

Reading 6

Entrepreneurship in Different Economic Systems

In this lesson you will learn what economic systems are and what they do. You will find that all economic systems must answer three central economic questions: What goods and services shall be produced? How shall these goods and services be produced? For whom shall they be produced? The basic characteristics of market and command economic systems will be presented, and you will learn how these systems answer the three central economic questions. You will also learn that the economic system in the United States is a mixed-market system because it has characteristics of both market and command economies.

You probably have a good idea of how businesses in the United States work. You know what kind of quality or service to expect when you buy something. If a product is defective, you expect to be able to return it and have it repaired or replaced or have your money refunded. If a firm failed to do these things, you might believe it had broken the rules of our economic system.

Although different nations have different ways of doing things, every country has an **economic system** that is made up of rules or conventions that govern the production and distribution of goods and services. These rules help people decide how resources are used to produce goods and services. They also determine who will get the products that are made.

Some economic systems rely on a central authority to make most economic decisions. Others spread decision-making power among many people. Regardless of who holds power, there are three **central economic questions** that must be answered in all economic systems: What goods and services should be produced from the supply of scarce resources? How should these products be produced? For whom should the products be produced?

Thousands of years ago, economic systems were based on traditions. People did things the way their parents had done them before. Rules were not written down because all the people understood what was expected of them. While there still are **traditional economies** in some places, economic systems today are usually much more complicated. Many of our rules are written into laws that are enforced by our government. Although we have written laws, they still fill the same purpose: They tell us which economic activities are considered right and which are thought to be wrong so that we can work together more easily.

One type of economic system is a market economy. In a **market economy**, the factors of production are owned and controlled by individuals or by groups of people. Individuals work to earn income to buy goods and services to satisfy their wants.

Businesses produce goods and services that are sold to earn a profit for their owners. The desire to earn a profit, or the **profit motive**, is the basic reason to operate a business in a market economy.

When Joslin started her business, she was hoping to find the answers to the three central economic questions: *What should be produced?* She offered a product for sale she believed people would buy. *How should it be produced?* She tried to find ways to keep the costs of operating her business as low as possible. *For whom should it be produced?* Those who are willing to pay the price of the good she is selling receive the product.

Suppose that in a market economy you owned a store where you offered heaters and air conditioners for sale at fair prices. If it was summer and the temperature reached 100°F day after day, your sales of air conditioners would probably be very good. You might not sell any heaters at all. You would decide to order more air conditioners from your supplier but no heaters. As a result, your supplier could choose to produce more air conditioners. The owners of the firm might decide to buy a machine that would help produce air conditioners more quickly. On the other hand, they probably would not produce more heaters. The profits you earn from selling air conditioners could allow you to take a vacation in Alaska, where it is cool and you don't need an air conditioner.

Successful entrepreneurs in a market economy offer products for sale that customers want and at prices they are willing to pay. This is how the *What?* question is answered. In the example above, you ordered more air conditioners but no heaters because air conditioners sold well and heaters did not.

In a market economy, entrepreneurs make products in the way they believe will result in the lowest costs of production. They expect this to improve their opportunity to earn profits. This is the way the *How?* question is answered. The supplier of air conditioners decided to buy a machine to make production more efficient and to increase profits.

The amount of goods and services people in a market economy buy depends on how much money they earn. A person's income depends

on the value of his or her contribution to production. The value of a person's skills depends on the supply of labor and the skills that are in demand. Workers who have skills that are in demand are likely to be well paid and to be able to buy many things. Workers who contribute little value to production may not be paid well and as a result may not be able to afford many things. This is how the *For whom?* question is answered in a market economy.

Entrepreneurship is very important in a market economy because this type of system relies on many different individuals to make most economic decisions. In her business, Joslin offers canvas bags for sale because she has seen that other firms have been successful in doing so. She has decided to buy the bags from another firm because she cannot make enough of them herself. If she offers a product and service customers want at a price they are willing to pay, she will be likely to earn a profit. This profit will allow her to buy products she would like to own and to expand her business.

Most businesses in a market economy are **private property**. That is, these businesses are owned by individuals, groups, or companies. They are not owned by the government. Workers also own private property. This may be in the form of homes, land, cars, and so forth.

Another type of economic system gives most ownership, control, and decision-making power to the government. Most businesses are not private property. This economic system is called a **command economy**. Until recently, many countries in Eastern Europe had command economies. In these countries, the government answered the three central economic questions. Firms produced the goods and services that the government directed them to make. The government determined the methods of production, most prices, and wages. Individual entrepreneurship was less important in such a system because people were not allowed to own their own businesses. A command economic system did not work efficiently because people had less reason to work hard to produce goods and services. In recent years, leaders of many countries that had command economic systems have tried to move toward a market economic system. One of their greatest

problems has proved to be a lack of people who possess entrepreneurial skills.

The economic system in the United States is most like a market economy, but there are a few characteristics of a command economy mixed into our economy. For example, government agencies tell some businesses (such as those producing electricity and natural gas) how much they can charge for their products. The government provides income through social security or welfare to people who are not presently contributing to production. Our government even owns a few businesses; such as the Tennessee Valley Authority, which produces and sells electric power. For these reasons, our economic system is a **mixed-market economy**. Although most economic decisions in the United States are made by individuals, there is also limited government involvement. Entrepreneurs should be aware of the role of government in our economy. Entrepreneurs need to keep following the changes in government's role in our economy.

CHECK YOUR UNDERSTANDING

Consider each of the following questions. If you are not sure of an answer, review the reading to find the information you need before moving on to the next question.

1. What is an economic system?
2. What are the three central economic questions that all economic systems must answer?
3. What is a market economy?
4. Why do people work in a market economy?
5. Why do firms produce goods and services in a market economy?
6. How are each of the three central economic questions answered in a market economy?
7. Why is entrepreneurship important in a market economy?
8. What is a command economy?
9. How are most economic decisions made in a command economy?

10. Why is individual entrepreneurship less important in a command economy?

11. What is a mixed-market economy?