

THE FREE MARKET

Why Market's Exist?

- ⦿ Market—arrangement that allows buyers and sellers to exchange things
- ⦿ Why Markets Exist?
 - Specialization
 - We are not self-sufficient
 - Specialization is the concentration of the productive efforts of individuals and firms on a limited number of activities
 - Buying and Selling
 - We need markets to sell what we specialize in and buy what others specialize in

Free Market Economy

- ⦿ Individuals and firms own the factors of production (land, labor, capital or entrepreneurship)
- ⦿ Individuals answer the three key economic questions
- ⦿ Players in the free market economy:
 - Households—persons or groups of people living in the same residence and consume goods and services
 - Firms—businesses or organizations that use resources to produce and sell a product

Factor Market and Product Market

- ◎ The Circular Flow diagram on page 30 illustrates the circular flow between households and firms
 - Households pay for goods and services
 - Firms supply households with goods and services
 - Households supply firms with land, labor, and capital
 - Firms pay households for land, labor, and capital

Self-Regulating Nature of the Marketplace

◎ Self-interest

- The buyer and seller consider only their self-interest (their own personal gain)
- Self-interest motivates the free market

◎ Competition

- Consumers have the incentive to look for lower prices
- Incentive—the hope of reward or the fear of punishment that encourages a person to behave in a certain way
- Competition—the struggle among producers for the dollars of consumers

The “Invisible Hand”

- ① The combination of self-interest and competition result in the market regulating itself
- ① Consumers get the products they want and the prices are reasonable
- ① This all happens without centralized control
- ① Adam Smith called this the “invisible hand of the marketplace”

Advantages of the Free Market

- ⦿ Economic efficiency
- ⦿ Economic freedom
- ⦿ Economic growth
- ⦿ Additional goals
 - Consumers decide what gets produced—this is called “consumer sovereignty”
- ⦿ BUT....no pure market economy exists on a large scale—the system has been modified in most countries

Traditional Economy

- Relies on habit, custom, or ritual to answer the three questions
- Agricultural and hunting practices are common
- Think—tribal society

Modern Economies

- ⦿ Limits of Free Market Economies
- ⦿ Laissez faire—doctrine that government should not intervene in the marketplace
- ⦿ The market cannot do certain things:
 - National defense
 - Education?
 - Health care?
 - Mass transit?

Government Involvement

- ◎ Government in the Factor Market
 - US Government: 2.8 million employees
 - \$9.7 billion paid for their labor each year
- ◎ Government in the Product Market
 - Governments purchase products
 - Governments provide roads, transportation resources, etc.