

SECTION  
**3**

READING STUDY GUIDE WITH ADDITIONAL SUPPORT

# Market Economies

### Before You Learned

Governments exert different amounts of control in different types of command economies.

### Now You Will Learn

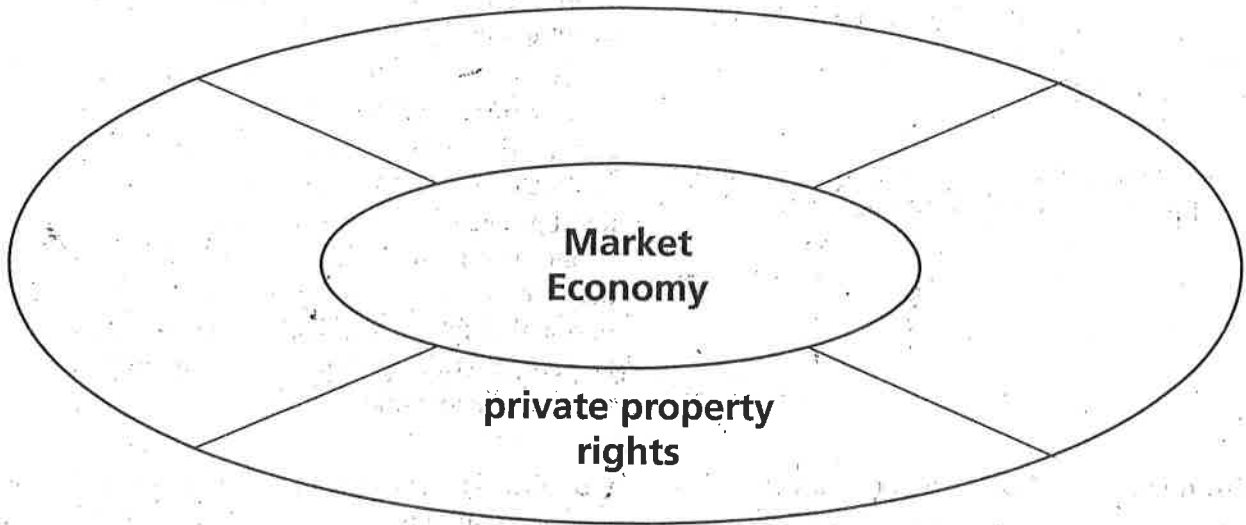
To function well, market economies require the following: private property rights, voluntary exchange, competition, consumer sovereignty, specialization, and minimal government involvement.

### Economic Terms

- **capitalism:** An economic system based on private ownership of the factors of production
- **competition:** The efforts of two or more people or businesses, acting independently, to get buyers to purchase their products, services, or resources
- **specialization:** The situation in which people or businesses concentrate their efforts in the activities that they do best
- **product market:** The place or situation in which goods and services are bought and sold
- **factor market:** The place or situation in which the factors of production are bought and sold

### As You Read

Take notes to help you understand market economies and how they work.



MARKET ECONOMIES, *CONTINUED***Fundamentals of a Market Economy**

A market economy functions well if the following features are in place: 1) Legal protection of private property rights. 2) Limited government involvement—the government should “leave things alone.” Such a system is called laissez-faire capitalism. However, in reality, governments are more involved in markets than this. 3) Voluntary exchange, or trades in which both the buyer and the seller believe that what they are getting is worth more than what they are giving. 4) Competition, or the effort of two or more businesses, acting independently, to get buyers to purchase their products or services. 5) Consumer sovereignty, or the idea that the freedom consumers have to buy or not buy a product or service gives them ultimate control over what is produced in a market economy. 6) Specialization, or the situation in which people concentrate their efforts in activities that they do the best. This allows them to use their resources to earn money most efficiently.

1. What might happen in a market economy if private property rights were removed?

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2. What do households sell in the factor market.

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**Impact of Market Economies**

To work, market economies require that buyers and sellers have economic freedom. Nations with market economies also tend to foster political freedom. With reduced national control, state and local communities have more freedom to make economic decisions. Since people tend to have good knowledge of their local resources, they tend to make better economic decisions than more distant bureaucrats do. Finally, people in a market economy can respond to changes fairly quickly, keeping the economy efficient.

Because people in a market economy try to maximize profits, resources are used most efficiently. Competition and profits also help motivate people to be creative, work hard, and be inventive. Disadvantages of market economies include their lack of ability to provide public goods and services, including national defense. The lack of security provided to people working in such an economy is another disadvantage.

3. Why is local control of economic decisions a positive feature of market economies?

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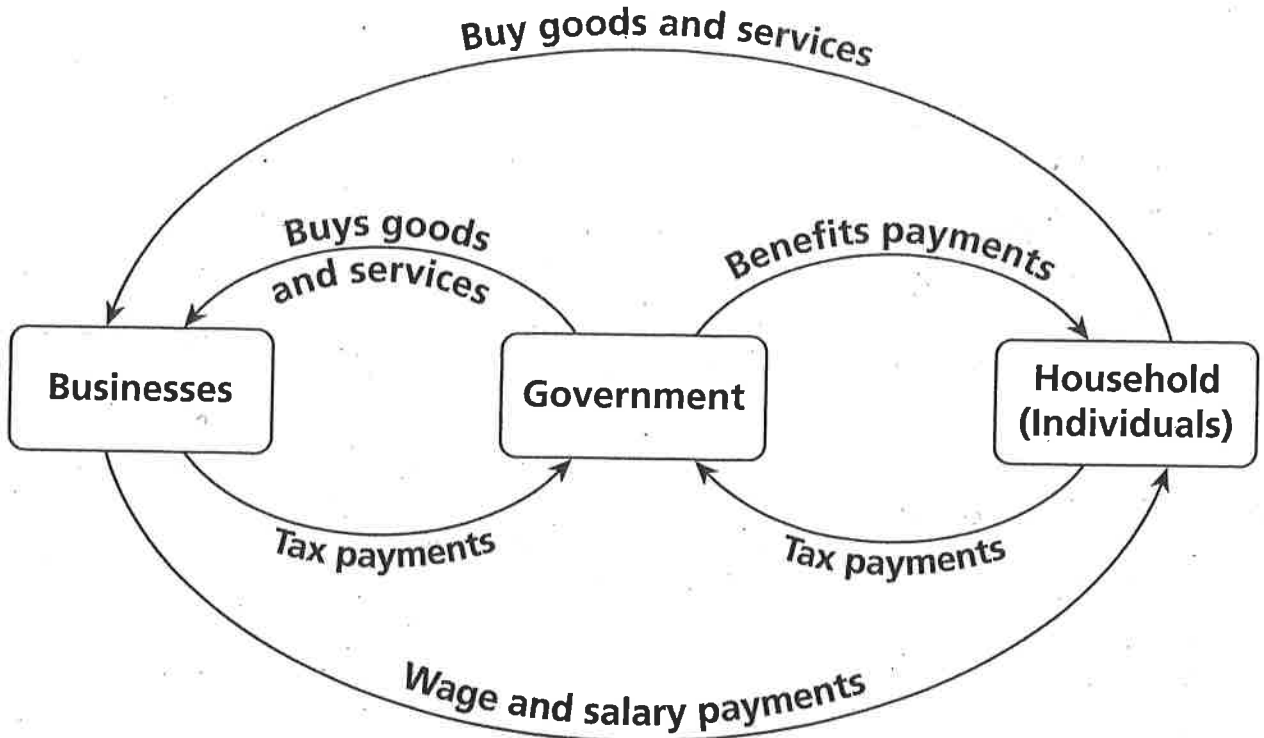
**Circular Flow of Market Economies**

The circular flow model helps economists understand how market economies operate. The model shows the two major actors in an economy, households and business, and the two markets where they interact, the product market and the factor market. Businesses provide goods and services that households purchase. Households provide land, labor, capital, and entrepreneurship that businesses purchase. In the model, money flows in one direction, while products and resources flow in the other direction.

MARKET ECONOMIES, CONTINUED

**APPLICATION**

*Mark It Up!*



CHAPTER 2

4. Reread your notes on "Circular flow of Market Economies." **Underline** the explanation of the circular flow model.
5. Compare this diagram with the one on page 53 in the textbook. **Circle** the part that has been added to this diagram.
6. **List** what the government takes in from and gives out to households.

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7. **List** what the government takes in from and gives out to businesses.

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