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ECONOMIC SYSTEMS

OVERVIEW

1. An allocation of resources answers the three economic questions: what to produce, how to produce, and for whom to produce.
2. There are different processes to help society answer the three economic questions. The processes differ in the degree that the decision making is centralized.
3. The best process for allocating resources depends on the goals of the society.
4. The method a society uses to answer the three economic questions is the economic system. Economic systems can be identified by asking who owns and controls the scarce resources within the society.
5. Under the economic system of capitalism, individuals own and control the scarce resources. Under communism, the resources are owned and controlled by the government. Under socialism, some resources are owned by individuals and some by government.
6. The circular flow model illustrates in capitalism how resource owners sell their resources to business to obtain income that is used to purchase the output produced by business.

MATCHING

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|---------|-------------------------|----|---|
| _____1. | allocation of resources | a. | an economic system where resources are owned and controlled by the government |
| _____2. | economic system | b. | an economic system where resources are owned and controlled by individuals |
| _____3. | capitalism | c. | an economic system where some resources are owned and controlled by individuals and other resources are controlled by the government. |
| _____4. | socialism | d. | answers the three questions of what, how and for whom |
| _____5. | communism | e. | the process used by a society to answer the three questions of what, how, and for whom. |
| _____6. | markets | f. | a model of the economy illustrating the flow of resources and goods and the flow of money |
| _____7. | circular flow | g. | a system for allocating resources where buyers and sellers meet to determine price and trade |

TRUE-FALSE

- _____ 1. The circular flow model says that income must equal output.
- _____ 2. By telling who gets how much of which good, we have allocated resources.
- _____ 3. Socialism is an economic system where markets cannot exist.
- _____ 4. The circular flow model illustrates the flow of resources in one direction and the flow of money in the opposite direction.

IN THE NEWS

1. One problem with communism is that if everyone doing the same job is paid the same wage, there is no reward for being productive. This lack of incentives reduces the total amount of output produced. In communist China, there was a relaxation of government control permitting a limited amount of individual control over resources. Individual ownership allows individuals to reap the reward of their productivity, which, the Chinese officials hope, will increase the output of agricultural products and other goods.

What goal does this reading reflect, and how is capitalism more effective at obtaining it?

2. During World War II, the allocation of resources in the United States became more centralized. The government assumed more control over the flow of resources. A rationing and priority system made sure that resources flowed into uses wanted by the government. If, as a consumer, you wanted resources allocated into certain consumer goods such as meat, sugar, or gasoline, you had to have the government's permission with a suitable ration card and priority. In this manner, the United States acted more like a communist than a capitalist nation.

In what way is centralized control more effective than decentralized control?

3. Economic planning was an important fact of life in communist countries. To allocate resources and answer what, how, and for whom, communist governments made elaborate plans. The plans told how much of each good and service to produce. When looking at a capitalistic economy, communists saw the lack of planning and wondered how we could get along.

If there is no central planning in capitalism, who does the planning?

4. There have been several communities established in the United States which were based on utopian or religious ideals. One of the most successful is the Amana Colonies in central Iowa. In the 1850s, a group of German settlers with a common religious belief purchased a large tract of land and eventually established several villages. Together these villages were self-sufficient. All property was held in common, and families were assigned houses, although all ate in community dining halls. Jobs were assigned to all individuals above school age. By the end of the 1930s, the common property arrangement was discarded and was replaced by stock ownership in a profit sharing company.

- a. What economic system was the original Amana settlement most like? Why?
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b. Discuss how resources were allocated in the Amana Colony.

c. What economic system did the Amanas become most like in the 1930s? _____

PRACTICE TEST

Circle the correct answer.

1. A society decides to produce both baseballs and swim goggles. Which economic question is answered?
 - a. What.
 - b. How.
 - c. For whom.
 - d. All of the above.

2. Which of these is true?
 - a. Economic freedom is the highest priority of every society.
 - b. Economic goals never conflict.
 - c. The economic goals pursued depend on the values of the society.
 - d. Economic goals are always equally desirable.

3. Which is not an economic system? .
 - a. Communism
 - b. Capitalism
 - c. Idealism
 - d. Socialism

4. In this economic system, resources are allocated by the individuals of the society. It is a system of:
 - a. capitalism.
 - b. socialism.
 - c. communism.
 - d. impossible to tell.

5. Which sector of the circular flow model receives resources from the resource market and contributes output to the product market?
 - a. Consumer
 - b. Business
 - c. Financial
 - d. Labor

ANSWERS

Matching

1. d
2. e
3. b
4. c
5. a
6. g
7. f

True-False

1. T
2. F
3. F
4. T

In the News

1. The goal is efficiency. Human nature being what it is, more productive use is made of resources when personal incentives exist. Under capitalism, private ownership of resources allows the rewards to flow to the resource owners.
2. Centralized control is effective at making sure that the resources go to the priorities established by the government rather than to uses determined by the individual members of the society.
3. The planning is done by the individual firms and households. Rather than have one plan made by a central organization, the decisions are made by the many individuals who actually do the production and consumption.
4. a. With centralized ownership and decision making, the Amana Colonies were originally most like communism.
b. Jobs were assigned for workers and land was held by the collective organization. Consumption of food and shelter was on the basis of need.
c. By establishing a stock ownership company with profit sharing, the Amana Colonies became more like capitalism.

Practice Test

1.a., 2.c., 3.c., 4.a., 5.b.