

The 3 Key Economic Questions every Society must answer: *Who? What? and 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. And 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, every nation is faced with “**The 3 Key Economic Questions:**

- **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.
- **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).
- **How** – should goods & services be produced?
“How to produce?” is an efficiency question. All economic systems must determine how goods and services will be produced.

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.

An economic system is primarily characterized by its key institutions, especially those relating to the ownership and control of resources and the means of production. Two real-world economic systems that differ based on key institutions are capitalism and communism. Capitalism is an economic system in which ownership and control is largely in private hands (businesses and households), as opposed to public hands (government). One of the key institutions underlying capitalism is private property rights. Communism, in contrast, is an economic system in which ownership and control predominately rests with government. Socialism is a third noted economic system that borrows institutions from both capitalism and communism.

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

Two Pure Extremes

Capitalism, communism, and socialism are three real-world economic systems that exhibit varying degrees of decision making by individuals and governments and are part of a continuum bounded by two theoretical extremes--pure market economy and pure command economy. A pure market economy is an idealized economy that relies exclusively on decisions made through markets to allocate resources. A pure command economy is an economy that relies exclusively on decisions by governments to allocate resources. *Neither type* of economic system currently exists in the world, nor has either *ever* existed. Both ideals are best considered benchmarks that can be used for comparison. The key word that makes each a theoretical extreme is "exclusively." ***Real world economic systems rely on both markets and governments to allocation resources. While some real world economic systems come close to one extreme or the other, they never actually reach the ideal.***

The 3 Key Economic Questions every Society must answer:

Who? What? and How?

● ***Who*** _____

● ***What*** _____

● ***How*** _____

Economic System _____

Mixed System _____

In a Market Economy: _____

In a Command Economy: _____

Market Economies (“Capitalism”) _____

Command Economies (“Socialism”) _____

Command Economies (“Communism”) _____

New Vocabulary/Terms

