



Name: _____

Date: _____

CHAPTER 2, SECTION 1

Just the Facts Handout

Three Economic Questions

All nations must decide how to answer the following three economic questions:

- What goods will be produced?
- How will the goods be produced?
- For whom will the goods be produced?

Two Major Economic Systems

How a society answers the three economic questions defines its **economic system**.

Free enterprise is an economic system in which individuals own most, if not all, of the resources and control the use of those resources. Sometimes free enterprise is called capitalism or a market economy.

Socialism is an economic system in which government controls and may own many of the resources. A command economy is a particular type of socialist economic system.

Major Differences Between Free Enterprise and Socialism

Free enterprise and socialism have major differences in the following areas:

- resources
- government's role in the economy
- economic plans
- income distribution
- controlling prices
- private property

Resources

In free enterprise, resources are owned and controlled by private individuals. In socialism, government controls and may own many of the resources.

Government's Role in the Economy

In free enterprise, government does not decide what goods and services will be produced or how they will be produced. Under socialism, government may make these economic decisions.

Economic Plans

Under socialism, government decision makers may write an **economic plan**. This plan specifies the direction economic activities are to take. A free enterprise economic system would have no such plan.

Income Distribution

Income distribution refers to how all the income earned in a country is divided among different groups of income earners. Less attention is paid to income distribution in free enterprise than in socialism. Government decision makers under socialism are more likely to use government's powers to redistribute income, usually directing it away from society's high earners.

Controlling Prices

In free enterprise, prices are allowed to go up and down. Government does not attempt to control prices. In socialism, government decision makers do control prices, although not all socialist systems control prices to the same extent.

Private Property

Under free enterprise, private property is sacred. The proponents of free enterprise believe that owners of private property are more likely to take care of that property and to use it in its most productive way.

According to socialists, those who own property will end up having more political power. Socialists believe that government should own most nonlabor property, such as factories, raw materials, and machinery. They believe that government will make sure the property is used to benefit the many instead of the few.

Mixed Economies

Mixed economies have features of both free enterprise and socialism. Both the United States and China have mixed economies. However, the United States has much more free enterprise than does China, and China has much more socialism than does the United States. To avoid confusion, economists consider the United States to have a free enterprise economic system, and China to be a socialist nation.

Economic Systems: Past, Present, and Future

In a **traditional economy**, the answers to the three economic questions are based on customs, traditions, and cultural beliefs. An example of a traditional economy is the old feudal system in Western Europe.

The Visions Behind Free Enterprise and Socialism

Both free enterprise and socialism are the products of certain **visions**—ways of looking at, understanding, and explaining the world. Free enterprise is based on the ideas of Adam Smith, an eighteenth-century economist. Socialism is based on the ideas of Karl Marx, a nineteenth-century economist.

Smith thought that we all desire to make ourselves better off. He believed that our self-interest prompts us to work hard, take risks, and in the end benefit others through our activities. Smith believed that if people want to serve their own self-interest, they have to serve others first.

Karl Marx, on the other hand, saw self-interest as hurting others. His **labor theory of value** holds that all value in produced goods is derived from labor. Marx believed that in a capitalist society, the owners of factories and businesses exploit the workers by paying them far less than they are worth. Marx used the term **surplus value** to describe the difference between the total value of production and the subsistence wages paid to workers.

Answer questions 1–6 in the Section 1 Assessment on page 40 of your textbook.