

# *Economic Systems & Institutions*

## A. Economic Systems

### 1. Economic system

2. There are 3 basic types of economic systems that differ in how economic decisions are made

a. Traditional economy – major production & distribution decisions are determined by customs & traditions

(1)

(2)

(3)

(4)

b. Command economy – major production & distribution decisions are made by a central authority (the government)

(1)

(2)

c. Market economy – major production & distribution decisions are made in a decentralized manner (no government involvement) by individual households & business firms

(1)

(2)

3. Every modern economy is a “mixed economic system” having some features of traditional, command, & market economies, but the “mix” varies from one economy to another

a.

b.

## B. The United States Economy

1.

2. There are a few common characteristics in the U.S. economy:

a.

b.

c.

- d. Voluntary exchange
  - e.
3. The U.S. & all economic systems attempt to achieve the following broad social goals:
- a. Economic freedom
  - b. Economic efficiency
  - c. Economic equity
  - d. Economic security
  - e. Economic stability
    - (1) Job stability at full employment
    - (2) Price stability
  - f. Economic growth
4. Since many broad social goals conflict, difficult trade-offs frequently have to be made in making specific policy decisions
- C. Economic Institutions
- 1. Economic institution – an enduring organization, practice, or relationship established by people to cope with basic economic problems
    - a.
    - b. Some institutions exist only in certain economic systems
      - (1)
      - (2)
  - 2. The U.S. has very specific economic institutions
    - a. In the U.S., the **household** is the typical unit of consumption
      - (1) Households
      - (2)
      - (3)
    - b. In the U.S., the profit-seeking *private firm* is the typical unit of production
      - (1)

- (2)
- c. Government agencies play an important regulatory role in the economy & some government enterprises produce goods or services directly
- 3. There are 3 main types of *business organizations* for private firms in the U.S.
  - a. Sole proprietorship – a business owned & controlled by one person
    - (1)
    - (2) Advantages
    - (3) Disadvantages
  - b. Partnership – a business owned & controlled by two or more people
    - (1)
    - (2) Advantages
    - (3) Disadvantages
  - c. Corporation – a business owned by many stockholders (part owners) but operations are controlled by a board of directors (chosen by the stockholders)
    - (1)
    - (2) Advantages
    - (3) Disadvantages
    - (4)
    - (5) Stock
    - (6) Corporate bond
- 4. Other forms of business organizations in the U.S. include corporate combinations (mergers), franchises, cooperatives, & non-profit organizations

- a. Corporate combination (mergers) – when one corporation joins with or absorbs another corporation
  - (1) Horizontal combination
  - (2) Vertical combination
  - (3) Conglomerate combination
- b. Franchise – a type of business where a person or group (franchisee) pays a parent company (franchiser) for the right to start a business using the parent company’s name & selling its products
  - (1)
  - (2)
  - (3)
- c. Cooperative (Co-op)
  - (1)
  - (2)
- d. Nonprofit organization – business that provides goods or services, yet pursues some goal other than profit
  - (1)
  - (2)

#### D. Economic Incentives

- 1. Economic incentives
- 2. These economic incentives are powerful motivating forces for most people with the pursuit of economic self-interest as a basic motivation in market economies, which leads people & business to provide goods & services that other people want
  - a.
  - b.
- 3. The hope of earning a **profit** motivates business firms to incur the risks & costs involved in producing goods or services for the market
  - a. Profit
  - b.