

THE AMERICAN ECONOMY

The American economy, when operating properly, is one of the marvels of the world. It is a highly complex and abstract thing that almost defies description. Obviously, one cannot draw a picture, or take a photograph, of the economy. Yet, it is something very real.

When I introduce the concept of the American economy to my college students, I often ask them to use their imagination for a moment in order to get some idea of what the economy is like. I tell them to imagine it as a gigantic mechanism, or device, which uses an enormous volume of inputs in the form of labor, natural resources, and tools and machines, to produce an incredibly large volume and variety of outputs in the form of finished goods and services, ranging from hamburgers and hair-cuts, to automobiles, houses, and space vehicles.

As incredible as this gigantic mechanism is, it is not perfect. It requires constant attention to keep it operating properly. It sometimes moves too fast, and at other times it moves too slowly. Thus, policy makers must frequently tap on the "brakes" or push down on the "accelerator pedal." This marvelous mechanism has no automatic pilot control on it. Thus, even when it reaches the point where it is operating at the maximum efficiency level, there is no guarantee that it will continue to operate

in the proper manner for very long. Thus, it is necessary to constantly monitor the economy and take corrective actions when necessary. And it is absolutely crucial that those individuals who make decisions regarding adjustments to the economy have a sound understanding of how it works. Just as an inexperienced mechanic can do great damage to your automobile, economic policy makers who do not have a sound understanding of economics can do great damage to the economy. If the brakes are applied too hard, or the economy is accelerated too rapidly, it can take a long time for the economy to recover from the resulting damage.

The Free-Enterprise System

The American economy goes by more than one name. It is often referred to as a "private-enterprise" or "free-enterprise" system. It is also known as an example of "capitalism" and as a "market economy." These terms are often used interchangeably and they mean almost the same thing. However, economists generally use the term capitalism and market economy to refer to the American economy. Basically, capitalism is a form of economic organization in which businesses are privately owned and operated, and where freely operating markets coordinate most economic activity. It is because two of the most important characteristics of capitalism are private ownership of property and the freedom of opportunity to engage in business activities that

the terms "private-enterprise" system and "free-enterprise" system are so often used to refer to the American economy.

The word, capitalism, emphasizes the private ownership aspect of the American economy, whereas the term, market economy, emphasizes the fact that a system of free markets makes most of the basic economic decisions. We will use the term market economy in most of our discussion because we are primarily interested in understanding how the basic economic questions are answered in the American economy.

In the American market economy, individuals are free to engage in whatever business and work activities they choose so long as they do not violate any laws. It is this freedom of choice, accompanied by the profit motive, that makes the American economy work. Because it is predominantly a market economy, the American economy is self-regulating. In other words, government intervention into the operation of the economy is kept to a minimum.

Let's now look more closely at how the American economy operates.

The Amazing Invisible Hand

If you live in a large city, you and millions of your fellow residents would be on the verge of starvation within a week or so if the tons and tons of food that must arrive in your city daily were to be delayed. Yet, you have probably never lost any sleep worrying about such a possibility. You probably feel confident that the food, as well as most other items you might wish to purchase, will almost always be in the stores waiting for you when you arrive. Like most other Americans, you probably just take it for granted that when you want to purchase something it will be available. You may not understand how the economic system works, but you are confident that it will provide you with most of the goods and services you need at precisely the time you need them. However, if you give the matter some thought, you will realize that the fact that the economy is able to deliver the proper amount of goods and services to people whenever and wherever they choose to buy them is a truly remarkable accomplishment. Who is responsible for the elaborate planning necessary to accomplish this task? The answer may surprise you.

Who Does the Planning?

Suppose you live in New York City and one day you suddenly have the urge to have banana pudding with fresh bananas and vanilla wafers as desert for dinner. It's been a long time since you've had banana pudding, or purchased any of the ingredients necessary for making it. Yet, you can be almost certain that if you go to the nearest

supermarket all the ingredients you need will be there waiting for you. The pudding mix and vanilla wafers may include sugar refined from sugar cane grown in Louisiana or Florida. The wafers will contain wheat flour produced from wheat that may have been grown in Kansas. And the milk you add to the pudding mix may have been produced on a dairy farm in upstate New York. Just think of all the people in all the various parts of the country who played a role in producing the products that will become a part of your dinner desert.

But the most amazing part of all is the final ingredient, the fresh bananas. The highly perishable bananas had to be grown in a foreign country and shipped to your local supermarket at just the right time so they would be neither green nor overripe on the very day you decided you wanted them. How did all these people know to produce enough of these products, and how did your supermarket manager know to have the ingredients available when you arrived? They didn't know you were going to decide to have banana pudding on that particular day.

Who makes sure that New York City, and all the other cities and towns of the United States, have the proper amounts of each of the thousands of goods and services that the people need and want? Does the government of each city plan for the needs of its citizens? Or do the state and federal governments plan to have the right amounts of the various goods and services delivered to each geographic area at the proper times?

The answer to the above questions is that no government at any level determines either the production or the distribution of goods and services in the United States. If the government doesn't do the planning, then who does? As hard as it may be to believe, the answer to this question is, "Nobody." No individual, no business firm, and no government agency is responsible for seeing that all the economic needs of the people of New York City, or any other city or town, are met. Yet most of the needs are met. Goods and services are produced and distributed to the people in the correct amounts, at the proper times, and in the right locations.

The Invisible-Hand Principle

The production and distribution of economic goods and services in the United States is determined by the American economic system itself. Some economists say the economic system works like an "invisible hand" in determining what should be produced, how it should be produced, and for whom it should be produced. This invisible-hand principle was first identified by Adam Smith, a Scottish professor who published a monumental work entitled *THE WEALTH OF NATIONS* in 1776, and who is generally considered to be the founder of economics.

In this book Smith argued that, in a market economy, if individuals were allowed to pursue their own self interests without interference by the government, they would be led, as if by an invisible hand, to achieve what is best for society. Although the American economy is very different from the type of economy that Adam Smith described in 1776, the principle of the invisible hand still applies to our economy in a modified way.

With some exceptions, individual are generally motivated by economic forces. Most individuals tend to act in such a way as to obtain the greatest amount of satisfaction for the least amount of sacrifice or cost. Thus, businesses will attempt to maximize their profits, workers

will seek higher wages and/or increased leisure time, and consumers will attempt to get the maximum pleasure from goods and services purchased at the lowest possible prices.

In order to maximize profits, businesses must produce the goods and services that consumers wish to buy, and make them available to consumers at the correct times and in the right places. This partially explains why the ingredients for banana pudding are usually available in most supermarkets whenever individuals wish to buy them. Producers of these ingredients, and store managers, do not know which individuals are going to want these products on any particular day, but they know that a certain number of people will probably want to purchase these items each day. If the producers and sellers want to maximize profits, they must have commodities available when and where consumers want them. By doing so, businesses are pursuing their own self-interests while at the same time providing for the interests of consumers. This is the "invisible-hand" principle at work.

The Importance of Competition

The American economy, today, is very different from the hypothetical market economy that Adam Smith described in the *WEALTH OF NATIONS* more than two hundred years ago. Smith described an economy with many small sellers engaged in such strong competition with one another that none were able to take advantage of consumers. Any efforts by a business to take advantage of its customers by raising prices arbitrarily high were doomed to failure because consumers would simply abandon the seller and buy the identical product from another seller at a lower price.

In Adam Smith's hypothetical economy, there were no giant corporations, no patent laws or other barriers to entry into an industry that would enable a company to gain exclusive rights to market a product, no labor unions, no government regulation, and no advertising or brand name products. In addition, Smith's economy was

different in several other ways from today's American economy. Thus, Smith's contention that, if individuals were allowed to pursue their own self-interests, without interference by government, they would be led, as if by an invisible hand, to achieve what is best for society, does not apply to all areas of the American economy. Smith's hypothetical economy had built-in safeguards to prevent individuals and businesses from taking advantage of one another. The American economy does not always have such safeguards.

The key to successful operation of the invisible-hand principle is a high degree of competition. Many areas of our economy have a great deal of competition, whereas other areas have very limited competition. Take, for example, fast food restaurants. In most cities and towns, there are so many fast food restaurants that competition forces each restaurant to keep prices as low as possible and the quality of service as high as possible. If a restaurant fails to do these things, their customers will go to other restaurants, where prices are lower and service is better.

Thus, restaurants are pursuing their own self-interests when they try to keep prices competitive and quality high in order to attract as many customers as possible and thus maximize their profits. At the same time, consumers are pursuing their own self-interests when they patronize those restaurants that provide the highest quality for the least price. In this case, the invisible-hand principle is working. Both businesses and consumers are pursuing their own self-interests, and because there is a high degree of competition, their activities are leading to what is best for both.

Now let's look at an example where the invisible hand principle does not work. Suppose a single drug company obtains a patent on a life-maintaining drug that is needed by millions of Americans in order to stay alive. If the single company has the exclusive right to sell the drug, it has no competition at all. Thus, it can charge an extraordinarily high price for the drug without losing customers because the customers must have the drug in order to stay alive. Under such circumstances, the government might intervene and order the drug company to sell patent rights to one or more other drug companies in order to bring at least a little competition into this market.

There are many examples in the American economy in which competition is very limited, and thus sellers are in a position to take advantage of consumers in the form of high prices and low-quality service. In many small communities there is a single bank, single drug store, single movie theater, single grocery store, and so forth. On a national level, there are several industries where only a small number of companies control most of the nation's production, and thus are in a position to charge

higher prices than would be the case if there was more competition.

In a later chapter we will take a more detailed look at the importance of competition in the American economy. We will look at things companies do in an effort to reduce competition, and what government does in an effort to increase competition. For the moment, though, suffice it to say that the invisible-hand principle applies in a modified way to some parts of our economy, but not to all parts.

The Price System

Although competition helps prevent individuals and businesses from taking advantage of one another when they pursue their own self-interests, even if we had adequate competition throughout the entire economy, it would not be sufficient to enable the economy to operate properly. An economy must also have a coordination and communication system through which the various sectors can interact with one another. The basic coordination and communication system of a market economy is the price system.

Through the price system, producers and consumers transmit valuable information to each other that helps keep the economy in balance. This information helps producers decide whether to increase or decrease production of various products. It also helps employees decide which careers to choose. Let's look at some examples.

Communicating Messages Between Buyers and Sellers

Suppose consumers decide they want more beef and less pork. How would they inform the beef and pork producers of their preferences? They would send a message through the price system by buying more beef and less pork. As more and more beef is bought, there will be a temporary shortage, causing a rise in the price of beef. As beef prices rise, beef producers will begin to increase their production of beef because, at the higher prices, beef production is more profitable.

At the same time that beef production is being increased, there will be a reduction in the production of pork. As consumers reduce their consumption of pork, there will be a temporary surplus, which will lead to lower pork prices. At the lower prices, pork production will become less profitable and thus less pork will be produced.

Communicating Messages Between Employers and Employees

In a market economy, employers and employees also send messages to each other through the price system. This communication helps to provide the proper allocation of workers among the various job categories.

Suppose, for example, that there is a surplus of accountants and a shortage of computer programmers. How will the price system restore balance to these two occupations? Competition among accountants for the scarce jobs in that field will cause a decline in the earnings of accountants. At the same time, the earnings of computer programmers will be increasing because potential employers will be competing with each other to hire the scarce computer programmers.

Since the earnings of accountants will be falling, and the earnings of computer programmers will be rising, young people planning a career in one of these two fields will be more likely to enter the higher paying field of computer programming. As more young people train to become computer programmers, and fewer train to become accountants, balance will be restored between these two occupations. Thus, the price system has communicated messages between employers and employees, and helped to correct the problems of shortages and surpluses.

Government Intervention

One of the most controversial aspects of the American economy is the question of how much government involvement in the economy is appropriate. Some people believe that the government should play a major role in the American economy while others believe government should play little or no role. Regardless of your view on this subject, I think you will agree that a certain amount of government involvement is necessary in any economy to ensure an orderly and equitable society. In the American economy, the government of the United States, a government of the people, by the people, and for the people, serves as rule maker and referee, protector, provider of collective goods and services, and sometimes as regulator of prices and the quality of services.

Making and Enforcing Rules

If you buy a new home, how can you be sure that someone will not later tell you that the house belongs to them instead of you, and attempt to evict you from the house? The answer to this question is that you will have a legal title or deed showing that you own the house, and anyone who tries to illegally take it from you can be arrested and sent to jail. This is just one example of the government serving as rule maker and enforcer of rules. There are many such examples. When a new car dealer sells you a car with a warranty, he or she must abide by that warranty because it is a legal contractual agreement. When you accept a job and sign a contract agreeing to work for a certain wage or salary, both you and your employer must abide by the terms of that contract. When you buy ten gallons of gasoline from a local gas station, the station

owner cannot determine how much gasoline should be in a gallon. That has already been determined along with many other standards of measure.

Over time the government has established many rules, which it enforces. Can you imagine what it would be like to live in a society where there were no economic rules or nobody to enforce the rules that did exist? It would be much like a basketball game with no rules and no referees, except that the seriousness of the consequences would be much greater. In a sense, the government serves the same role in the economy that a referee serves in a sports event.

Protector

In the above examples, the government is protecting people from having their property illegally taken from them, or being cheated by a merchant or employer. There are many other ways in which the government intervenes in the economy to protect people. The government has established rules designed to protect workers from having to work under unusually dangerous conditions and rules to help ensure that products sold to consumers are safe. Many lives have been lost in the past due to unsafe working conditions, and due to the sale of unsafe products. Today, the government tries to minimize injury and loss of life from such causes. The government has also enacted laws that regulate the amount of pollution that companies may put into the air and waterways, and laws that make it illegal for employers to hire children below certain ages.

Producing Collective Goods and Services

One of the most important areas in which the government is involved in the economy is in the production and distribution of collective goods and services. Collective goods and services (also known as public goods and services) are things which tend to benefit large groups of people and would not be available to everyone if each individual had to provide them for himself or herself. National defense, highways, and the public schools, are examples of collective goods and services provided by government. National defense is an example of an item that could not be adequately provided by private enterprise. Individuals and businesses might arm themselves in an effort to protect themselves and their property, but it would be impossible for them to provide adequate defense for the nation as a whole. This is why Americans generally agree that the government should collect tax dollars from the people in order to provide for the nation's defense.

Like national defense, highways are another thing that could not be provided by individuals. In theory, at least, private enterprise could build highways and then charge motorists a fee for each mile driven just like the government does on toll highways. However, in the early days of the automobile, the public began to demand that government build highways upon which they could drive their private automobiles, and the government has been building and maintaining public highways ever since.

Some people benefit from highways more than others. Some individuals drive thousands of miles each month while others use the highways only occasionally. Still others do not directly use the highways at all, although they buy food and other items that have been transported to them on the nation's highways. Taxes for financing the cost of building and maintaining the nation's highways are based on the theory that those people who benefit the most should pay the most. Thus, part of the price of each gallon of motor fuel is a tax that goes to the state and federal governments and is put into a special fund for building and maintaining highways. The more miles a person drives, the more fuel that person buys, and thus the more taxes he or she pays for building and maintaining highways. In this way, those who benefit the most from the nation's highways pay the most toward building and maintaining them.

In the early days of American history, only the children of wealthy parents were able to get an education. Since there were no public schools, parents who wanted their children to receive an education had to hire a private tutor or enroll their children in a private school where a tuition fee was charged. Eventually, however, our society decided that it was in the nation's best interests to make education available to all, and thus our public school system, which is funded with tax dollars, was born.

Regulating Prices and the Quality of Services

As we saw earlier, competition is very crucial to keeping prices down and quality up. However, there are some areas of our economy in which competition is not always considered an efficient way to accomplish these

goals. Public utility companies that provide gas, water and electricity to various local communities usually do not have any competition. The reason is that competition has generally been considered less efficient than government regulation in keeping prices down and the quality of services up in these areas.

For example, a single company can deliver electric power to all the customers in a local community over one set of power lines more efficiently than could three competing firms using three sets of

transmission lines. For this reason, economists have long referred to public utilities as "natural monopolies," and traditionally the government has granted a single company the exclusive right to supply electricity to each community. In exchange for the guarantee that it would not face competition, the company was required to accept government regulation of the rates it charged and the quality of service it provided.

However, in the late 1990s efforts were initiated to bring some competition into the public utilities industries and to reduce government regulation. In the future, customers will increasingly be able to choose among competing companies when deciding from whom they will buy their electricity, for example. The various companies that generate electricity will compete with one another in selling the generated power to consumers, but the transmission of the purchased electricity from the power source to individual homes will probably still involve a single company. The same will likely be true also in supplying natural gas and water to households. Thus, we will probably see increased competition gradually replace government regulation in the public utilities industry during the first decade of the new century.

Answering the Basic Questions

As we saw in Chapter 1, there are three basic economic questions that must be answered by every economic system. They are: (1) What goods and services shall be produced? (2) How shall they be produced? and (3) For whom shall they be produced? Let us examine how the American economy answers these basic economic questions.

What Shall Be Produced?

The people partly through government and partly through consumer spending answer the question of what shall be produced in the United States. A portion of the nation's limited resources must be used for national defense and other government services, and the people determine what portion will be used for this purpose through their elected representatives in government. Of the remaining productive resources, some will be used for the production of capital goods (things like factories, tools, and machines) that will ultimately be used to produce additional goods and services. The rest of the resources are available for the production of consumer goods and services.

In many nations the government decides how many and what kinds of consumer goods and services will be produced. But in the United States, consumers decide what shall be produced. This process of allowing consumers to determine what shall be produced is called consumer sovereignty. It means that people vote with their dollars for the goods they want most. Those items that are

bought in large quantities are produced in large quantities. Those items that consumers refuse to buy, or buy in small quantities, will either go out of production or, at the very least, be produced in small amounts.

The kinds of new products produced, the styles of clothing manufactured, the types of books published and movies produced, and the kinds of songs recorded are all determined by consumer tastes as reflected in their buying habits. Whether or not a newly introduced product, or a newly produced movie, will succeed or fail depends upon the number of votes it gets in the market place. If not enough people buy a product to make its production profitable, it will be withdrawn from the market.

A classic example of a new product failing for lack of consumer dollar votes is the Edsel automobile introduced by the Ford Motor Company in 1957. The company spent hundreds of millions of dollars to design, produce, and promote this new car. Some called the launching of the Edsel "The most expensive such venture in the history of commerce." Ford's Edsel division had its own plant with 800 executives and 15,000 workers. And nearly 1,200 automobile dealers across the country gave up profitable franchises for other makes of cars in order to sell Edsels. The Ford Motor Company had left little to chance when it formally introduced the Edsel to the public in September 1957. Extensive market research had been conducted, and the new car was launched with a massive advertising campaign. Yet, the Edsel flopped miserably. In November of 1959, the company discontinued manufacture of the Edsel. During its two years on the market, the Edsel accounted for less than one percent of all cars sold, and it lost its manufacturer hundreds of millions of dollars.

Nobody will ever know for sure why the Edsel was not accepted by the American public. However, it can be said with absolute certainty that the failure of the Edsel demonstrated the enormous power of consumer sovereignty. The spending of hundreds of millions of dollars was not sufficient to make American consumers accept a product they did not want.

In determining the production of consumer goods and services, consumers also indirectly determine the production of the factories, tools, and machines necessary to produce the consumer goods. If people won't buy Edsels, there is no need for Edsel factories. Likewise, if consumers demand some new consumer product, there will be a need for production facilities to produce that product.

How Shall Goods and Services Be Produced?

The methods of production used to produce goods and services in the American economy are determined by the production costs of the various methods of production. Basically, the least cost,

most efficient method of production must be used by businesses that have a substantial degree of competition. For example, suppose a business firm has been producing a product for several years, using traditional production methods, and selling the product at a small profit for \$30 each. Now suppose that new technology is developed that will enable the product to be produced and sold, at a profit, for a price of only \$25. If any of the firm's competitors adopt the new technology and begin selling the product for \$25, the firm must also adopt the new technology or be forced out of business. In a competitive market economy, efficiency is the price of survival. Firms are almost continuously pressured to find more efficient, lower cost, methods of production. Consumers generally benefit from this process because it usually means lower prices for the goods and services they buy than would otherwise be the case.

For Whom Shall Goods and Services Be Produced?

This is the most controversial of the basic economic questions. Income distribution, and thus the distribution of the goods and services produced by the economy, has long been a source of heated debate in this country. If the economy alone were allowed to answer this question, goods and services would be distributed strictly on the basis of dollar votes. Those people with the most dollars would receive the most goods and services, and those people with no dollars would receive nothing at all.

The controversy stems from the fact that those people with the most dollars are not necessarily the most deserving or the most in need of the goods and services produced. They are also not necessarily the ones who work the hardest. Some wealthy people receive much of their wealth through inheritance rather than from hard work.

On the other hand, some of the hardest working people in our society are some of the poorest. For example, migrant farm workers remain poor despite the fact that they work extremely hard because their pay is low, and their work is usually seasonal.

Nevertheless, there must be an important relationship between what people contribute to the economy and what they are entitled to receive. In other words, people must earn what they get. Economic incentives are very crucial to the proper functioning of the American economy, and individuals and businesses must be able to see potential rewards for their work and risks.

The concern is not that everyone should receive the same amount of goods and services. Such a goal is neither possible nor desirable in an economy such as ours. Obviously, some people should receive more than others because they

work much harder than others. The concern is to see that people are not denied sufficient food, clothing, shelter, and medical care. That is why a number of government and private charity programs have been developed to help the very poor obtain at least some goods and services.

Potential vs. Actual Performance of the Economy

The American economy is potentially a very strong economy. This is true because our economy has an abundance of high-quality productive resources, which are the envy of the world. When fully employed, these resources can provide a very prosperous lifestyle for the American people. We have a highly skilled labor force, and an abundance of natural resources, factories, machines, tools and so forth. However, unfortunately, we don't always fully utilize these resources.

During the late 1920s, the economy was strong and prosperous. However, during the Great Depression of the 1930s, the nation suffered enormous poverty and suffering. The unemployment rate reached 25 percent, and millions of Americans were hungry and homeless. However, while men, women, and children picked through garbage in search of food throughout much of America, sheep farmers in the western states slaughtered sheep by the thousands and destroyed their carcasses. The market price had fallen below the shipping costs, and thus farmers would lose money if they shipped the sheep. At the same time, while millions were without bread, wheat was left in the fields, uncut, because the price was too low to cover the harvesting cost.

In addition, many of the nation's factories, that could have been turning out the goods, and providing the jobs, that Americans wanted and needed so desperately, sat partially or totally idle. The factories didn't operate because they couldn't sell their products, and people couldn't buy the products because they didn't have jobs. The American economic system was simply allowed to break down, and it remained broken down for a decade.

The cost of the Great Depression was astronomical. According to estimates by economic historians, if the economy had fully used all of its resources during the 1930s, the dollar value of the additional production would have been higher than the cost of World War II. This would have been enough money to have covered the cost of a new house, and several new cars, for every American family during the decade.

The real tragedy is that the Great Depression never really needed to happen. The nation had all the productive resources necessary to produce a prosperous lifestyle during the 1930s just as in the 1920s. However, many of the resources were allowed to remain idle while millions were hungry and homeless. The policy makers of the 1930s can

be excused to some degree because modern economics was still in its infancy.

There is far less justification for allowing the economy to slip into the severe recession of 1981-82, which was the worst economic downturn since the Great Depression. During this recession, or mini-depression as it was called by some economists, the unemployment rate reached a peak of 10.7 percent. Long lines of people waited for free food handouts in many cities across the country, and thousands lined up in front of potential places of employment whenever there were reports that some additional workers might be hired. Homelessness, domestic violence, and other socioeconomic problems soared as they always do during severe recessions. At the depth of the recession, nearly one-third of the nation's industrial capacity lay idle at a time when poverty was on the rise.

If all these idle resources could have somehow been employed during the period, the nation would have experienced booming prosperity instead of economic stagnation. The lost production resulting from idle productive resources during the 1981-82 recession, and all other recessions and depressions, is lost forever. It can never be made up. Our nation will always be poorer because of our failure to fully employ productive resources in the past.

Unlike the Great Depression of the 1930s, failure to avert the severe recession of 1981-82 was not the result of a lack of economic knowledge. Instead, it resulted from a failure of politicians to implement sound economic policies. Mainstream economists were cut out of the decision-making process, and economic policymaking was done largely by politicians who had little or no formal training in economics. The results were very costly.

In summary, the American economy is potentially a very strong economy when productive resources are fully employed. However, far too often the economy does not operate at full capacity. Sometimes external events, which are beyond the control of policy makers, are to blame. But, at other times, the fault lies with the policy makers themselves.

Chapter Highlights

1. The American economic system is predominantly a market economy that relies primarily on a system of free markets to make basic economic decisions. It is also an example of capitalism. Capitalism is a form of economic organization in which businesses are privately owned and operated and where free markets coordinate most economic activity.
2. According to the invisible-hand principle, if individuals were allowed to pursue their own self-interests without interference by government, they would be led as if by an "invisible hand," to achieve what is best for society.
3. Although the American economy is very different from the type of economy that Adam Smith described in *The Wealth of Nations*, the principle of the invisible hand still applies to our economy in a modified way. However, for the invisible-hand principle to work, there must be a high degree of competition.
4. The price system is the coordination and communication system of capitalism. It, communicates messages between buyers and sellers and between employers and employees.
5. The government serves as rule maker, referee, protector, provider of collective goods and services, and sometimes as regulator of prices and the quality of services in the American economy.
6. American consumers determine what will be produced by voting in the market place with their dollars. This process of allowing consumers to determine what shall be produced is called consumer sovereignty.
7. The question of how goods and services shall be produced is determined by competition through the price system. Basically, the least costly, most efficient method of production must be used by businesses that have a substantial degree of competition.
8. Goods and services are distributed by the American economic system on the basis of dollar votes. However, a number of government and private charity programs help to ensure that the very poor obtain some goods and services.
9. The American economy is potentially a very strong economy when productive resources are fully employed. However, the economy does not always operate at its potential full capacity.