

Key Characteristics of the U.S. Economic System

The high ranking of the United States on the Index of Economic Freedom is not surprising. Americans dearly value their economic freedom, so much so that we even describe our economy as a free enterprise system. In a **free enterprise system**, individuals own the factors of production and make decisions about how to use those factors within the framework of the law. Seven key characteristics of a free enterprise system are explored below.

1 - Economic Freedom

As the term free enterprise suggests, the essence of our nation's economic system is freedom—the ability of individuals to act in their own best interest in free markets. In practical terms, this means we can buy what we want and from whom we want. If we do not like what one firm is selling, we can take our business elsewhere. We are free to start businesses or to seek any job we choose. Firms are free to make what they want, hire whomever they choose, and set their own wages and prices.

Because our economic system allows individuals and businesses so much freedom, it is often referred to as a **laissez-faire** economy. Economists use the term *laissez-faire* to describe a market economy that is relatively free of government intervention. (In French, *laissez-faire* means “let them do.”) But in fact, laws exist that limit what producers and consumers can do in this country. Stores are not free to sell alcohol to teenagers. Businesses are not free to hire child laborers. Economic freedom does not give anyone the right to break the law, but it does allow us to act in our economic best interest within the law.

2 - Competition

Because virtually anyone can enter the market at any time, many rival sellers usually vie for customers' business. The resulting competition is a hallmark of the free enterprise system.

Competition provides an incentive for businesses to create new and better products and ways of serving customers. For consumers, this means more goods and services to choose from. Competition also encourages producers to use their resources efficiently in order to lower costs. When lower costs translate into lower prices, consumers win again.

3 - Equal Opportunity

In 1776, the Declaration of Independence declared,

We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.

Most Americans today understand these words to mean that we are born equal in terms of our rights, freedoms, and the opportunity to make the best of our talents and abilities. Our belief in the United States as a “land of opportunity” is deeply rooted in our country's history as a nation of immigrants.

Nonetheless, our free enterprise system has not always offered equal opportunity to everyone. Women, African Americans, and other minority groups have had to fight discrimination in education and employment. Through the efforts of citizens and government intervention, these barriers to economic opportunity have fallen. Today every citizen has the same legal right to gain an education and compete in the marketplace.

4 - Binding Contracts

In business, a **contract** is an agreement between a buyer and a seller. Contracts are used in all kinds of economic transactions. Even the slip of paper you sign when you use a credit card is a contract. In our free enterprise system, people are free to decide what contracts they want to enter into—but once agreed on, a contract is binding. That means both sides have to fulfill their ends of the deal.

Because free enterprise depends on buyers and sellers honoring their agreements, it is important to have a legal system that upholds contracts. U.S. courts recognize the binding nature of contracts. They also recognize that people and businesses can run into financial problems and become unable to pay their debts. Bankruptcy is the legal process by which such situations can be resolved. Although bankruptcy allows people in debt to get a fresh start financially, a major downside is the negative effect it will have on their credit reports, which will make it difficult to obtain loans in the future. Furthermore, not all debts are eliminated during bankruptcy.

5 - Property Rights

A necessary element of a free enterprise system is the right to own property. **Property rights** are the rights of those

who own land, buildings, or other goods to use or dispose of them as they choose.

In other countries, past and present, rulers have had the power to seize another person's property for their own use. The U.S. Constitution protects against this abuse of power. It guarantees access to the courts in case of disputes about property. It further guarantees that an owner will be paid for property that is taken by the government for public use. These constitutional guarantees are crucial to the free market. Why would people buy homes or start businesses, unless they were certain they would get to keep their property?

The Constitution also provides for the protection of intellectual property by empowering Congress to enact patent and copyright laws. **Intellectual property** refers to creations of the mind that have commercial value. A **patent** gives an inventor the sole right to make, use, or sell his or her invention for 20 years. A **copyright** similarly gives the creator of a literary or artistic work the sole right to reproduce, distribute, perform, or display the copyrighted work. Current copyrights last for 70 years beyond the life of the author.

Why do we need intellectual property laws? Think about what would happen without them. As soon as a new invention (or book or song) became public, others would copy it and put it on the market. The inventor (or writer or composer) would get no reward for his or her efforts. Without a reward, inventors and creative individuals would have no incentive to invent new things or create new works. Patents and copyrights encourage creativity and innovation by guaranteeing that inventors and artists can profit from their creations.

6 - Profit Motive

If any one force could be said to drive a free enterprise system, it is the profit motive. **Profit** is the money earned by a business after subtracting its costs of operation. The desire to make a profit is known as the **profit motive**. The profit motive is closely tied to the incentives-matter principle. Profits are our incentive to work or start businesses in the hope of making money for ourselves.

Some people confuse the profit motive with greed or with stealing wealth from others. Most economists, however, see the profit motive as a positive force in society. It is, they remind us, the reason most businesses exist. As Adam Smith observed, people produce goods and services not out of the kindness of their hearts, but in order to improve their economic situation—to make a profit, i.e. The driving force in capitalism.

7- Limited Government

The final key characteristic of a free enterprise system is a relatively limited role for government in the economy. In the United States, the government does not try to control firms. Nor does it often compete with firms.

Government intervention in the economy is generally limited to seven areas.

Protecting property rights and contracts. The government enforces laws that protect property owners and patent and copyright holders.

Promoting the general welfare. The government funds projects and programs that benefit society as a whole. (This is the characteristic that is blown out of proportion by the left and where you get Obama's "You didn't build that")

Preserving competition. The government enacts laws that protect and preserve a competitive marketplace.

Protecting consumers, workers, and the environment. The government requires businesses to ensure that their products do not harm consumers. It also imposes regulations on firms to promote workplace safety and reduce pollution.

Stabilizing the economy. The government works to keep the economy growing steadily rather than alternating between periods of boom and bust.

Looking at these seven characteristics of a free enterprise system brings us back to the question we started with: *Who or what decides what you get?* In our economic system, the answer is both a *who* and a *what*. The *what* is the market, made up of millions of individuals who buy and sell goods every day on a strictly voluntary basis. The *who* is you, your family, and your friends, all exercising your freedom of choice as consumers. What are the effects of these choices? Later on, you will learn more about how the choices you and others make in the market help determine what you might get tomorrow.

Notice that those that favor a more left-of-center approach want to 'distribute' (a nice word, isn't it) the work and risks that others took. Sometimes it's just plain stupid luck that one has that leads to success, but most of the time a foolish risk is met with punishing blows, when it doesn't meet the markets need.