Chapter 2: Economic Systems
Section 1
Objectives

1. **Identify** the three key economic questions that all societies must answer.

2. **Analyze** the societal values that determine how a country answers the three economic questions.

3. **Define** the characteristics of a traditional economy.
Key Terms

- **economic system**: the structure of methods and principles that a society uses to produce and distribute goods and services

- **factor payment**: the income people receive in return for supplying factors of production

- **profit**: the amount of money a business receives in excess of expenses

- **safety net**: a set of government programs that protect people who face unfavorable economic conditions

- **standard of living**: level of economic prosperity

- **innovation**: the process of bringing new methods, products, or ideas into use

- **traditional economy**: an economic system that relies on habit, custom, or ritual to decide the three key economic questions
Introduction

• What goals and values affect how a society answers the key economic questions?

1. Each society is guided by its economic system, which affects the way in which it does business within the society itself and with other societies.

2. A society’s values, such as freedom or tradition, guide the type of economic system that society will have.
Three Economic Questions

• As a result of scarce resources, societies must answer three key economic questions:
  1. What goods and services should be produced?
  2. How should these goods and services be produced?
  3. Who consumes these goods and services?

• How a society answers these three questions defines the type of economic system that society has.
1. What goods and services should be produced?
   – Each society must decide what to produce in order to satisfy the needs and wants of its people.
   – Because resources are limited, each decision that a society makes about what to produce comes with an opportunity cost.

2. How should goods and services be produced?
   – As a society decides how to produce its goods and services, it must consider how best to use its land, labor, and capital.
Combining Factor Resources

**Hand Tools**

1 acre of land + 56 worker-hours + capital = 15 bushels of wheat

**Modern Mechanical Equipment**

1 acre of land + 2.9 worker-hours + capital = 40 bushels of wheat
3. Who consumes goods and services?

– This question is largely determined by how societies distribute income.

– Through factor payments, including profits, societies can determine who will be the consumers of the goods and services produced.
Society Goals for Economy

Societal goals for Economy:
1. Economic efficiency
2. Economic Freedom
3. Economic Security
4. Economic Equity
5. Economic Growth
Economic Efficiency

• Societies answer the three economic questions based on the importance they attach to various economic goals.

• Because resources are always scarce, societies try to maximize what they can produce using the resources they have.
  – If a society can accurately predict what to produce, it increases economic efficiency.
Economic Freedom and Security

• Some societies limit the economic freedoms of its people.
  – Some freedoms Americans enjoy: other economies do not: how we use our resources, what to buy/sell, jobs, etc.

• Economic systems also strive to achieve a certain degree of economic security.
  – People need to feel safe about participating in the economy: have enough money to buy needs/wants, products perform as advertised, enough jobs for all who want to work.
Economic Equity

- Economic equity is another economic goal that is defined differently in different societies. Each society must decide how to divide its economy.

- EX US says work for what you get; Europe says Govt should provides necessities; N Korea says we tell you what you need/want
Economic Growth

- A society also strives for economic growth. A nation’s economy must grow so it can provide jobs for the new people joining the workforce.

WHY?
- To improve its standards of living.
- To provide Innovation which creates new products and jobs.
Economic Goals in Conflict

• There are some additional economic goals for certain societies, including environmental protection, full employment, and pricing.

• All societies must prioritize their economic goals, or arrange them in order of importance. Each choice comes with some kind of trade-off.
Traditional Economies

• The oldest and simplest economic system is known as a traditional economy.
  
  – Traditional economies rely on habit, custom, or ritual and revolve around the family. There is little room for innovation or change.
  
• Traditional economies are usually found in communities that tend to stay small and close.
  
  – Often members of these societies work to support the entire community, rather than just themselves or their immediate families.
Traditional Economies, cont.

- Traditional economies are successful if they meet their own needs.
  - In many cases, these communities lack modern conveniences and have a relatively low standard of living.