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The term free market economy is sometimes used to describe some economies that exist today (such as Hong Kong), but pro-market groups would only accept that description if the ...

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activities and

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transactions (*see* [Capitalism](#)). Individuals are free

to make economic decisions concerning their

employment, how to use or accumulate capital,

what expenditures to make, and whether to use

their resources now or to save them for later

consumption. The principles underlying free-

market economies are based on [laissez-faire](#) (non-

intervention by government) economics and can

be traced to the 18th-century Scottish economist

[Adam Smith](#). According to Smith, individuals

acting in their own economic self-interest will

maximize the economic situation of society as a

whole, as if guided by an “invisible hand.” In a

free-market economy the government's function is

limited to providing what are known as “public

goods” and performing a regulatory role in certain

situations.

Public goods, which include defense, law and

order, and education, have two characteristics:

consumption by one individual does not reduce

the amount of the good left for others; and the benefits that an individual receives do not depend on that person's contribution. An example is a lighthouse. One individual's use of light provided by a lighthouse does not reduce the ability of others to use it. In addition, the lighthouse owner cannot restrict individuals from using the light. The latter illustrates the "free-rider" phenomenon of public goods—both those who helped pay for the lighthouse and those who did not will enjoy the same amount of light. The "free-rider" problem can be eliminated if governments collect taxes and then provide public goods.

Government's role in a free-market economy also includes protecting private property, enforcing contracts, and regulating certain economic activities. Governments generally regulate "natural monopolies" such as utilities or rail service (*see* [Monopoly](#)). These industries require such a large investment that it would not be profitable to have more than one provider. Regulation is used in place of competition to prevent these monopolies from making excessive profits. Governments may also restrict economic

freedom for the sake of protecting individual rights. Examples include laws that restrict child labor, prohibit toxic emissions, or forbid the sale of unsafe goods.

Proponents of free-market economies believe they provide a number of advantages. They see free-market economies as encouraging individual responsibility for decisions and they believe that economic freedom is essential to political freedom. In addition, many people believe that free markets are more efficient in economic terms. Free markets provide incentives both to individuals to allocate resources, such as labor and capital, among the most productive uses, and to firms to produce goods and services that the public wants, using the most efficient means of production.

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Free-market economies are also criticized.

Opponents believe that a free-market economy cannot ensure basic social values, such as alleviating poverty, or that the income distribution that results from a free-market economy may not be equitable. A free-market economy may also permit the accumulation of vast wealth and powerful vested interests that could threaten the survival of political freedom.

Alternative economic systems include [communism](#) and mixed economies. In communism, the government plans the economy and all means of production are publicly owned. The economy of the former Union of Soviet Socialist Republics was an example of a planned economy: all decisions regarding production and distribution were made by the government. In contrast, a mixed economy is one where the government does some planning and owns or controls more industries than in a free-market economy. Governments may own key industries such as steel, aviation, and banking, while the individual still plays an important role. Sweden and France are examples of mixed economies.

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