

- (10 pts.) We have discussed two different lines along which economic systems can be classified. We also watched a short video clip explaining how agriculture in China works. How would you categorize the Chinese system of agriculture according to each of the classification approaches? Briefly explain both the two taxonomies and how Chinese agriculture fits into each.

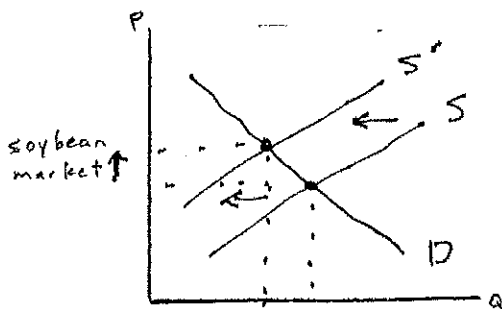
Economic systems can be classified according to the decision-making process (how they answer the questions What, How, and For Whom) and according to the ownership of resources.

Decision-making process: Centrally planned or command economies centralize the decision-making process, while market systems decentralize the decision-making process and rely on the interaction of households and firms in markets to make resource allocation decisions.

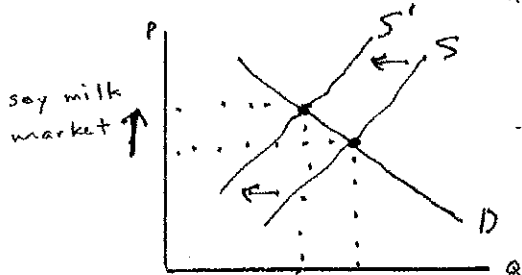
Ownership of resources: Socialism refers to an economic system where the scarce resources of that society are commonly or publicly owned. Capitalism refers to an economic system where scarce resources are privately owned. A critical function of government in such a system is the definition and enforcement of property rights.

Chinese farmers are given production quotas to meet, but are free to grow what they want after they meet their quota. They generally have permanent rights to farm their land, but do not own it in the sense that they cannot sell their rights to someone else.

- (10 pts.) Two pieces of information for you to use in answering part (a): The federal subsidy program for ethanol has increased the demand for corn and led to record high corn prices. Soy milk is a popular substitute for cow's milk, especially for those who are lactose intolerant.
  - Using supply and demand analysis, explain how higher corn prices affect the market for soybeans. Then explain how the market for a soybean-based product like soy milk is secondarily affected by the ethanol program. Illustrate your answers in supply and demand diagrams for soybeans and for soy milk.

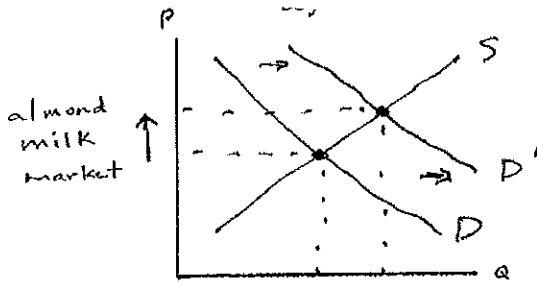


Since <sup>Farmers</sup> can plant either corn or soybeans, they are substitutes in production. An increase in corn prices will decrease the supply of soybeans, leading to higher prices.



Soybeans are a primary input in the production of soy milk. When soybean prices increase, the cost of manufacturing soy milk increases and the supply curve for soy milk shifts left.

- b. What do you think will happen to the stock price of Blue Diamond, a large almond producer that markets its own brand of almond milk, a close substitute for soy milk. Draw a diagram that supports your answer.



Soy milk and almond milk are close substitutes. When the price of soy milk goes up, demand for almond milk increases. Blue Diamond's profits rise.