

## 5.01 Economic Question Activity

The 3 Key Economic Questions every Society must answer:

# WHO? WHAT? HOW?

As we have been learning, *everyone* is forced to deal with scarcity. We, as individuals, are forced to deal with it. We, as families, are forced to deal with it. And we, as societies, as countries, are forced to deal with it. The way we, as individuals, face it is through the choices we make. Since all of us make different individual choices, it stands to reason that we all use different methods, or reasoning, to arrive at those choices. Different societies & countries also use different methods to arrive at their choices. Because of **scarcity** (not enough to go around because of LIMITED resources), every nation is faced with **The 3 Key Economic Questions Every Society Must Ask:**

- **What** –goods & services should be produced?  
“What to produce?” is an allocation question. All economic systems must determine how to allocate productive resources in the form of land (natural resources/raw materials), labor (work for which we earn pay) and capital (human - education & job training) (physical – buildings, equipment & tools).
- **Who** – consumes the goods & services produced in society?  
“For whom?” is a public choice question. All economic systems must determine which goods and services will be available for public use and which for private use.
- **How** – should goods & services be produced?  
“How to produce?” is an **efficiency** (the ability to do something or produce something without wasting materials, time, or energy) question. All economic systems must determine how goods and services will be produced.

In Column 1 list the three questions that each society must answer. In column 2 explain the question that must be answered.	
Column #1	Column #2
1-	
2-	
3-	

How do different economic systems respond to the 3 Key Economic questions? First of all, we need to define exactly what an “**Economic System**” is:

- The institutional framework of formal and informal rules that a society uses to determine what to produce, how to produce and how to distribute goods and services.

Another, more popular term for economic system is economy. An economy, or economic system, is the structural framework in which households, businesses, and governments undertake the production and consumption decisions that allocate limited resources to satisfy unlimited wants and needs.

Economic systems can be categorized according to who makes most of the decisions in an economy. Most economies can generally categorized as one of two kinds:

- **Market Economy**  
An economy that relies on a system of interdependent market prices to allocate goods, services, and productive resources and to coordinate the diverse plans of consumers and producers, all of them pursuing their own self-interest.
- **Command Economy**  
An economy in which most economic issues of production and distribution are resolved through central planning and control.

So, *how* do different economic systems respond to the three basic economic questions? In a socialist or command system, the central authority determines what, how, and for whom goods and services will be produced. **A *Mixed System* incorporates elements of both command and market systems in determining answers to the three questions.** Mixed economies with strong market components also include a public goods and services sector, just as command economies like Cuba include a private goods and services sector.

- ***In a market economy, most of the decisions in the economy about what to produce, how to produce it and who receives it are made by individuals and firms.***

At the other end of the spectrum:

- ***In a command economy, government officials make most of the decisions in the economy about what to produce, how to produce it and who receives it.***

Most economic systems also contain elements of tradition or repeating decisions in ways made at an earlier time or by an earlier generation. Today, nearly all economies are actually mixed, in that some economic decisions are made by individuals and private firms, but some are also made by government officials, either through rules and regulations or through government-owned firms.

The U.S. economy leans toward the market-oriented side of the spectrum. An economy like Cuba or North Korea is near the command economy side of the spectrum. But the dividing line between market and command economies in most nations is blurry rather than bright.

### **Market Economies (“Capitalism”)**

Capitalism is undoubtedly at the top of any list of economic systems operating in the modern world. This system is based on: (1) private property--private ownership of resources and the means of production, (2) individual liberty--relative freedom on the part of the resource owners to use their resources as they see fit, and (3) competitive markets--a system of relatively competitive markets.

Under capitalism, governments establish the basic rules of the game and are responsible for the production of public goods, but the vast majority of resource allocation decisions are undertaken by individuals, as either consumers or producers. The United States is one of the more noted examples of capitalism. However, most modern industrialized economies of Europe, Asia, North America, and South America operate under capitalism.

### **Command Economies (“Socialism”)**

In theory, socialism is the transition between capitalism and communism and is based on: (1) government ownership of resources and the means of production, (2) worker control of government, and (3) income distributed according to needs. As practiced in the real world, socialism is an economic system based on (1) nationalized industries--government ownership and control of key industries and (2) central planning--relatively detailed, but not comprehensive, resource allocation decision making by the central government.

Under real world socialism, governments exert extensive control over resource allocation decisions, primarily involving key industries such as transportation, energy production, communication, and health care. While Sweden exemplifies modern socialism, several European nations have practiced varying forms of socialism over the decades.

### **Command Economies (“Communism”)**

In theory, communism is an economic system based on: (1) a classless society, (2) common ownership of resources, (3) no government, and (4) income distributed according to needs. As practiced in the real world, communism is an economic system based on (1) government ownership--government ownership and control of most resources and the means of production and (2) central planning--excruciatingly detailed and comprehensive resource allocation decision making by the central government.

Under real world communism, governments undertake the vast majority of the resource allocation decisions, with few decisions undertaken by individuals. The former Soviet Union was the primary example of real world communism before it disbanded in the late 1980s. China, Cuba, and a scattering of African nations continue to operate under various forms of communism.