

Economics
Guided Reading

Chapter Two – Economic Systems
Section 3 – Centrally Planned Economies

Directions

Following the page and heading prompts to read your Economics textbook assigned pages and write in the missing words or phrases. Answer all questions in complete sentences.

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Objectives

After studying this section you will be able to:

1. Describe how a centrally planned economy is organized.
2. Analyze the _____ planned economy of the former Soviet Union.
3. Identify the problems of a centrally planned economy.

Section Focus

In a centrally planned, or _____, economy, the central government _____ the economy. Central planning has limitations and disadvantages not found in market economies.

Centrally planned economies operate in direct _____ to free market systems. Centrally planned economies oppose private property, free market pricing, competition and _____ choice.

How is a Centrally Planned Economy Organized?

In a centrally planned economy, the central _____, rather than individual producers and consumers in markets, answer the key economic questions of production and consumption. A central bureaucracy makes _____ the decisions about what items to produce, how to produce them, and who gets them. After collecting information, bureaucrats tell each firm what and how much to produce. It is up to the bureaucrats to ensure that each firm has enough raw materials and works to meet its production goals.

Government Control of Factor Resources and Production

In a centrally planned economy, the government _____ both land and capital. In a sense it owns labor, too, by _____ where individuals work and what wages they are paid. The government decides what to produce, how much to produce and how much to charge. Each year, it directs workers to produce a certain number of trucks, so many yards of cotton fabric, a certain amount of glass, and so.

Vocabulary

Socialism – a social and political _____ based on the belief that democratic means should be used to _____ wealth throughout a society.

Communism – a political system characterized by a centrally planned economy with all economic and political _____ resting in the hands of the central government.

Collective – large farm _____ from the state to groups of peasant farmers.

Heavy Industry – Industry that requires a large capital investment and that produces items used in _____ industries.

Farmers are told what to plant, how to plant and where to send their crops. The free market forces of self-interest and competition are _____ from the system.

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Socialism and Communism

The words most often associated with centrally planned economies are socialism and _____. They are often used interchangeably, but we need to make a distinction between the two terms.

Socialism is a social and political _____ based on the belief that democratic means should be used to distribute wealth e_____ throughout a society. Real equality, socialists argue, can only exist when political equality is _____ with economic equality. Economic equality is possible only if the public controls the centers of economic power. Although socialist nations may be democracies, socialism requires a high degree of _____ to achieve economic equality.

In socialist countries the government often owns major industries, such as utilities. Socialism, as you will see in Section 4, exists to varying degrees in different nations throughout the world.

Communism is a political system that arose out of the philosophy of _____. Communism is characterized by a centrally planned economy with _____ economic and political _____ resting in the hands of the central _____.

Unlike socialists, however, communists believed that a socialist society can only come about after a _____ revolution. While socialist economies can still allow for democracy, communist governments are authoritarian. _____ governments exact strict obedience from their citizens and do not allow individuals freedom of judgment and action. Throughout history, communist nations have been dominated by a single political party or _____. The former Soviet Union was a communist nation that provides us with a good case study of how a centrally planned economy works – and – doesn't work.

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Problems of Centrally Planned Economies

Central planning can be used to jumpstart selected industries and guarantee jobs and income. The other side of the coin, however, is poor _____, serious _____ of non-priority goods and services, and diminishing _____.

In _____, centrally planned economies can work effectively toward explicitly stated goals. For example, in 1928, Soviet leader Joseph Stalin instituted the first of several five-year plans to boost production. While a disaster in terms of agriculture, Stalin had some success in increasing output in heavy industries.

Perhaps the greatest _____ of centrally planned economies is that their performance almost always _____ of the ideals upon which the system is built. In addition, such systems generally cannot meet consumers' needs or wants. Since the government owns all production factors, workers lack any incentive to work hard. These systems also do not reward _____; actively discourage any kind of change. The large expensive bureaucracy necessary to make the thousands of production and distribution decisions to run the economy lacks the _____ to adjust to consumer demands. Decisions become overly _____. Finally command economies sacrifice individual freedoms in order to pursue societal goals.

Many areas of the world, especially less developed countries, have experimented with centrally planned economies, but most of these experiments have failed. Instead, most of these nations have moved toward mixed economies over the past twenty years. In the next section, you will read about today's mixed economies.

Chapter Two – Economic Systems

Section 4 – Modern Economies

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Objectives

After studying this section you will be able to:

4. Explain the rise of _____ economic systems.
5. Interpret a circular flow model of a mixed economy.
6. Compare the mixed economies of various nations along a _____ between centrally planned and free market systems.
7. Understand the role of free enterprise in the economy of the United States.

Section Focus

It is doubtful that any nation can exist successfully under a pure centrally planned economy or a pure market economy. Most modern economies _____ features of both systems. The economy of the United States is based on the principles of the _____.

You cannot find today any economic system that relies exclusively on central planning or the individual initiative of the free market. Instead, most economies are a mixture of economic systems. Most contemporary mixed economies _____ the market with government _____, or involvement, in the marketplace.

The Rise of Mixed Economies

No single economic system has _____ the answers. _____ economies are cumbersome, do not adequately meet consumer needs, and limit freedom. _____ economies have little potential for growth or change. Even _____ economies, with all their advantages, have certain drawbacks.

The Limits of Laissez Faire

Adam Smith and other early free market philosophers believed that, left to its own devices, the free market system would provide the greatest benefit for consumers and raise the standard of living. They preached

Vocabulary

Laissez Faire – The doctrine that states that government generally should not _____ in the marketplace.

Private Property – Property owned by _____ or companies, not by the government or the people as a whole

Free Enterprise – An economic system characterized by _____ or corporate ownership of capital goods; investments that are determined by private decision rather than by state control; and determines in a _____ market.

Continuum – A _____ with no clear divisions.

Transition – Period of change in which an economy moves away from a centrally planned economy toward a _____ - based system.

Privatize – to sell _____ firms to individuals.

_____ , the doctrine that government generally should not intervene in the marketplace. Even Smith acknowledged, however, the need for a certain _____ degree of government intervention in the economy.

As market economies have evolved since Smith's time, government intervention has become greater because some needs and wants of modern society are difficult to answer in the marketplace. How well, for example, could the marketplace provide for national defense or for roads and highway systems?

Some _____ that markets could meet fall to governments so that _____ members of society can participate. _____ is one example. Other needs that could fall into this category are health care and mass transit.

Governments create laws _____ property rights and enforcing _____. There would be little incentive to develop new products without property rights or _____ laws (laws that give the inventor of a new product the exclusive right to sell it for a certain period of time). Without laws insisting on _____, many people fear that some firms would _____ others in their industry and be able to charge consumers any price.

You will recall from your study of American history that the 5th and 14th amendments to the Constitution declare that no person may be deprived of "Life, liberty, or property, without due process of law." The 5th Amendment also says that "just _____" must be paid to owners when private property is taken for public use. Private property is property that is owned by individuals or companies, _____ by the government or the people as a whole. The Framers of the Constitution ensured that the United States government would protect this fundamental right.

Balancing Control and Freedom

A society must assess its value and _____ its economic goals. Some goals are better met by the open market and others are better met by government action. In addition, societies must evaluate the _____ of pursuing each goal.

Each nation decides what it's willing to give up to meet its goals. What are you willing to give up? Are you willing to pay taxes to fund the army? To give money to people without jobs.? To give all people an education? To subsidize farms? Should the government establish job-safety guidelines or a minimum wage?

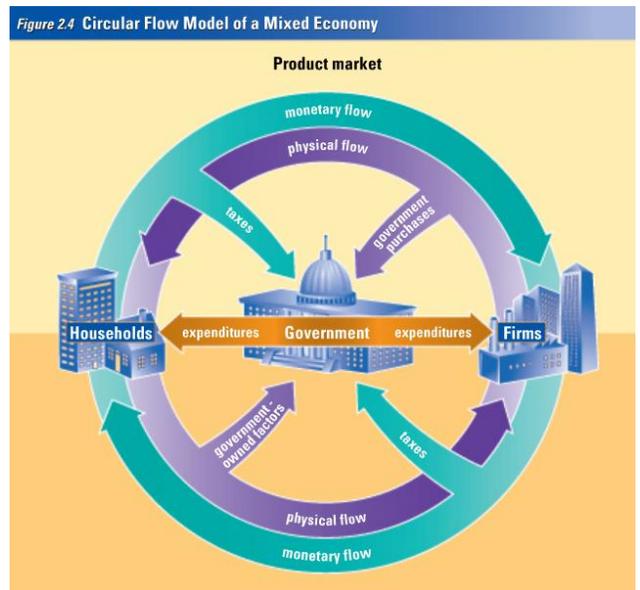
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A Circular Flow Model of a Mixed Economy

To illustrate the structure of most modern economies accurately, we need to add _____ to our picture of the circular flow of economic activity. Figure 2.4 illustrates the government's role in the marketplace in a _____ economy. The government can enter the circular flow of economic activity in many ways.

Government in the Factor Market

Just like business, the government purchases land, labor and capital from households in the _____



market. For example, the United States government pays 2.8 million employees \$9.7 billion a year for their labor.

Government in the Product Market

Governments purchase goods and services in the _____ market. They need buildings and office supplies, telephones, computers and fax machines, for example.

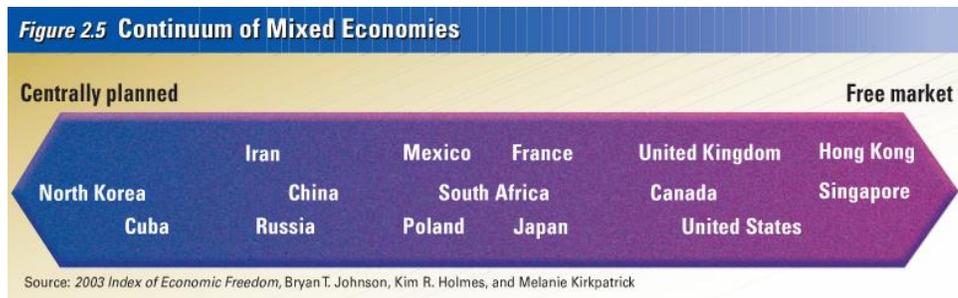
Governments also provide certain goods and services through factor resources that they _____. The federal, state and local governments in the United States, for example, provide 4 million miles of roads.

Transferring Money

As you can see from the outer ring of Figure 2.4, governments collect _____ from both households and businesses. Governments then _____ the money they collect to businesses and individuals for a variety of reasons ranging from worker disability to the survival of an industry. The greatest expenditure of the United States government is _____.

Comparing Mixed Economies

The _____ of the United States economy is the free market. An economic system characterized by private or corporate ownership of capital goods is called _____. In a free enterprise system investments are determined in a free market by _____ decision rather than by state control. Figure 2.5 below shows a continuum of mixed economies. A _____ is a range with no clear divisions. On one end of the scale is the centrally planned economy. On the opposite end is the free market economy.



Mixed Economies Where Government Intervention Dominates

Reflecting an economy almost totally dominated by the government, _____ occupies one end of the scale. Government owns _____ the property and all economic output. State-owned industries produce 95 percent of North Korea's goods. Almost all imports are _____, and production of goods and services by foreign companies is _____.

In China, where the economy is dominated by government, one quarter of all enterprises are at least partly owned by individuals. China, like many nations that have relied heavily on central planning in the past, is in _____, a period of change in which an economy moves away from central planning toward a market-based system. To make the transition, state firms must be _____, or sold to individuals, and then allowed to compete with one another in the market place. As you will read in Chapter 18, economic transition is a difficult, and often painful, process.

Mixed Economies Where the Market System Dominates

At the other end of the scale, with one of the world's freest markets, is _____. Hong Kong, once administered by Great Britain, is now a special administrative region of China. It continues, at the beginning of the twenty first century, largely under the free enterprise system it enjoyed under British rule.

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In Hong Kong, the _____ sector rules. The government protects private property and rarely interferes in the free market aside from establishing wage and price controls on rent and some public services. It is highly receptive to foreign investment and imposes virtually _____ barriers on foreign trade. Banks in Hong Kong operate independently of the government, and foreign-owned banks have nearly all the same rights as domestic ones.

The United States Economy

The United States has a _____ economy. Still, the government _____ to keep order, provide vital services, and to promote the general _____. Some people argue for more government services, while others say that the government already intervenes too much in the economy. Nevertheless, the United States enjoys a high level of economic _____.

United States law _____ private property. The market place operates with a low level of government _____. Foreign investment is encouraged. So, too is free trade, although the United States does protect some domestic industries and does retaliate against trade restrictions imposed by other nations. The banking industry operates under relatively _____ restrictions, and foreign-owned banks have few additional restrictions. In the next chapter, you will read in detail about the government and the free enterprise economy of the United States.

Section 4 Assessment

1. What is laissez faire?
2. Why have some nations begun a transition to free enterprise?
3. Why are nations with centrally planned economies sometimes slow to succeed when they privatize industry?
4. Compare the U.S. free enterprise system with other economic systems you have read about in this chapter.