compromises necessary, are all made by individuals who have been selected by their fellow citizens to guide the hand of authority in the ways that best serve their country. Another effective method is to take part in the working of the government itself. From the smallest towns and villages to the grand scope of an entire nation, there must be those who implement the decisions being made.

Similarly, those who draw up petitions or form action groups to address issues can have a very real effect on public policy. Letters can be written to government leaders including city council members, State legislators, and members of Congress. Joining political parties, working on campaigns, and contributing time and money towards political causes can also be useful ways to participate, because working to make a party stronger or get a certain candidate elected can have a real impact on laws and policies at all levels of government.

The simplest way to participate in politics is to vote, to exercise the right to speak and be heard. Voting at every level, from national to local, helps to ensure that the needs of the people are being heard and addressed. Being informed and participating are rights and responsibilities of every citizen.

>> This soldier, like many active-duty service members, is casting his vote by absentee ballot.

Civil Society As you have seen, the American democratic system provides citizens with many ways to fulfill their responsibility to participate in the political process. Other useful vehicles for participation are the many associations and groups that constitute civil society.

Civil society is that private area of American life outside of governmental institutions or interference. It includes any voluntary activity in which people join together for social, cultural, religious, economic, or political purposes, and it functions on the basis of trust and shared values.

Civil society provides opportunities for people to join together to advocate for things they believe in and to make life better. They do this in many ways—by improving living standards and neighborhoods, undertaking charitable work, joining international organizations such as the Red Cross, joining interest groups, working to improve human rights, and so on. The 1963 March on Washington for civil rights is an example of civil society in action, as is the Ten Point Coalition, a national group of Black American ministers targeting at-risk youth in their communities.

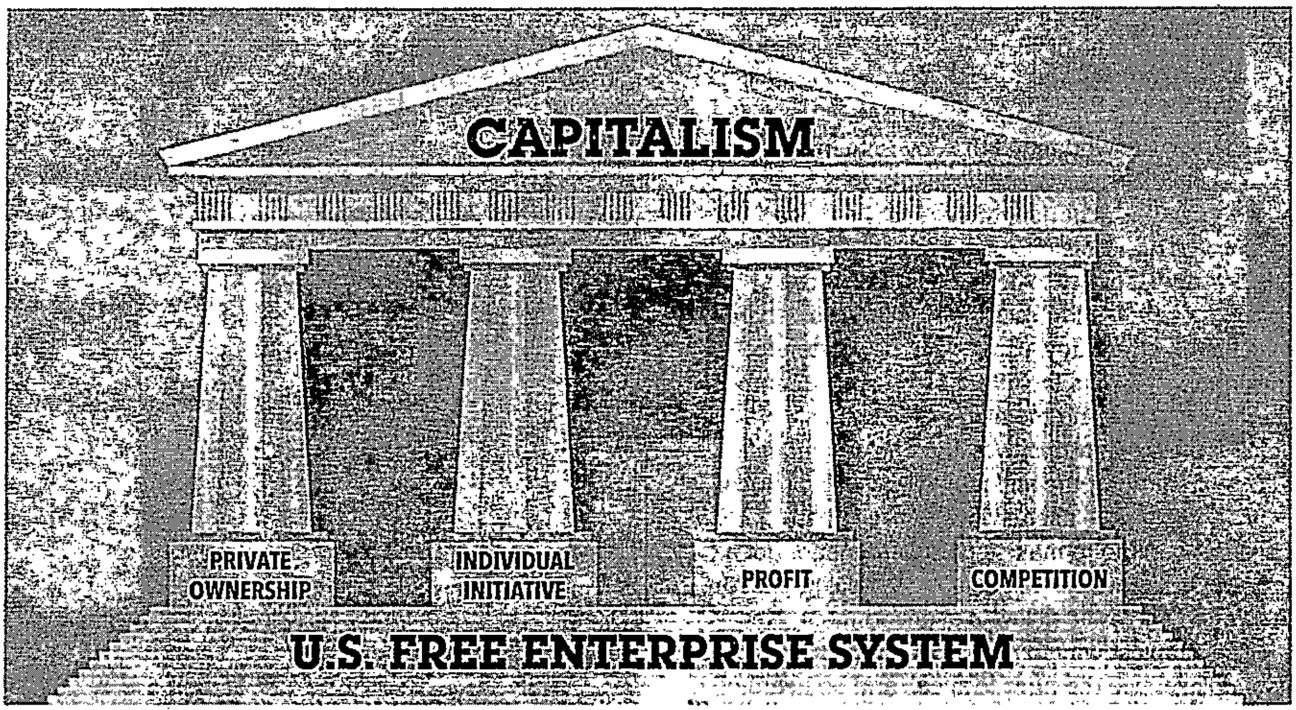
A constitutional democracy like the United States recognizes and protects the existence of civil society, because the exchange of ideas and positive actions makes for a better functioning, more effective, more stable nation. Government does so in many ways—through constitutional guarantees such as the freedom of speech and assembly, for example, or by helping to create a safe environment in which citizens can thrive.

At the same time, civil society makes it possible for citizens to influence government in ways other than voting and elections. In non-democratic nations, the associations and activities of civil society are often undermined or even illegal. In these societies, people cannot work to improve their situations or those of others.

☑ **INTERPRET** What is the most basic duty of a U.S. citizen?

Democracy and the Free Enterprise System

The American commitment to freedom for the individual is deep-rooted, and it is as evident in the nation's economic system as it is in the political system. The American economic system is often called the **free enterprise system**. It is an economic system characterized by the private ownership of capital goods; investments made by



>> The four pillars are the basis for free enterprise, or capitalism, in the United States. **Analyze Charts** What are some examples of each pillar, such as home ownership or starting a business?

private decision, not by government directive; and success or failure determined by competition in the marketplace. The free enterprise system is based on four fundamental factors: private ownership, individual initiative, profit, and competition.

How the System Works The free enterprise system is often called capitalism. It is also known as the private enterprise system and as a market-based system. It does not rely on government to decide what items are to be produced, how much of any particular item should be produced, or how much any item is to sell for. Rather, those decisions are made in the marketplace. Millions of producers and consumers obey the unwritten law of supply and demand: When supplies of goods and services become plentiful, prices will tend to drop; when, on the other hand, supplies become scarce, prices will very likely rise.

Democracy and the free enterprise system are not the same thing. One is a political system, and the other is an economic system. However, both are firmly based on the concept of individual freedom. America's experience with both systems clearly suggests that the two reinforce one another in practice.

Because the United States is a democracy, Americans enjoy a long list of economic rights. These include the right to choose one's work, the right to join or not join labor unions, and the right to acquire, use, transfer, and dispose of property as one wishes (while abiding by any local zoning laws).

These rights are important to individuals and society because they promote equality and ensure just and favorable conditions for all. They have been secured through constitutional guarantees such as the 5th and 14th Amendments, and through court cases and legislation throughout the nation's history.

That is not to say that the American free enterprise system is without flaws. Many Americans believe that society as a whole benefits through the continuous creation of new businesses, new jobs, and increased wealth when individuals can pursue their own interests and have opportunities to use private property to create jobs and generate income. Yet, this American ideal is not always fulfilled in practice. Historically, racial and gender discrimination have limited opportunities for many Americans to find good jobs or start their own businesses. Growing disparities between the rich and poor, the favoring of some industries over others by government policies, and the takeover of businesses by larger companies or private investors, have led to occasional calls for a change in the American economic system. For the most part, however, criticisms are focused on revising specific aspects of capitalism, rather than attempting to replace that system entirely.

Government and the Free Enterprise System

The basis of the American economic system is the free market. However, government does play a role in the American economy, and it always has. Government's participation in the economy serves a two-fold purpose: to protect the public and to preserve private enterprise.

Government's participation in the economy can be seen at every level in this country: national, State, and local. Here are but a few examples: Economic activities are regulated by government through antitrust laws, pure food and drug laws, antipollution standards, and city and county zoning ordinances and building codes.

The nation's economic life is promoted in a great number of public ways. Congress grants copyrights and patents to artists and inventors to protect their ideas and work, thereby fostering competition and entrepreneurship in the United States. The government also grants money for transportation systems and the growing of particular food crops, builds roads and operates public schools, provides services such as the postal system and weather reports, and much more.

Thus, some activities that might be carried out privately are in fact conducted by government. Public education, local fire departments, and city bus systems are longstanding examples of the point.

How much should government participate, regulate, promote, police, and serve? Many heated debates in American politics center on that question, and we are often reminded of Abraham Lincoln's advice about the object of government.

> The legitimate object of government, is to do for a community of people, whatever they need to have done, but can not do, at all, or can not, so well do, for themselves—in their separate, and individual capacities.
>
> —Abraham Lincoln

LIST What are the four factors of the free enterprise system?

>> This cartoon shows a train being sidetracked by a monopoly. **Analyze Political Cartoons** Why might there be tension in the economy between the government and private enterprise?

ASSESSMENT

1. **Draw Conclusions** Why is democracy the political system of the U.S. government?
2. **Apply Concepts** Explain the ideas behind majority rule and minority rights.
3. **Explain** Why are civic and political participation important?
4. **Analyze** Analyze the impact of citizen participation as a means of achieving political and social change.
5. **Apply Concepts** How does supply and demand work?

12.1

Freedom of choice and competition mean that a vast variety of goods are available in a capitalist economy. Here, shoppers peruse wares at historic Charleston City Market in South Carolina.

BOUNCE to Activate Flipped Video

Objectives

Identify the factors of production.

Understand the role played by the National Government in both the public and private sectors of the U.S. free enterprise system.

Understand the relationship between U.S. government policies and the economy.

Describe the fundamental factors in a free enterprise system and understand how the government fosters competition and entrepreneurship, as well as how government regulation can restrict private enterprise.

Key Terms

capitalism
factors of production
capital
entrepreneur
free enterprise system
free market
law of supply and demand
monopoly
laissez-faire theory
socialism
communism
collectivization
privatization
Great Leap Forward
command economy
Adam Smith
Karl Marx
Hugo Chávez
Josef Stalin
Mikhail Gorbachev
Fidel Castro
Mao Zedong
Deng Xiaoping

Types of Economic Systems

You have confronted these questions several times already: What functions should a government undertake? What should it have the power to do? What should it not be allowed to do? These questions are particularly significant in the realm of economic affairs.

Capitalism and the Factors of Production

Questions of politics and economics are inseparable. The most important economic questions faced by a nation are also political questions. For example: Who should decide what goods will be produced? How should goods and services be distributed and exchanged? What types of income or property ought to be taxed? What social services should a government provide?

Capitalism provides one response to these questions. **Capitalism** is an economic system in which individuals are free to own the means of production and maximize profits. Many aspects of capitalism will be familiar to you because the United States and most other nations in the world today have adopted this economic system.

Certain resources are necessary to any nation's economy, no matter what economic system is in place. Economists call these basic resources, used to make all goods and services, the **factors of production.**

Land Land, which in economic terms includes all natural resources, is an important factor of production. Land has a variety of economic uses, such as agriculture, mining, and forestry. Along with farms and other property, economists categorize the water in rivers and lakes and the coal, iron, and petroleum found beneath the ground as part of the land itself.

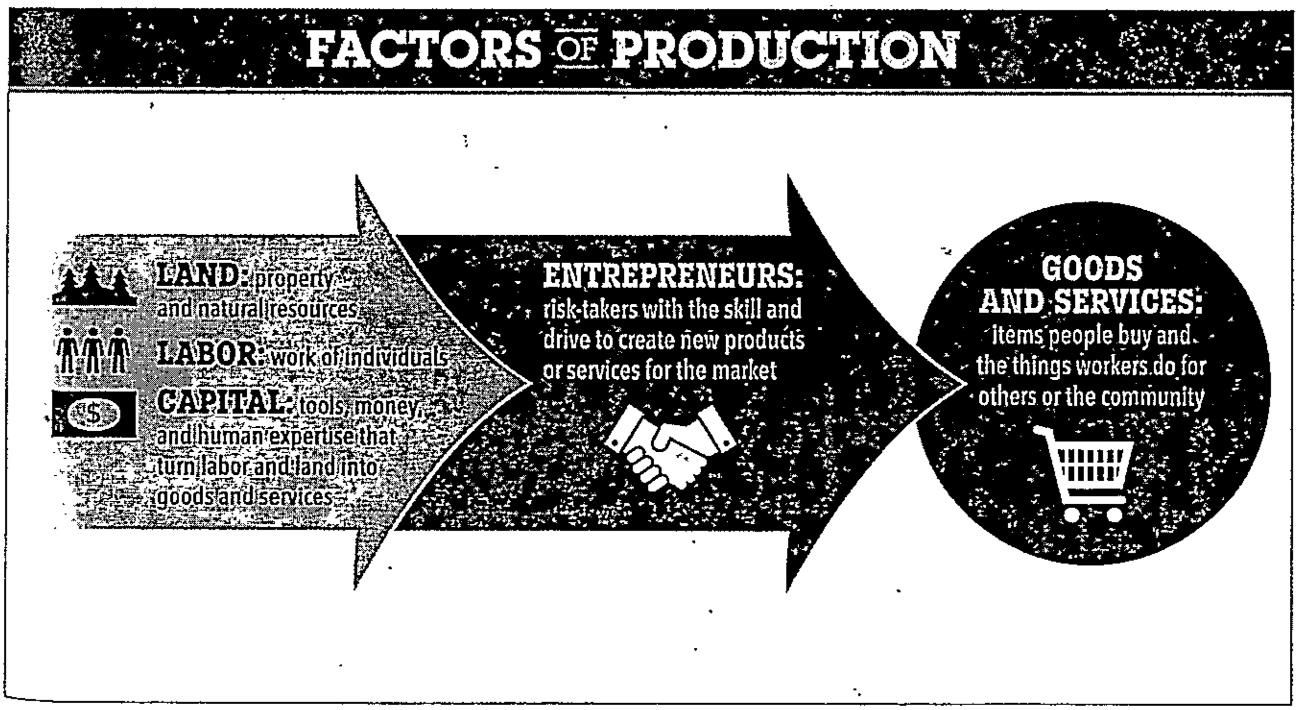
Capital A second factor of production is **capital**—all the human-made resources that are used to produce goods and services. Physical capital (also called "capital goods") includes the buildings, machines, computers, and other materials workers need to turn land and another factor, labor, into goods and services. Note that capital is a product of the economy that is then put back into the economy.

Labor Yet another factor of production is a human resource—labor. Men and women who work in mines, factories, offices, hospitals, and other places all provide labor that is an essential part of a nation's economy. In a capitalist, or free market, economy, individuals "own" their labor and can sell it to any employer. Human capital includes the knowledge and skills that workers gain from their work experiences—an investment in themselves.

One who owns capital and puts it to productive use is called a *capitalist.* That term is applied to people who own large businesses or factories as well as investors and the owners of small businesses. The American economy is called *capitalistic* because its growth depends very largely on the energy and drive of thousands of individual capitalists, not the government.

Entrepreneurs To actually produce goods and services, someone must bring together and organize the factors of production. An **entrepreneur**—literally, an "enterpriser"—is an individual with the drive and ambition to combine land, labor, and capital resources to produce goods or offer services, and is willing to risk losses and failure. Entrepreneurs start businesses and make them grow, creating jobs and goods and services that contribute to a high standard of living.

DISTINGUISH Are all capitalists entrepreneurs? Explain.



>> Land, labor, and capital are the building blocks of the economy known as the factors of production. **Analyze Information** What role do entrepreneurs play in a capitalist economy?

The American Free Enterprise System

Capitalism is often referred to as a **free enterprise system,** which is an economic system characterized by private ownership of capital and by investments that are determined by private decision, not by public authorities. This system needs a **free market,** a market in which buyers and sellers are free to buy and sell as they wish. A free market is most likely to exist in a democratic nation, such as the United States, where security and the rule of law are protected by the government.

A free enterprise system lets consumers, entrepreneurs, and workers enjoy freedom of choice. Consumers can choose from a variety of products and services. Entrepreneurs can switch from one business to another. Workers can quit their jobs and seek new ones, and they can choose to organize labor unions as a way to bargain for better working conditions or benefits.

A capitalistic system—a free enterprise system—is based on four fundamental factors: private ownership, individual initiative, profit, and competition.

>> A small business owner cuts the ribbon at the grand opening of her bakery. The 23 million small businesses in the United States account for 54 percent of national sales and 55 percent of jobs.

Private Ownership In a capitalistic system, private individuals and companies own most of the factors of production—the basic resources used to produce goods and services. They decide how this productive property will be used—for example, to build a business or invest in technology. What the property produces is theirs, as well. The owners of productive property are sometimes individuals, but more often they are groups of people who share ownership of a company.

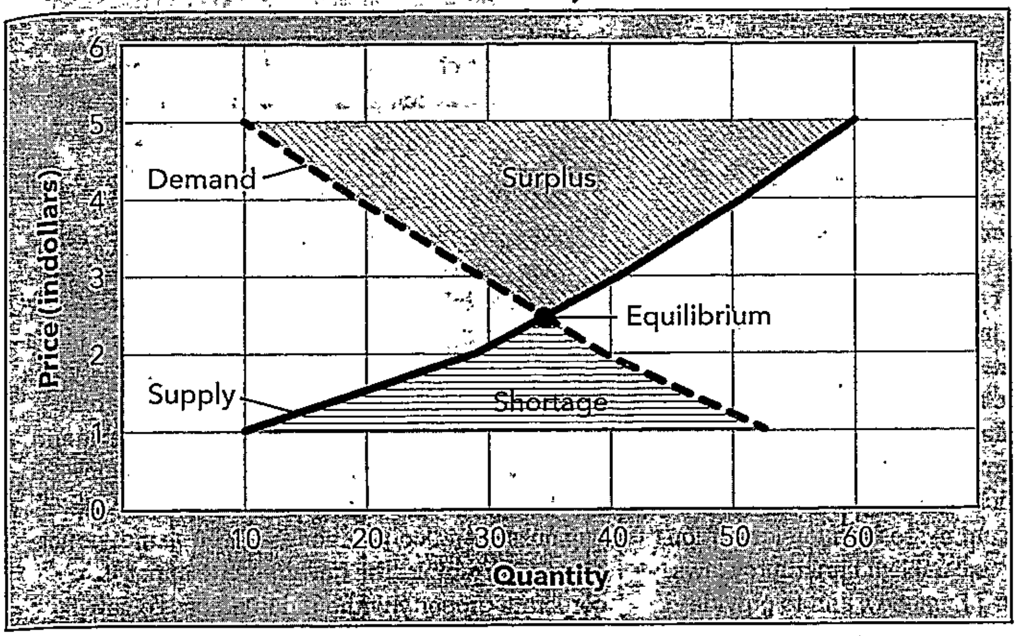
In the American free enterprise system, the right to acquire, use, transfer, and dispose of property is one of a long list of economic rights held by the people. These rights have been secured through the 5th and 14th Amendments, which declare that no person may be deprived "of life, liberty, or property, without due process of law," as well as through court cases and legislation. The 5th Amendment also says that "just compensation" must be paid to owners when their private property is taken for some public use. These rights are vital to individuals and society because they promote equality and ensure just and favorable conditions for all.

In a free enterprise system, individuals own the right to their own labor. They sell that labor by taking a job, and the pay they receive represents the price paid for their work. Individuals also have the right to join or not join labor unions. In other economic systems, workers may have little choice as to the kinds of work they will do and little opportunity to change jobs or increase their earnings.

Individual Initiative In our economy, entrepreneurs are an essential factor in the production of goods and services. Under a free enterprise system, all individuals are free to start and run their own businesses (their own enterprises). They are also free to dissolve those businesses. Importantly, the atmosphere of a free market, as well as a free society that encourages the exchange of ideas, can and often does lead to innovation and scientific and technological discoveries. All these conditions promote growth in the economy and often improve the quality of everyday life.

The Profit Motive Just as individuals are free to choose how they will spend or invest their capital in a free enterprise system, they are also entitled to benefit from whatever their investment or enterprise earns or gains in value. The "profit motive" is the desire to gain from business dealings. It drives entrepreneurs to create goods and services people will want to buy, and is a major reason why entrepreneurs are willing to take risks.

Supply and Demand



>> A surplus occurs when supply is high and demand is low. Equilibrium occurs when supply and demand are in balance. **Analyze Graphs** What conditions are necessary for a shortage to occur?

The Role of Competition The freedom to enter or start a new business at any time leads to competition. Competition is a situation in which a number of companies offer similar products or services. They must compete against one another for customers. In a free enterprise system, competition often helps to hold down prices and keep quality high. This is usually the case because customers are likely to buy from the company with the best product at the lowest price. Competition promotes efficiency; the producer has the incentive (more sales) to keep costs low.

Under these competitive conditions, the **law of supply and demand** determines the market price for goods or services. Supply is the quantity of goods or services available for sale at a range of prices. As the price increases, more of a product will be offered for sale. Demand is buyers' desire and ability to purchase a good or service.

As the price falls, more of a product will be demanded by buyers. If supply increases and demand remains the same, prices will fall. If demand decreases and supply stays the same, prices will also fall. On the other hand, if demand increases and supply remains the same, prices will rise.

Monopolies and Trusts Competition does not always work smoothly. Sometimes a single business becomes so successful that all its rivals go out of business. A firm that is the only source of a product or service is called a **monopoly**. Monopolies can be very powerful in the marketplace.

Practically speaking, they can charge as much as they want for a product. Since there is no other supplier of that good or service, the consumer must pay the monopoly's price or do without.

In the late nineteenth century, political leaders in the United States gradually became convinced that certain monopolies were stifling competition and interfering with the free market. They were especially concerned about a type of monopoly called a *trust*. A trust exists when several corporations in the same line of business work together to eliminate competition from the market and regulate prices. By the latter part of the nineteenth century, trusts had gained tight-fisted control over the markets for petroleum, steel, coal, beef, sugar, and other commodities.

Constitutional Protections and Government Regulation In response, Congress acted under its commerce power to pass the Sherman Anti-Trust Act in 1890, which remains the basic law to curb monopolies—and thus, foster entrepreneurship—today. The Sherman Anti-Trust Act prohibits "every contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade or commerce among the several States, or with foreign nations."

Again acting under its commerce power, Congress established the Anti-Trust Division in the Department of Justice in 1933, to further promote entrepreneurship and foster competition. The Anti-Trust Division monitors business activities to determine whether competition within an industry is threatened. It can, for example, stop the sale or merger of a company if that move threatens competition in a particular market. On rare occasions, the Justice Department has acted to break up a monopoly to restore competition.

The Constitution offers several other protections that foster both competition and entrepreneurship. Thus, for example, Article I, Section 8 gives Congress the power to regulate commerce with foreign nations and among the States, to establish bankruptcy laws, to regulate the value of U.S. money, and to provide for the punishment of counterfeiting.

All of these protections together create a framework within which the free enterprise system can function. This means that entrepreneurs can start new businesses and compete in the marketplace knowing, for example, that there is a uniform national currency.

>> This engraving shows economist Adam Smith, who believed that government regulations on commerce are ill-founded and counterproductive.

Another economic right held by Americans is found in Article I, Section 8 (Clause 8). Here, the Constitution specifies that Congress can grant inventors "the exclusive Right to their respective Writings and Discoveries." From these words evolved the U.S. patent system, created in 1790 when President Washington signed the Patent Act. Since that time, inventors and entrepreneurs have invested money and effort on innovations, secure in the knowledge that others cannot copy their ideas for a given period of time—today, generally twenty years.

Finally, the 5th and 14th amendments forbid both the Federal Government and the States (and their local governments) from acting in any unfair or arbitrary way. These amendments apply to businesses and corporations, as well as individuals. Thus, for example, the government cannot take corporate property without due process of law.

Laissez-Faire: The Theory Early capitalist philosophers believed that if only government did not interfere, the free enterprise system would work automatically. **Adam Smith** presented the classic expression of that view in his book, *The Wealth of Nations,* in 1776. Smith wrote that when all individuals are free to pursue their own private interests, an "invisible hand" works to promote the general welfare. In short, Smith introduced laissez-faire capitalism. *Laissez-faire* is a French idiom meaning "to let alone."

Laissez-faire theory holds that government should play only a very limited, hands off role in society, confined to: (1) foreign relations and national defense, (2) the maintenance of police and courts to protect private property and the health, safety, and morals of the people, and (3) those few other functions that cannot be performed by private enterprise at a profit. The proper role of government in economic affairs should be restricted to functions intended to promote and protect the free play of competition and the operation of the laws of supply and demand.

True laissez-faire capitalism has never in fact operated in this country, yet it has a profound effect on the structure of the nation's economic system, which can be described as laissez-faire capitalism with limited government involvement.

ANALYZE INFORMATION Choose one of the four factors of a free enterprise system and explain why it is essential to the success of the system.