

STUDY GUIDE Chapter 2, Section 1

For use with textbook pages 31–38

ECONOMIC SYSTEMS

KEY TERMS

- economic system** The way in which a nation uses its resources to satisfy its people’s needs and wants (page 31)
- traditional economy** A system in which economic decisions are based on customs and beliefs that have been handed down from generation to generation (page 34)
- command economy** A system in which the government controls the factors of production and makes all decisions about their use (page 34)
- market economy** a system in which individuals own the factors of production and freely make decisions about what to produce and what to consume. (page 35)
- market** The voluntary exchange of goods and services between buyers and sellers (page 36)
- circular flow of economic activity** An economic model that shows the factors of production and money as flowing continuously between businesses and individuals (page 37)
- mixed economy** An economic system that combines the characteristics of more than one type of economy (page 38)

DRAWING FROM EXPERIENCE

What kinds of food does your school offer? Do businesses sell sub sandwiches, pizza, tacos, or other “fast food” on your campus? Are vending machines present? Who decides what foods students can buy at your school? Who decides what is sold at the school store? The answers determine the type of economic system that operates at your school.

This section focuses on the various types of economic systems that exist throughout the world by looking at their characteristics and differences.

ORGANIZING YOUR THOUGHTS

Use the chart below to help you take notes as you read the summaries that follow. Think about who decides the basic economic questions in each economic system.

Type of system	Basic economic questions decided by
Traditional Economy	
Command Economy	
Market Economy	
Mixed Economy	

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READ TO LEARN

● Introduction (page 31)

Individual nations have different **economic systems**, or ways of determining how to use resources to satisfy people's wants and needs.

● Three Basic Questions (page 31)

Different types of economic systems exist in the world. However, each system must answer the same three basic questions:

- A. **What should be produced?** We live in a world of scarcity and trade-offs. If more of one thing is produced, then less of something else will have to be produced.
- B. **How should it be produced?** In addition to deciding what to produce, an economic system must decide how to produce it. Trade-offs exist in the answers to this question, too.
- C. **For whom shall it be produced?** The type of economic system determines how goods and services are distributed. In the United States, goods and services are distributed by a price system. People's income determines their ability to purchase items. Other systems might share products equally among members of society, for example.
 1. Explain how the price system determines how goods and services are distributed in the United States.

● Types of Economic Systems (page 33)

Economists identify four types of economic systems. They differ according to how each answers the three basic questions of what, how, and for whom to produce. In the real world, however, no such "pure" systems exist. All economies are mixed to some degree.

A **traditional economy** is a system that answers the three basic questions according to traditions and customs. Things are done the way they have always been done. Everyone knows what is expected of them. Change is discouraged and production methods are often inefficient. Therefore, choices among consumer goods are rare.

A **command economy** is a system in which government leaders control the factors of production and make all decisions about their use. Individuals have little influence over how the basic economic questions are answered. An advantage of this system is the speed with which economic plans can be changed. However, because the government sets wages, people have no incentive to work hard or efficiently. A lack of consumer choices also exists.

A **market economy** is sometimes called "capitalism." This is the opposite of command systems. Individuals own the factors of production. They decide what to produce and how to produce it. The **market**—the voluntary exchange of products between buyers and sellers—guides economic choices instead of tradition or government control. Competition gives consumers a wide choice of

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products and helps to determine how much they cost. Factors of production and money flow back and forth between individuals and businesses in a model called a ***circular flow of economic activity***.

A ***mixed economy*** combines parts of a market economy and parts of a command economy. Private ownership of property and individual decision-making are combined with government regulations. Most of the world's nations, including the United States, have mixed economies.

- 2. In which economic system does choice play the biggest role? In which two systems does it play the smallest role?
