CONNECT How do economic decisions and policies affect your daily life?
Section 3.1

What Is an Economy?

OBJECTIVES

• 

Explain the concept of an economy.

• 

Discuss how scarcity and factors of production affect the economy.

• 

Compare and contrast how traditional, market, and command economies answer the three basic economic questions.

• 

Explain why most economies are mixed.

• 

Identify examples of different political and economic philosophies.
An economy is a nation’s method for making economic choices that involve how it will use its resources to produce and distribute goods and services to meet the needs of its production.
VOCABULARY

- economy
- resources
- factors of production
- infrastructure
- entrepreneurship
- scarcity
- traditional economy
- market economy
- command economy
Section 3.1

What Is an Economy?

Differences and Similarities Among Market and Command Economies

- Market Economy
- Both Market and Command Economies
- Command Economies
What Is an Economy?

Differences and Similarities Among Market and Command Economies

Market Economy: Consumers decide what will be produced by their purchases, businesses decide how, possession of money decides who makes purchases.

Both Market and Command Economies: Limited by economic resources—land, labor, capital, entrepreneurship.

Command Economies: Government decides what to produce, how to produce, who gets that which is produced.
What Is an Economy?

What Creates an Economy?

**Economy**

- Manufacturing
- Buying
- Selling
- Transporting
- Investing

**economy**

The organized way a nation provides for the needs and wants of its population.
What Creates an Economy?

Economists use the term factors of production when they talk about economic resources.

**Factors of Production**
Resources that are comprised of land, labor, capital, and entrepreneurship.

**Resources**
All the things used in producing goods and services; a source of aid or support that may be drawn upon when needed.
What Is an Economy?

What Creates an Economy?

- **Land**: Provides raw materials
- **Labor**: Full- and part-time workers, managers, and professional people
- **Capital**: Money, buildings, infrastructure
- **Entrepreneurship**: Organizing factors of production to create goods and services

**infrastructure**
The physical development of a country, such as roads, ports, and utilities.

**entrepreneurship**
The skills of people who are willing to invest their time and money to run a business; the process of starting and operating your own business.
### What Is an Economy?

#### Political and Economic Philosophies

#### Graphic Organizer

Comparing Two Economic Resources

<table>
<thead>
<tr>
<th>Labor</th>
<th>Entrepreneurship</th>
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</tbody>
</table>
### Comparing Two Economic Resources

<table>
<thead>
<tr>
<th>Labor</th>
<th>Entrepreneurship</th>
</tr>
</thead>
<tbody>
<tr>
<td>requires people</td>
<td>requires people</td>
</tr>
<tr>
<td>refers to work</td>
<td>refers to skills</td>
</tr>
<tr>
<td>workforce is economic resource</td>
<td>ideas are economic resource</td>
</tr>
</tbody>
</table>
What Creates an Economy?

**Scarcity** forces nations to make economic choices.

**scarcity**
The difference between wants and needs and available resources.
What Is an Economy?

Types of Economic Systems

The Three Economic Questions

What?

How?

For whom?
What Is an Economy?

Types of Economic Systems

The Three Economic Questions

**What?**
Consumers decide what will be produced

**How?**
Businesses decide how to produce

**For whom?**
People with the resources to buy
What Is an Economy?

Types of Economic Systems

- **Traditional Economy**
  - An economic system in which habits, traditions, and rituals answer the basic questions of what, how, and for whom.

- **Market Economy**
  - An economic system in which there is no government involvement in economic decisions.

- **Command Economy**
  - A system in which a country’s government makes all economic decisions regarding what, how, and for whom.

- **Mixed Economy**
What Is an Economy?

Political and Economic Philosophies

The Different Political and Economic Philosophies

[Diagram showing categories: Political and Economic Philosophies, Capitalism, Communism, Socialism]
What Is an Economy?

Political and Economic Philosophies

The Different Political and Economic Philosophies

**Capitalism**
- marketplace competition
- private ownership of business
- successful employers and employees prosper
- some social services
- some government regulations

**Communism**
- usually authoritarian
- controls factors of production
- assigned jobs
- goods given according to need
- no financial incentive to increase productivity

**Socialism**
- more government involvement in economy and social services
- tax rates high
- government may run key industries
- government makes many economic decisions
What Is an Economy?

Political and Economic Philosophies

Privatization versus Nationalization

- Privatization: Less Government Involvement
- Nationalization: More Government Involvement
1. **Define** *economy* and explain the three questions it seeks to answer.

An economy is the organized way a nation provides for the needs and wants of its people. Three questions are:

1. What goods and services should be produced?
2. How should goods and services be produced?
3. For whom should goods and services be produced?
2. **Explain** the relationship between economic resources and the concept of scarcity.

The difference between wants and needs of a country’s people and available economic resources is scarcity. Economic resources are all the things used in producing goods and services. They include land, labor, capital, and entrepreneurship. A nation must choose how to use those resources to produce and distribute the goods and services for its people. Countries have varying amounts of resources. Some have fertile land for farming, but limited capital. Others may have limited natural resources, but they compensate with a highly educated labor force.
3. **Compare and contrast** privatization and nationalization. Which political and economic philosophy would most likely be prevalent when a country decides on privatization? On nationalization? Explain.

Privatization is when a country sells its state-run businesses. Nationalization occurs when a government takes over a privately held company. Privatization would be more prevalent in a country moving toward a capitalistic philosophy. Nationalization would be more prevalent in a country moving toward a communistic philosophy.
Section 3.2
Understanding the Economy

Before You Read

CONNECT How do your actions affect the economy?
OBJECTIVES

• **List** the goals of a healthy economy.

• **Explain** how an economy is measured.

• **Analyze** the key phases of the business cycle.
Aspects of an economy such as consumers, businesses, and governments affect the economy and marketing decisions.
## VOCABULARY

- productivity
- gross domestic product (GDP)
- gross national product (GNP)
- inflation
- consumer price index (CPI)
- producer price index (PPI)
- business cycle
- expansion
- recession
- depression
- recovery
Identifying Economic Measurements
Identifying Economic Measurements

- Unemployment Rate
- Standard of Living
- Gross Domestic Product (GDP)
- Inflation Rate
- Labor Productivity
The Economy and Marketing

Examples of the Three Goals of a Healthy Economy

- Increase Productivity
- Decrease Unemployment
- Maintain Stable Prices
The Economy and Marketing

Examples of the Three Goals of a Healthy Economy

- **Increase Productivity**: Government and business analyze labor productivity, GDP, GNP
- **Decrease Unemployment**: Government analyzes unemployment and standard of living
- **Maintain Stable Prices**: Government monitors inflation, CPI, PPI

**Goals of a Healthy Economy**
The Economy and Marketing

Economic Measurements

Labor Productivity

Productivity
Output per worker hour that is measured over a defined period of time.
The Economy and Marketing

Economic Measurements

- Labor Productivity
- Gross Domestic Product (GDP)

**gross domestic product (GDP)**
The output of goods and services produced by labor and property located within a country.
Economic Measurements

- Labor Productivity
- Gross Domestic Product (GDP)
- Gross National Product (GNP)

**gloss national product (GNP)**
The total dollar value of goods and services produced by a nation, including goods and services produced abroad by U.S. citizens and companies.
The Economy and Marketing

Economic Measurements

Labor Productivity

Gross Domestic Product (GDP)

Gross National Product (GNP)

Inflation

Rising prices.
The Economy and Marketing

Economic Measurements

- Labor Productivity
- Consumer Price Index (CPI)
- Gross Domestic Product (GDP)
- Gross National Product (GNP)
- Inflation

**consumer price index (CPI)**
Measures the change in price over a period of time of 400 specific retail goods and services used by the average urban household.
The Economy and Marketing

Economic Measurements

- Labor Productivity
- Consumer Price Index (CPI)
- Gross Domestic Product (GDP)
- Producer Price Index (PPI)
- Gross National Product (GNP)
- Inflation

*producer price index (PPI)*

Measures wholesale price levels in the economy.
The Economy and Marketing

**Economic Measurements**

- Labor Productivity
- Gross Domestic Product (GDP)
- Gross National Product (GNP)
- Inflation
- Consumer Price Index (CPI)
- Producer Price Index (PPI)
- Standard of Living
- Unemployment Rate
Examples of the Three Types of Goods and Services That Make Up the GDP

- Private Investment
- Government Spending
- Personal Spending
Examples of the Three Types of Goods and Services That Make Up the GDP

Private Investment
Examples: home construction, business spending on items such as equipment and software

Government Spending
Examples: federal expenditures on social programs, defense, state expenditures on infrastructure, parks

Personal Spending
Examples: goods and services for personal use
The Economy and Marketing

How Do These Two Economic Measurements Compare?

- Consumer Price Index (CPI)
- Producer Price Index (PPI)
- Both
Section 3.2

Understanding the Economy

The Economy and Marketing

Graphic Organizer

How Do These Two Economic Measurements Compare?

- **Consumer Price Index (CPI)**
  - measures changes in prices of retail goods and services

- **Producer Price Index (PPI)**
  - measures wholesale price levels

- **Both**
  - measure inflation and changes in prices over a period of time
The Business Cycle

**business cycle**
Recurring changes in economic activity.

**expansion**
A time when the economy is expanding.

**recession**
A period of economic slowdown that lasts for at least two quarters, or six months.

**recovery**
The term that signifies a period of renewed economic growth following a recession or depression.
The Business Cycle

During a depression, consumer spending is very low, unemployment is very high, and production of goods and services is down significantly.

**depression**

A period of prolonged recession.
## The Economy and Marketing

### Graphic Organizer

<table>
<thead>
<tr>
<th>Factors Affecting the Business Cycle</th>
<th>How Can this Factor Affect the Business Cycle?</th>
<th>How Can the Business Cycle Affect this Factor?</th>
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<tbody>
<tr>
<td>Businesses</td>
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<td>Government</td>
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# Factors Affecting the Business Cycle

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<tbody>
<tr>
<td>Businesses</td>
<td>Businesses tend to expand operations during a recovery phase, hastening economic improvement.</td>
<td>Being in a recession can lead to reduced consumer spending resulting in a reduction in sales.</td>
</tr>
<tr>
<td>Consumers</td>
<td>Decreases in consumer spending can lead to recession.</td>
<td>Consumers might find wages increasing during recovery or expansion.</td>
</tr>
<tr>
<td>Government</td>
<td>The government might issue rebates to spur spending and encourage economic expansion.</td>
<td>In a recession, tax income might be reduced, forcing government to examine expenditures.</td>
</tr>
</tbody>
</table>
1. **Explain** how monitoring economic measures helps economists achieve the three goals of a healthy economy.

   Monitoring economic measures helps economists quickly notice changes in productivity, employment, and prices, and determine when the government should respond to changing conditions; for example, by lowering interest rates to spur the economy.
2. **Describe** the effect of high unemployment on a nation’s economy.

High unemployment has a negative effect on a nation’s economy. The unemployed cannot make purchases so companies produce less and cut back on capital projects. Tax revenue decreases. Unemployment benefits cause state governments to reduce spending.
3. **Describe** what happens to an employee in each phase of the business cycle.

During an expansion, jobs are readily available and wages typically increase; employees can move from one job to another fairly easily. In a recession, employees may be laid off and finding another job can be difficult. In a trough, jobs are typically scarce but may gradually become more plentiful. In a recovery, more jobs become available as the economy grows and workers may see their wages increase, enabling them to increase their standards of living.
End of Chapter 3
political and economic analysis

Section 3.1
What Is an Economy?

Section 3.2
Understanding the Economy