom line of companies everywhere. IP theft also raises unemployment rates and lowers tax revenues, especially in developing countries. Losses in tax revenue are more costly than one might think. Experts estimate that in four years, a 10 percent drop in the global piracy rate would add roughly 2.4 million new jobs, \$400 billion in profits, and \$67 billion in tax revenues world-wide.

## What Does It Mean For You?

While you might think that software piracy does not affect you directly, this is far from the truth. Companies that lose profits from IP theft often pass the cost of piracy on to you—the honest consumer. For every song or movie downloaded or sold illegally, businesses must charge paying customers more to cover their production costs. In addition, government revenue that could go to your education, parks, or better roads instead is funneled into law enforcement to prevent IP piracy. But perhaps the biggest loser in IP piracy is creativity. After all, if you were an artist or designer, would you be willing to spend your money as well as months or years of your life to develop a new product, only to have it copied and your profits taken away by someone else?

## Analyzing the Issue

- Identifying** What economic policy allowed IP piracy to grow in China?
- Describing** What is the relationship between piracy rates and developing countries?
- Applying** Check your local newspaper, news magazines, or Internet news sources for recent articles about intellectual property theft. How does IP piracy affect your state?

### PIRATED SOFTWARE DOLLAR LOSSES BY REGION (IN MILLIONS)

European Union (\$12,151)	Asia Pacific (\$7,897)
North America (\$7,549)	Rest of Europe (\$2,313)
Latin America (\$1,546)	Middle East/Africa (\$1,239)



**Source:** Second Annual BSA and IDC Global Software Piracy Study, 2005

*photo: A bulldozer destroying pirated CDs, DVDs, and videos in Moscow, Russia*

