

CHAPTER 3: SECTION 1

Characteristics of Free Enterprise

How Does Free Enterprise Answer the Three Economic Questions?

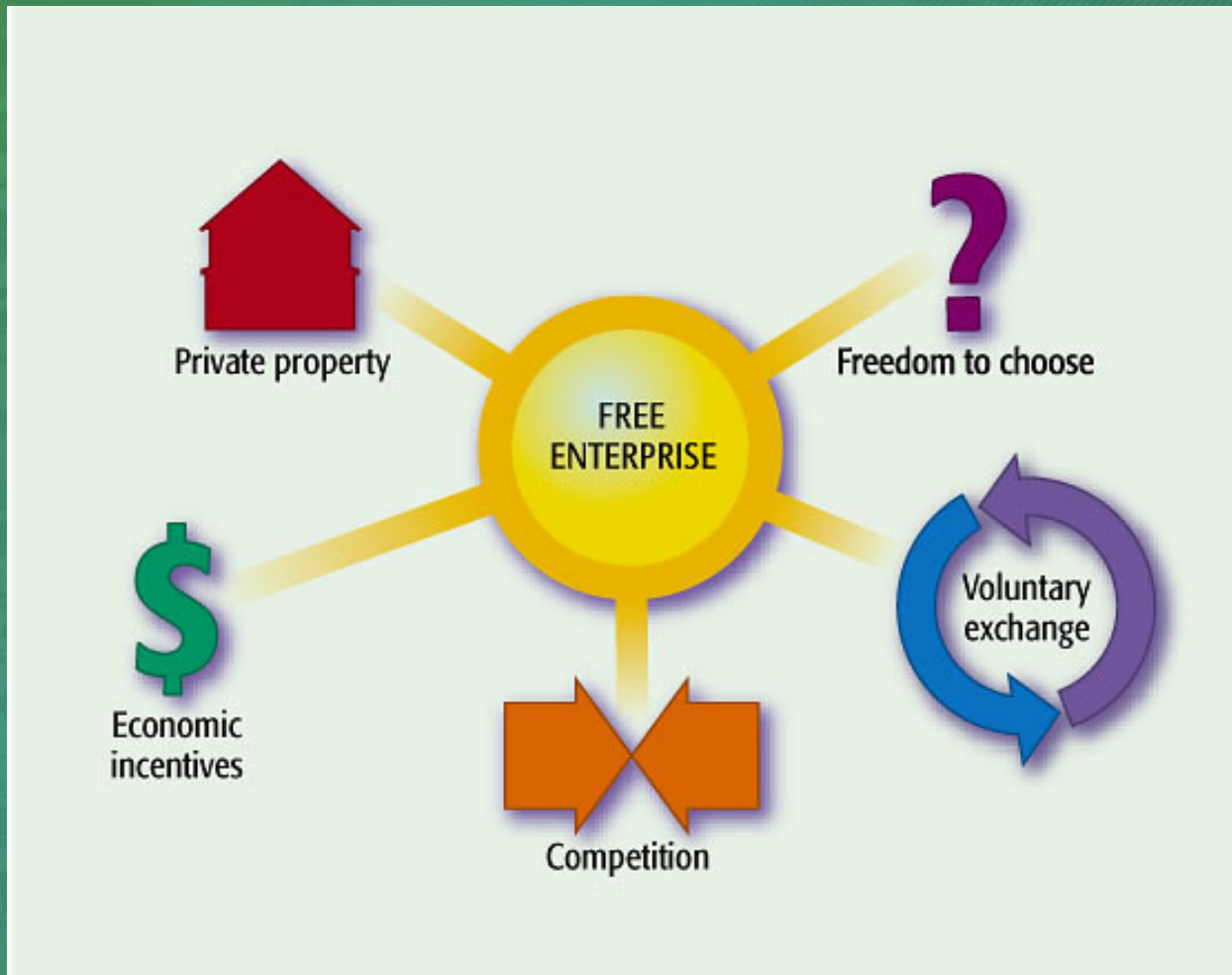
- ▶ In a free enterprise economy, business firms will produce the goods that consumers want to buy. For example, General Motors and Ford Motor Company decide what style and make of cars they will produce based on what they think the car-buying public wants to buy.
- ▶ The individuals who own and manage the business firms decide how goods will be produced.

- ▶ In a free enterprise economy, goods are produced for people who are both willing and able to buy them. For example, a person may have \$1,000 to spend on a new computer, but be unwilling to replace his or her old computer. In this case, the potential buyer is able, but not willing, and a sale will not take place.

Five Features of Free Enterprise

- ▶ Free enterprise has five major characteristics: private property, choice, voluntary exchange, competition, and economic incentives. (See Transparency 3-1.)
- ▶ **Private property** can be described as any good that is owned by an individual or a business, such as a car, a house, or a piece of machinery. Any good that is owned by the government is referred to as **public property**.

TRANSPARENCY 3-1: Free Enterprise



In a free enterprise system, individuals own most, if not all, of the resources.

- Sometimes the government may have a need for private property. Under the right of *eminent domain*, the government can take ownership of private property even without the consent of the owner. In such cases, the government will compensate owners for their loss. Eminent domain has been used to obtain private land for such uses as building new schools, highways, and government buildings.
- ▶ Another key element of free enterprise is *freedom of choice*. Workers have the right to choose what work they want to do and whom they will work for. Businesses have the right to choose the products they will produce and offer for sale. Likewise, buyers have the right to choose the products they will buy.

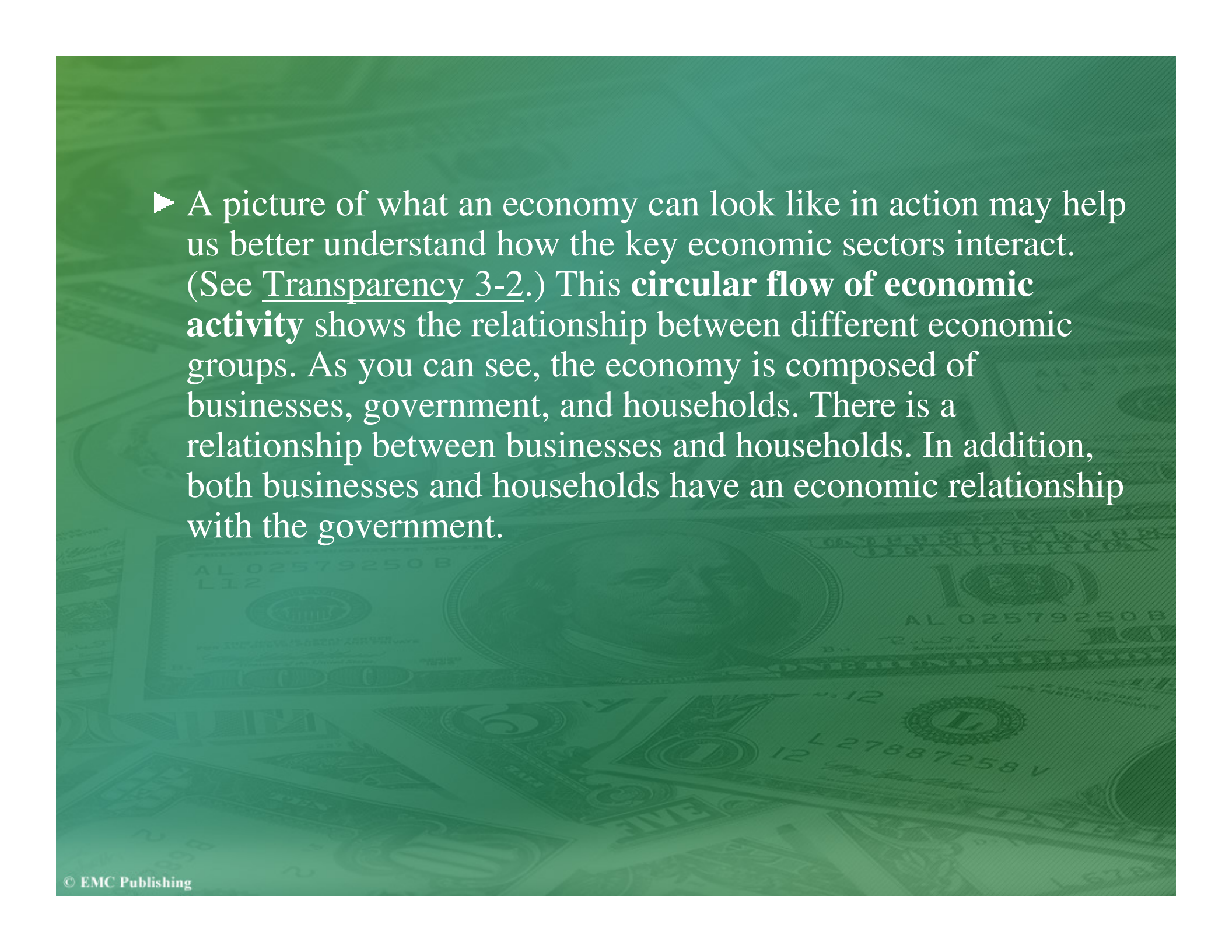
- ▶ In free enterprise, individuals have the right to make exchanges or trades that they believe will make them better off. Trading \$10 cash for a book is an example of a voluntary exchange.
- ▶ Free enterprise also gives way to *competition*. Consumers are likely to benefit from competition between sellers. Workers can also benefit from competition. The competition between employers for labor services will often result in higher wages.
- ▶ Under free enterprise, money acts as an *incentive* to produce. If you produce goods and services that people are willing and able to buy, you receive money in return.

Laws, Institutions, and Regulations

- ▶ Free enterprise takes place in many countries, and the economic climate may vary from country to country. Legal systems and institutions can either help or hinder free enterprise.

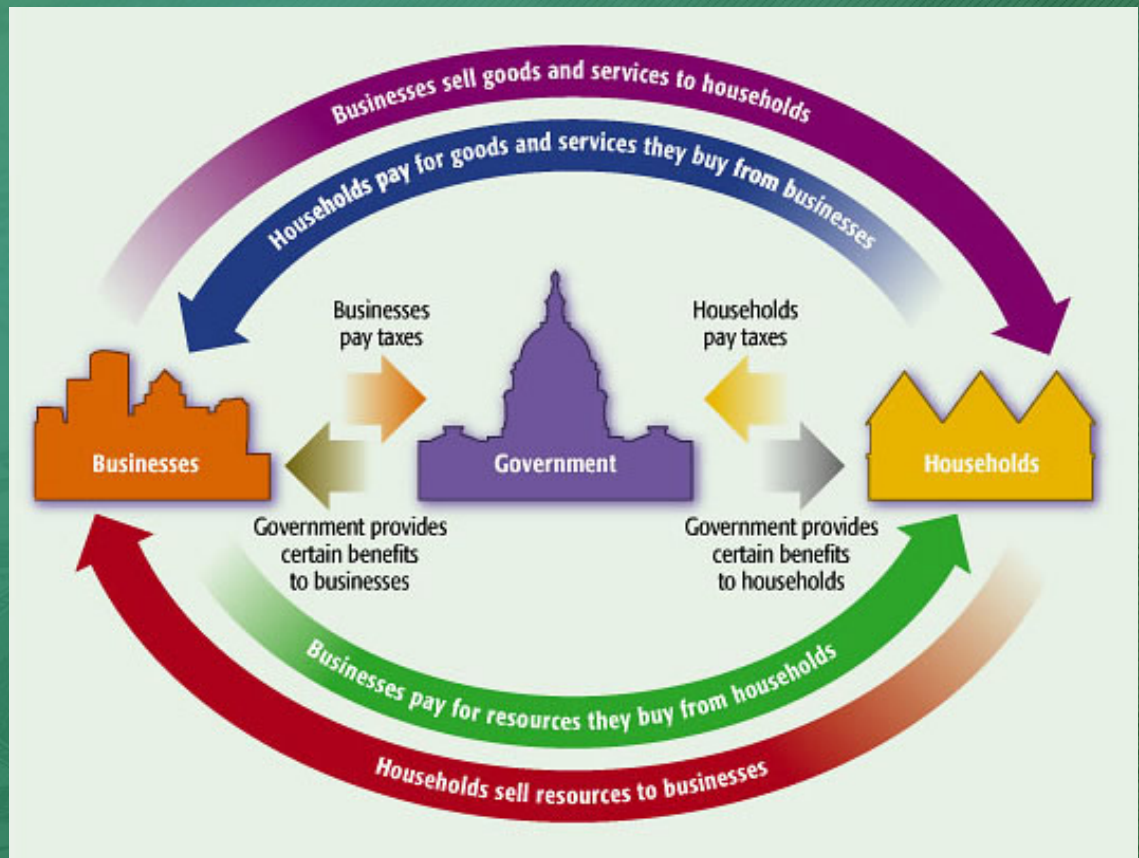
The Circular Flow

- ▶ Much of what characterizes a free enterprise economy has to do with how the key economic sectors—government, businesses, and households—deal with each other.
- ▶ A **household** is defined as an economic unit of one person or more that sells resources and buys goods and services.

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- The background of the slide is a green-tinted image of several US dollar bills, including a \$100 bill and a \$5 bill, arranged in a pattern that suggests a circular flow of money.
- ▶ A picture of what an economy can look like in action may help us better understand how the key economic sectors interact. (See Transparency 3-2.) This **circular flow of economic activity** shows the relationship between different economic groups. As you can see, the economy is composed of businesses, government, and households. There is a relationship between businesses and households. In addition, both businesses and households have an economic relationship with the government.

TRANSPARENCY 3-2: The Circular Flow of Economic Activity

- ▶ Households buy goods from businesses and sell resources to businesses.
- ▶ Both businesses and households pay taxes to the government.
- ▶ Both businesses and households receive benefits from the government.



- ▶ Examples of goods and services received by households are roads, schools, and national defense.
- ▶ The circular diagram is useful because it helps us see how a change in one economic activity (such as paying taxes) will lead to a change somewhere else in the economy (such as the amount households spend on goods and services produced by businesses).