

## Economic Systems and Economic Tools

### Chapter 2 Section 1 Discussion Questions

**Directions:** Read Chapter 2 Section 1 (p. 32) and answer the following questions on your own paper.

1. What questions must all economies answer?

1. What goods and services will be produced?

2. How will they be produced?

3. For whom, will they be produced?

2. What is an economic system?

**Economic System:** The set of mechanisms and institutions that resolves the what, how, and for whom questions for an economy.

3. How do the three economic questions relate to one another?

The answer to one economic question depends on the answers to the other questions.

4. Define pure market economy and provide an example.

**Pure Market Economy:** an economic system with no government involvement so that private firms account for all production.

**Example:** Capitalism: puts the consumer at the center of it all, because it allows consumers to decide the what, how, and for whom of economic systems. **HOWEVER**, does not really exist.

5. Describe the “Invisible Hand of Markets.”

Adam Smith: market forces coordinate production as if by an “invisible hand.” Smith argued that, “although each individual pursues his or her self-interest, the “invisible hand” of market competition promotes the general welfare.” OR voluntary choices answer the economic questions

6. Identify and explain the problems with pure market economies.

1. Difficulty enforcing property rights – no central government to enforce property rights or ensure rules of the game are followed.
2. Some people have few resources to sell – no guarantee of minimum income; some would struggle to survive.
3. Some firms try to monopolize markets – firms have profit incentive to monopolize markets.
4. No Public Goods – no national defense = no public goods
5. Externalities -- outside forces, external to market transaction. Private markets fail to account for externalities.

7. Define a pure centrally planned economy.

Pure Centrally Planned Economy: an economic system in which all resources are government-owned and

production is coordinated by the central plans of the government.

Example: Communism

8. Compare the “Invisible Hand of Markets” with “Visible Hand of Planners.”

Invisible Hand of Markets: voluntary choices of buyers and sellers direct resources and products.

Visible Hand of Planners: government is planning all aspects of economy

9. Identify and explain the problems with pure centrally planned economies.

1. Consumer gets low priority
2. Little Freedom of Choice
3. Central Planning can be inefficient
4. Resources Owned by the State are sometimes wasted
5. Environmental Damage

10. What are mixed economies? Provide an example.

Mixed Economies: mixes central planning with competitive markets.

Example: United States because markets play a large role

11. Explain why the United States is a market economy.  
**United States is also considered a market economy because the government accounts for about one-third of all U.S. economic activity.**
12. What is the process of privatization and how does this occur in a transitional economy?  
**Transitional Economies are in the process of shifting from central planning to competitive markets. Transition also involves converting state-owned enterprises into private enterprises.**
13. Define traditional economies.  
**Traditional Economy: An economic system shaped largely by custom or religion.**
14. Reflect back on the different types of economies and explain how each economy answers the economic questions differently.