Economics Makes the World Go Round!

There are three basic types of economic systems. Traditional systems are found in agricultural societies where people make what they need to survive. In a command system, the government controls all production and distribution. In a market system, supply and demand determines what is produced and sold. Most countries have mixed economies that fall somewhere in between pure market and pure command economies. Every economic system has to answer three basic questions: What to produce? How to produce? For whom to produce?

Economies in Europe

You’ll find several types of basic economic systems during your study of Europe:

- The United Kingdom has a mixed market economy that ranks as the second-largest economy in the European Union. Service industries like banking, insurance, and business services account for most of the UK’s gross domestic product (GDP). Since 1979, the British government has turned over many state-owned companies like British Steel, British Coal, and British Airways over to private ownership (business), setting up free market competition instead of government control.

- Germany has a mixed economy known as a social market economy. It combines three things: a market system (free enterprise and competition), some state control, and social welfare where help is given to the poor. In 1990, when West Germany and East Germany were united, West Germany absorbed huge costs bringing East Germany’s command economy into its market system. Despite that setback, the new Germany has emerged as the strongest economy in Europe!

- Russia has a mixed market economy. The Russian economy has struggled as it transitions from a command economy under the Soviet Union government to a market economy today. Many government-owned companies are being sold to the private sector (business), but Russia still faces financial problems and huge costs to upgrade its old manufacturing plants and industries to modern, more efficient standards.

Essential Skills

In your own words, define a market economy. An economy with little government control, privately owned businesses, competition, supply and demand determines prices.
Essential Skills
Complete the chart below comparing the economies of the United Kingdom, Germany, and Russia.

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of Economy</th>
<th>Growing or Struggling</th>
<th>What the Government Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>mixed market economy</td>
<td>growing</td>
<td>not much</td>
</tr>
<tr>
<td>Germany</td>
<td>mixed social market economy</td>
<td>growing</td>
<td>Social welfare</td>
</tr>
<tr>
<td>Russia</td>
<td>mixed market economy</td>
<td>Struggling</td>
<td>less and less</td>
</tr>
</tbody>
</table>

Quick Quiz
Answer the questions below.

1. List the three basic questions economic systems have to answer. What to produce? how to produce it? For whom to produce?
2. Next to each question below, write T for traditional system, C for command system, and M for market system.
   - C a. The government controls what is produced and how it is produced.
   - M b. Supply and demand determines what is sold and how much it costs.
   - T c. People make what they need to survive.
3. The most common economic system today is:
   - a. command
   - b. market
   - c. mixed

Think About It
History shows that command economies typically have not been successful, growing economies. Why do you think that is the case?

Command economies have a lot of government control. This means not much change or starting of new businesses, which means no growth.
Chapter 26

SS6E6 The student will analyze the benefits of and barriers to voluntary trade in Europe.

a. Compare and contrast different types of trade barriers such as tariffs, quotas, and embargoes.

b. Explain why international trade requires a system for exchanging currencies between nations.

It's Time to Trade

Countries sometimes set up trade barriers to restrict trade because they want to sell their own goods to their own people. They don't want foreign competition to come in with lower prices! Just about every country has some restrictions on foreign imports. Trade barriers include:

- **Tariffs** are taxes placed on imported goods. Tariffs cause the consumer to pay a higher price for an imported item, increasing the demand for a lower-priced item produced domestically.

- **Quotas** are restrictions on the amount of a good that can be imported into a country. Quotas can cause shortages that cause prices to rise.

- **Trade embargoes** forbid trade with another country.

Trade in Europe

The European Union (EU) was primarily established to set up free trade among countries in Europe. Today, the EU is a powerful trade bloc, making up one-fifth of the world’s trade. Products produced in Europe can now move freely, without tariffs, to other EU member nations. This free trade leads to tremendous cost savings for European consumers and businesses!

In order to protect its members, the EU sometimes establishes quotas on trade with other nations. For example, the EU placed quotas on clothing imports from China when EU members with strong textile industries (like France and Italy) complained about cheap import prices. The EU also has internal quotas. For example, the EU strictly limits the amount of fish a boat can bring to port in order to give countries equal fishing advantage.

The EU will also embargo imports from foreign countries if that country doesn't follow specific quota rules. Embargoes are also put in place for safety reasons, such as an embargo against African fish products due to unsanitary water conditions. The EU may also embargo imports from countries for political reasons, such as a country that violates its citizens' human rights.
Quick Quiz
Decide if the examples below represent a tariff, quota, or embargo. Write the correct word next to each example.

Quota 1. Only 3000 pairs of American blue jeans can enter France.
Tariff 2. The U.S. charges an extra 10 cents per pound on bananas from Costa Rica.
Embargo 3. No Brazilian beef can be sold to Spain.
Quota 4. Only 10,000 barrels of oil can be delivered from Saudi Arabia to Italy this month.
Embargo 5. The EU will not accept any products from an African nation because its government will not allow free speech or freedom of religion.

Your Money = My Money!
Because every country does not use the same type of money, international trade requires a system for exchanging currencies between nations. Money from one country must be converted into the currency of another country to pay for goods in that country. This system is called foreign exchange. The exchange rate is how much one currency is worth in terms of the other. For example, an exchange rate of 5 euros to the dollar means that five euros are worth the same as one dollar.

The European Union took a big step in simplifying currency exchange when it established the euro as the common currency for its member nations. This one common currency has made trade—and travel—much easier within Europe! The euro bills all look the same, but the coins have a standard euro design on one side and symbols from individual countries on the other side.

Special Economics Info
The value of the euro in relationship to the dollar changes frequently. Let's say that one euro is equal to 1.5 American dollars. Using that exchange rate, answer the questions below.

1. Which is worth more: one euro or one American dollar? Euro Explain your answer: It takes more than 1 American dollar to equal 1 Euro.

2. You want to buy a purse in Italy that costs 30 euros. How much do you need in American dollars to buy the purse? $45

3. You have 575 dollars. Do you have enough money to buy a jacket in France that costs 55 euros? (87.50) Yes

4. Your friend from Spain has 4 euros. Does he have enough money to buy a hamburger and fries for $5.95? (6.0) No

5. Considering the exchange rate listed above, would an American traveling in France be pleased about the exchange rate? Why or why not? No, because they wouldn’t be getting as much value.
Chapter 27

SS6E7 The student will describe factors that influence economic growth and examine their presence or absence in Europe.

a. Explain the relationship between investment in human capital (education and training) and gross domestic product (GDP).

b. Explain the relationship between investment in capital (factories, machinery, and technology) and the gross domestic product (GDP).

c. Describe the role of natural resources in a country's economy.

d. Describe the role of entrepreneurship.

Influences on Economic Growth

There are basic factors that influence economic growth in any part of the world. They are the productive resources used to produce goods and services. They include human capital (people who perform labor), capital (factories or machinery), and natural resources (things that come from the land like minerals or trees). Another factor is entrepreneurship, which includes the ideas, innovation, and risk involved in starting a business.

Economists measure a nation's economic performance by a standard called Gross Domestic Product (GDP). The GDP is the total market value of the goods and services produced by a country's economy during a specific year. Economists use it to determine the health of a country's economy and compare it to other economies. Since Germany and the United Kingdom have two of the strongest economies in Europe, they have high GDPs. Russia and Ukraine are slowly working their way out of the former Soviet Union's command economy, so they have lower GDPs.

Quick Quiz

Answer the questions below.

1. List four productive resources used to produce goods and services.
   a. human capital
   b. natural resources
   c. capital
   d. entrepreneurship

2. What is the Gross Domestic Product, or GDP?
   The total market value of the goods and services produced by a country's economy during a specific year.
How to Raise Your GDP!

How a country manages its productive resources makes a big difference in the strength of its economy. For example, investment in human capital delivers long-lasting rewards. Studies have shown that investment in education and skills training clearly correlates to a higher GDP. Education creates a smarter and more productive workforce, which leads to greater economic growth.

There is also a clear relationship between investment in capital like factories, machinery, and technology and GDP. Examples include a company building a new factory or buying new computers. Investment in capital equipment helps economic growth by providing workers with the best and newest tools, making them more productive.

Most European countries have good education systems and strong capital investment. With its booming economy and emphasis on education, Germany is an example of how investment in people and capital equipment leads to economic strength. Germany's government has established vocational schools and universities to train its workforce. Investment in capital equipment is a priority for German companies and the German government.

In contrast, Russia and Ukraine have much lower GDPs than many other European countries. Both countries are rebuilding their economies after suffering serious financial problems once they became independent in the early 1990s. In Ukraine, educational systems suffered because there was little money for schools or teachers' salaries. In Russia, years of low capital investment have left manufacturing plants with old, outdated technology.

Essential Skills

The chart below shows GDP per capita (per person) in Europe. Study the chart and answer the following questions.

1. List the countries with the four highest GDPs. **U.K., Belgium, France, Germany**

   Do these countries have high or low investment in education and capital equipment? **High**

2. List the countries with the three lowest GDPs. **Poland, Russia, Ukraine**

   Do these countries have high or low investment in education and capital equipment? **Low**

3. What type of economy did the countries with the lowest GDPs have prior to 1991? **Command**

GDP Per Capita for Selected European Countries

![GDP Per Capita Chart](chart.png)

Source: CIA World Factbook (2007)
Natural Resources and Entrepreneurs

One reason that the United Kingdom and Germany have successful economies is because they have many natural resources. Natural resources have an important role in any nation's economy. They are the fuel for industry and a source of income when exported to other countries. The United Kingdom has valuable reserves of coal, oil, and natural gas. Germany has rivers, forests, and large deposits of coal and iron ore. Russia also has many natural resources, but they are located in remote areas and it is difficult and expensive to harvest them.

Entrepreneurs have a vital role in any country's economy. They come up with new ideas and use human, capital, and natural resources to bring their ideas to the marketplace. They must be willing to take risks, and often share those risks with others by borrowing funds from a bank or a wealthy investor. Entrepreneurs are valuable because they introduce innovative products and help economies adapt to changing conditions—a common occurrence in our fast-moving, global society!

Although small businesses are the cornerstone of many European economies, European countries do not have as much entrepreneurial activity as the United States or developing countries in Latin America or Asia. The reasons include high taxes, lots of regulations, and job security. Since entrepreneurs are such an important factor in economic growth, the EU is urging its members to reduce taxes and regulations on small businesses and helping set up training programs on how to run a business.

Quick Quiz
Fill in the blanks below. Use the Word Bank to help you, but you may not need all the words in it.

1. Natural resources provide fuel for __industry__ and are __source of income when exported__ to other countries to make money.

2. __Russia__ has lots of natural resources, but it's difficult and expensive to get to them.

3. Entrepreneurs help economic growth because they introduce __innovative product__ and help countries adapt to __changing conditions__ in the marketplace.