

People Power

The Private Enterprise System

Objectives

- A** Discuss the characteristics of a private enterprise system.
- B** Describe the economic freedoms that exist in a private enterprise system.



1375 King Avenue, P.O. Box 12279, Columbus, Ohio 43212-0279

Ph: (614) 486-6708 Fax: (614) 486-1819

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Sam wants to make a little extra money for her white water rafting trip this summer. Graduation is coming soon, and many of her friends and classmates need senior pictures. Since Sam has taken photography classes, owns a nice camera, and plans to study photography at college, several people offer to pay her to take their senior photos. So, Sam prints up flyers advertising her services, and over three weeks' time, she makes over \$400!

Sam's business venture is an example of what can happen in a private enterprise system. She had the freedom to offer a product or service and to profit from it. This might seem reasonable to you, but not all economic systems allow such freedoms. Read on to find out more about how private enterprise systems work!



Private Enterprise

Every society develops a system for making decisions about how it will use its resources to meet the needs and wants of its people. Each of these **economic systems** must answer these three basic questions:

1. What goods and services will be produced?
2. How will these goods and services be produced?
3. For whom will these goods and services be produced?

In a **private enterprise** economic system, these questions are answered by individuals and businesses, not by the government. Individuals and groups (rather than the government) own or control the economic resources—human and natural resources and capital goods—used to produce goods and services.

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Throughout the history of the United States, private enterprise has enabled the nation to produce more goods and services than any other single country. This success is due to the characteristics of the private enterprise system. Let's take a look at each of these characteristics.

The private enterprise system in the U.S. has led to significant economic growth.



Freedom in the marketplace

While you may think of a “marketplace” as a specific location, in economic terms it refers to any place where the buying and/or selling of goods and services occurs. Private enterprise is often called a **market economy**, or a **market system**, because markets, not the government, answer the economic questions of what, how, and for whom to produce.

The markets in private enterprise are self-regulated and self-controlled. In other words, these businesses are free to choose such things as:

- What they wish to produce
- Which resources to purchase
- What techniques of production to use
- How their goods or services will be marketed
- What price(s) they will charge
- When to close down or go out of business

*In the private enterprise ►
system, you're free to use
your skills and resources to
generate profits.*



At the same time, consumers may purchase anything that can legally be sold as long as they are able to pay for it. Each time a consumer makes a purchase, s/he is casting an economic vote in the marketplace. These economic votes enable consumers to control what will be produced. In the long run, if consumers don't buy a product, the producer must change it, replace it, or go out of business. For example, if an automobile manufacturer designs a new car that does not appeal to drivers, the car will not sell. If a movie studio makes a film that the public doesn't like, the film will not make money. In either case, the product must be replaced by something consumers *do* like if the producer wants to make a profit and stay in business. It is the responsibility of consumers to be well informed and to make educated choices in the marketplace so that producers will continue to make good products at fair prices.

Recently, U.S. automakers have drifted away from producing sedans, as customers are more interested in SUVs, crossovers, and trucks. American carmakers cannot compete with the sedans made by international companies such as Honda and Toyota. Read more about this shift in the marketplace here:

<https://www.consumerreports.org/general-motors/gm-to-drop-some-sedans/>.



Private property

Anything of value that people own is considered **private property**. It may be business property or personal property. It may be in such forms as land, furniture, buildings, resources, jewelry, money, equipment, clothing, or stocks. Ownership of private property also includes ownership of the results of your work. More examples of private property include:

- Farmers' ownership of the crops they raise
- Workers' ownership of the wages they earn
- Businesses' ownership of the goods or services they produce
- Individuals' ownership of the profit that comes from the sale of private property

Individuals and businesses in a private enterprise economy are free to decide how to use their private property and when and how to sell it. They can:

- Enter freely into contracts involving their private property
- Stop others from using their private property
- Abuse their private property as long as they are not stepping on the rights of others
- Control their private property in any way they choose
- Use their private property to make income
- Keep any income earned by renting, leasing, or selling their private property



▲ *If you own a house or apartment, you are free to rent it out to others as a way to earn income.*

Limited government control

The private enterprise system that exists in the United States is not a pure private enterprise system because there *is* a limited amount of government control. This private enterprise system is considered a **mixed system**—individuals and businesses are the primary economic decision makers, while government helps regulate and control the system.



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Want to know more about mixed economic systems? Check out the video “What Is a Mixed Economy?” by Mr. Sinn: <https://www.youtube.com/watch?v=9EseSEgLsvU>.

In the United States, the government steps in only to protect citizens; otherwise, it lets them pursue their own goals. Think of the government as a referee, ensuring that individuals and businesses play according to the rules. However, as life in the U.S. has become more complex, the role of government has gradually expanded. This has happened partly because Americans want the government to solve certain problems, such as inflation, pollution, health care, and unemployment.



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▲ *Laws and regulations help protect people in a private enterprise system.*

Competition

Have you ever thought about how many different ways a certain product can be produced? For example, books can be printed on different kinds of paper, using a variety of styles of type, bound with hard or paperback covers, and sold at high, medium, or low prices. They are produced as e-books that you can read on your e-reader, computer, or phone, or audiobooks you can listen to on your phone. Since there are so many different ways to produce many products, the company that finds the most efficient way is the one that will be able to compete successfully.

Competition is a rivalry between two or more businesses to attract scarce customer dollars. Therefore, a business must obtain and use resources efficiently. This will help the company keep its prices competitive with those of other firms. Other ways in which businesses compete for customers are by giving better credit options than those offered by rival companies, improving goods and services, creating new goods and services, and providing better service than their competitors.

The profit motive

Profit is the monetary reward business owners receive in return for taking the risk involved in starting a business. The desire to make a profit, called the **profit motive**, forms the economic basis for the private enterprise system. If a business did not make a profit, it would eventually cease to exist.



▲ Consider the competitive rivalry between McDonald's and Wendy's. Do you think that customers have gotten any benefits from the competition?

The freedom to use your private property to make a profit is as important as the freedom to own private property in the first place. Profit serves as a motive, or reason, for starting a business and as a goal toward which the individual or the business can work. Individuals and businesses in private enterprise can keep any profit they earn, or they can use it in any way they wish. For this reason, many people consider making a profit the greatest motivating factor in the private enterprise system.



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Check out this video "Going Places" about the profit motive:

<https://www.youtube.com/watch?v=OesP-6IUnmM>.

It might be a bit retro (okay, it's from 1948!), but while times may change, the profit motive doesn't.

The price-directed system

A private enterprise economy is often called a **price-directed system** because price determines what consumers buy, which jobs they will take, the success or failure of businesses, and the types of products that will be produced. Prices are important in making the system work correctly.

Supply and demand work together to determine prices in a private enterprise system. Consumers indicate their demand for products by the prices they are willing to pay for them. For example, when banana purchasers demand more bananas than are being supplied, the price of bananas will rise. If the price rises too high, some consumers will buy fewer bananas. The supply might then exceed the demand, causing the price to fall.



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THE GRAY ZONE

In a private enterprise system, wealth and income are not distributed equally. Poverty still exists, and there are people who cannot afford the very basics of life—even when receiving certain assistance from the government. United States citizens and businesses give over \$390 billion to charity each year; however, there are no laws requiring American companies to give to the less fortunate. Even if a company makes millions each year, it has the right to keep every penny. However, the public often thinks less of businesses that don't make any charitable contributions. Are businesses morally obligated to donate money? What do you think about charitable giving in a private enterprise system? Should businesses with a great deal of money feel obligated to donate some of their earnings?



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Weaknesses of the system

While the U.S. private enterprise system is the most productive that the world has ever known, it does have some negative aspects, or disadvantages. There are times when production drops because sales are low. When this happens, companies may lay off workers or even go out of business. This results in periods of unemployment.

Also, poverty has not been eliminated. There are still many people in the United States and in other countries with private enterprise systems who are not able to afford the basic necessities of life.

◀ *Income inequality in the U.S. has caused controversy and sparked protests.*

Property and income are not distributed equally in a private enterprise system. Some people own a great deal of property while others own little or none because they do not have the money to buy it. The private enterprise system does not always make it easy for people to increase their income, especially if they do not have access to higher education, training, and skills.



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Curious to read more about the disadvantages of the market system? Check out “The Disadvantages of Capitalism in the Economic System” by Liz Gold:
<https://bizfluent.com/info-8401627-disadvantages-capitalism-economic-system.html>.

Summary

In a private enterprise economic system, individuals and groups (rather than the government) own or control the economic resources. Characteristics of a private enterprise system include freedom in the marketplace, private property, limited government control, competition, the profit motive, and the price-directed system. Disadvantages of private enterprise include periods of unemployment, poverty, and unequal distribution of wealth.

TOTAL RECALL

1. What is a private enterprise system?
2. Describe the characteristics of a private enterprise system:
 - a. Freedom in the marketplace
 - b. Private property
 - c. Limited government control
 - d. Competition
 - e. The profit motive
 - f. The price-directed system
3. What are the disadvantages of a private enterprise system?



Economic Freedoms in Private Enterprise

Let's consider how a private enterprise system personally affects the people who live in it. What economic freedoms do they have that they would not have under another form of economic system? What do these economic freedoms mean to individuals and to the system itself?

Private enterprise is based on the idea that everyone is better served when individuals are free to set their own goals. It is a fact of human nature that we work much harder to meet goals we have set for ourselves than we do to meet goals set for us by others. Just think about how this works in your own life. If you decide to learn all you can about math so you can become an accountant, you will learn much more in your math classes than you will if the teacher sets the goals for you. If you work extra hard to get the promotion you want at work, you'll be more productive than if you simply follow your boss's orders. Economic freedom works in the same way. When people are free to make personal economic choices and to set economic goals for themselves, they work harder to achieve those goals. This benefits them, and because it increases production, it benefits the economic system as a whole.



▲ *Would you work hard if you knew that it wouldn't benefit you in any way?*



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The Heritage Foundation ranks each country's economic freedom every year. You can read about the United States' ranking here: <https://www.heritage.org/index/country/unitedstates>.

Then, read about the top-ranking country for economic freedom, currently Hong Kong: <https://www.heritage.org/index/country/hongkong>.

Based on what you've learned so far, why do you think Hong Kong received a higher ranking than the United States? What might happen if the United States had less economic freedom?

Economic freedom does not *guarantee* success to individuals or to businesses, but it does provide the *opportunity* for success. There are few countries that offer as much economic freedom as citizens enjoy under the private enterprise system. Let's see what these economic freedoms are and why they are important.

Freedom to choose

There are a number of economic choices that individuals in a private enterprise economy are free to make. One of the most basic is the freedom to choose your own personal economic goals. You are free to select the standard of living that you would like to achieve. You can decide how hard you are willing to work to achieve and maintain that way of life.

You can choose the kind of work you would like to do for a living. This choice will be limited only by your own interests, abilities, and training. You may apply for any job for which you are qualified. You may choose to accept or reject any jobs that are offered to you. Likewise, you are free to decide what salary or wages are acceptable. You can even move to another part of the country if that is where jobs in your field are available.

Once you have taken a job, you can choose whether you want to remain with that business or look for a job with another company. If you wish, you can continue to learn and to improve your skills so that you move up in the company or earn higher wages because of your increased value as an employee.

You even have the freedom to go into business for yourself. If you decided to do so, you would be considered an **entrepreneur**. You would have to make all the decisions and take all the risks involved in starting the business, but you would also be entitled to keep all the profits. Entrepreneurs are important to the private enterprise system. Without people who are willing to take the chance of going into business, the system would have much less change, fewer new products, and less efficient use of resources.



This video from Investopedia explains how entrepreneurs are an essential part of economic success: <https://www.youtube.com/watch?v=KEuTpRkZqiY>.

As you can see, individuals in a private enterprise system have the freedom to make a wide variety of economic choices. In other economic systems, people may be told by the government what work they will do, where they will do it, and what their wages will be. There might be no opportunity to go into business for yourself or with others. Workers may even need government permission to change jobs. Since these workers are not free to choose other employment, they have no hope of improving their standard of living. They may have so little interest in the work they have been assigned that they put forth as little effort as possible. This lowers production and affects everyone in the economy.

Freedom to own, use, buy, and sell private property

As you know, private property is anything of value that you own, whether it is business property or personal property. You also own the profits earned by your own business, the wages you earn by working for someone else, and the interest paid to you on your savings or investments. Your time and your talents are also your private property. You are free to put them to whatever use will be of the most benefit to you.

In a private enterprise, you are free to use your talent, time, and wages however you'd like. For example, you could start your own at-home baking business to earn a little extra money on the side! ►



The freedom to make decisions about how your private property will be used is a very important part of private enterprise. It gives you the freedom to try to make as much income as you are able. If you want to rent out your house to make more money, you can do so. And, if you want to sell your car because you don't drive much, you can do that, too. Without freedom of use, your property could not earn income for you, and its value to you would be reduced.

You are also free to save as much of your income as you want, to spend it on things you want to buy, or to invest it so that it will make more money for you. If you own land suitable for farming, you can raise crops on it, let it sit idle, or lease it to someone else for his/her use. If you have a surplus income after saving, spending, and investing, you can lend that money to others and charge them interest for the use of it.



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Under private enterprise, you are free to buy goods and services anywhere. If what you need or want is not available where you live, then you can look for it elsewhere. If the price is too high, or the quality is poor, you can decide not to buy.

In other economic systems, people may not be free to own, use, buy, and sell private property. They may be allowed to own only certain kinds of private property. The government owns and controls the economic resources and makes the economic decisions. This means that if the government decides to manufacture and sell tools instead of cookware, the individual cannot buy cookware even if s/he has the money to pay for it. It also means the individual's standard of living is controlled by the government.

Freedom to compete

Competition is an important characteristic of private enterprise. The freedom to compete is also an important economic freedom for individuals. You are free to use your abilities to compete for a scholarship at the college or university of your choice. If you are looking for a job, you are free to compete with other job seekers. If you own your own business, you can compete with similar businesses for customers. Freedom to compete allows you to market your assets to your best advantage.

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Almost no competition exists in other economic systems since there is only one owner or controller of the economic resources. This prevents individuals and businesses from enjoying any of the benefits of competition that citizens have in private enterprise.



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Watch this video from PolicyEd to learn about the importance of competition and how it benefits consumers: <https://www.youtube.com/watch?v=dj-U9TDRNsA>.

Limits to economic freedom

Even though private enterprise offers a great many economic freedoms, it does have certain limits.

People in a private enterprise system cannot buy anything and everything that they might like to buy. One limiting factor is competition among buyers. There are always many people who want to buy the same things. If you want to score tickets to next week's Taylor Swift concert but they're all sold out, you'll be out of luck.

People are also limited by their own choices. You have a finite amount of money, and if you choose to buy a new iPhone, you may not have the money to buy the new jacket you've had your eye on. You'll have to choose which item you'd rather buy. And, if you sell your private property to one person, you can't sell that same property to someone else.



Cunaplus_M.Faba/Stock/Getty Images Plus

▲ *The ability to buy whatever you want is limited by the availability of resources. If there's a shortage of the product you want, you won't be able to get it.*

Economic freedom is also limited by the laws that have been created to protect people. For example, businesses such as nail salons and day care services are required to be licensed to safeguard public health. Workers in such professions as medicine and law require specialized training and must pass examinations before they are allowed to provide their services. Businesses may not dump their waste into streams, sell products that are unsafe, or make false advertising claims about what products will do. No one is permitted to sell illegal drugs, stolen property, or services which s/he is not trained and/or licensed to perform. Think about what could happen if just *anyone* was allowed to perform open heart surgeries or teach high school classes! Everyone is protected by these laws and regulations.

*Next time you visit a salon, keep ►
an eye out for its licensing.*



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If you have a job, you've probably noticed that you don't control all the money you make—there are taxes to think about! To have the money necessary to run the country, the government collects taxes from individuals and businesses. This restricts economic freedom since taxpayers cannot use all of their income for their own purposes. However, taxes are a necessary limit to economic freedom since they provide the money needed to pay for fire and police protection, public schools, highway construction and repair, and other services that people need to operate their businesses.



Watch this video from Crash Course Economics to learn about the history and purpose of taxation: https://www.youtube.com/watch?v=7Qtr_vA3Prw. Do you think the benefits of taxation are worth the limits that it puts on economic freedom?

Summary

Economic freedoms in private enterprise include the freedom to choose your economic goals and the type of work you do, the freedom to make decisions about private property, and the freedom to compete. Limits to economic freedom include competition among buyers, personal choices, certain laws, and taxes.

TOTAL RECALL

1. How does economic freedom benefit individuals?
2. How does economic freedom benefit the economy?
3. Describe the following freedoms in a private enterprise system:
 - a. Freedom to choose
 - b. Freedom to make decisions about private property
 - c. Freedom to compete
4. What are the limits to economic freedom in a private enterprise system?

Make It Pay!

Think about the examples of private enterprise you see every day. Is there a “grand opening” of a new restaurant in your neighborhood? Is there a “for rent” or “for sale” sign on a house on your block? Have you noticed the price of gas going up or down? How do these examples illustrate private enterprise? How does the private enterprise system help people and companies in your area?