

## **UNIT 2 - ECONOMIC SYSTEMS (6 Days)**

The problem of scarcity forces every society to make difficult choices about how to use its resources. In trying to decide how to allocate those scarce resources, each society must answer three critical questions. How those questions are answered determines the type of economic system (market, command, traditional, mixed) that is present.

### **EPF.1 The student will demonstrate knowledge of basic economic concepts and structures by**

*e) comparing the characteristics of market, command, traditional, and mixed economies*  
(BUS6120.038)

Day 1 The three basic questions

Day 2 Command, traditional, and market economies

Day 3 The free market and the US economy

### **EPF.1 The student will demonstrate knowledge of basic economic concepts and structures by**

*f) identifying Adam Smith and describing the characteristics of a market economy*  
(BUS6120.039)

Day 1 Competition and the invisible hand

Day 2 Property rights

**Evaluation Day**

**EPF.2 The student will demonstrate knowledge of basic economics concepts and structures by**  
*c) comparing the characteristics of market, command, traditional, and mixed economies.*

## Day 1 - The three basic questions

### Content Knowledge

Most high school students already understand the major advantages and disadvantages of selling concert tickets using a first-come/first-served system, rather than a lottery to select from among those who applied for tickets. Unfortunately, many students have experienced the use of force to allocate resources on the school playground. Students also know that families typically use authoritarian systems to decide how resources are used — Mom and Dad decide.<sup>2</sup>

Individuals and organizations routinely use different decision-making systems to determine what should be produced, how it should be produced, and who will consume it.<sup>2</sup>

When examining systems, the teacher should note the characteristics of each economic system. However, the most distinguishing characteristic is “who makes decisions?” The greater the amount of decision-making that is left to the individual producer and consumer, the closer a system is to a market system. The greater the amount of decision-making that is left to a centralized authority, the closer the system is to a command system.

Another factor that may be considered is “who bears the risk?” The more the individual consumer or producer bears the risk of their decisions and is left to deal with the consequences, the closer the system is to a market system. The more risk is shared and socialized, the closer the system is to a command system. Further discussion of these ideas can be carried out on days two and three.

### Vocabulary

**Economic systems** – The institutional framework of formal and informal rules that a society uses to determine what to produce, how to produce and how to distribute goods and services.

### Virginia Board of Education Framework

The three basic economics questions are

1. What goods and services will be produced?
2. How will these goods and services be produced?
3. Who will consume these goods and services?

### Teaching Tips

1) An allocation activity helps the students recognize that who makes decisions determines the type of economic system. Have an item that most students in your class would like. For example, bring a can of cold soda after recess or make a "get out of homework free" coupon.

Ask how many students would like to have the item. Explain that many students want it so a decision will have to be made about whom gets it. Ask the students to suggest ways in which this decision can be made. Most suggestions can generally be categorized as lottery, authority decides, highest bidder, need, force and first-come, first-served. With these categories, it is then possible to discuss who makes the decision and who benefits or loses as a result. Then links can be made to how allocation decisions are made in the students' society.<sup>3</sup>

## **Lessons and Resources**

Economies in Transition: Command to Market Lesson 2: Who Decides?

Master Curriculum Guides in Economics: Teaching Strategies - 5-6 Lesson 2: What? How? For Whom?

Capstone Lesson 3: Economic Magic: Creating Something from Nothing

*Online*

EconEdLink I Don't Want Much, I Just Want More

<https://www.econedlink.org/resources/i-dont-want-much-i-just-want-more-allocation-competition-and-productivity/>

## **Day 2 - Command, traditional, and market economies**

### **Content Knowledge**

Students need to understand that governments can direct economic activity, but they often can't do it efficiently. A command economy takes the freedom to choose from the individuals in society and transfers it to a smaller group. It is impossible for this group to have all of the information necessary to efficiently and effectively allocate resources in a way that will satisfy the greatest number of wants.

Students also need to recognize that traditional economies are inefficient and lack an incentive to grow and change. Virtually all modern economies, including the economy of the United States, contain some parts of the command, market and traditional economic systems within them.

All market economies have several basic characteristics in common including private property, free enterprise, self-interest, competition, a price system and limited (*laissez-faire*) government. Property rights, defined as individual ownership and control of resources and products, are a fundamental characteristic of a market system. Property rights affect the way markets allocate resources. If property rights are well defined and enforced and markets are competitive, a market system ensures that resources are used in their most valued manner.

The American economy uses a market system to make many allocation decisions, and it is important for students to understand why the market system is used so extensively. Students also should be able to compare the characteristics of a market system with alternatives used more extensively in some other countries. With this understanding, students can assess the benefits and costs of alternative allocation systems when discussing difficult questions such as how incomes should be divided among people or who should receive a kidney transplant and who should not.<sup>2</sup>

Teachers should use the terms market, mixed and command to describe economic systems rather than capitalist, socialist and communist. These terms mean different things to different people, and they carry an emotional and political overtone that can be confusing and/or distracting.

### **Vocabulary**

**Command economy** – An economy in which most economic issues of production and distribution are resolved through central planning and control.

**Market economy** – An economy that relies on a system of interdependent market prices to allocate goods, services, and productive resources and to coordinate the diverse plans of consumers and producers, each of them pursuing their own self-interest.

**Mixed economy** – An economic system that exhibits characteristics of more than one type of economic system. Most modern systems are mixed and have various aspects of command, market and traditional systems within them.

**Traditional economy** – An economy in which customs and habits from the past are used to resolve most economic issues of production and distribution.

### **Virginia Board of Education Framework**

In a market economy, scarce goods and services are allocated through the influence of prices on production and consumption decisions.

In a traditional economy, the answer to all questions is “What has always been done.”

In a command economy the government or other central authority answers all of the questions.

A mixed economy is a combination. The United States is primarily a market economy; however, since it has some elements of government involvement (e.g., taxation and regulation) it is sometimes called a mixed economy.

Most of the world’s economies today are mixed economies and exist on a continuum between market and command. Some lean toward market; others lean toward command.

### **Teaching Tips**

1) Explain to students that traditional economies are those where the three basic economic questions are answered based on habit or tradition. Production is carried out in certain ways because “that’s the way we’ve always done it,” or “you don’t mess with success.” Ask students if they know of any traditional economies that still exist. Some students might suggest remote primitive tribes or cultures that are “cut off” from the outside world.

Then ask students if there are certain traditions in their family. Are there certain things that are done for holidays, for special events, etc.? Do these traditions take the place of making choices or drive decisions about where to go, what to eat, what to purchase, etc...? Are these examples of a “traditional” economy?

2) You can ask students to name historical nations that they feel had total control of the economy. Common responses may include Hitler’s Germany or the former Soviet Union. You can ask about current nations that they feel have total control over the economy. Common responses may include Cuba or North Korea.

Ask students what they feel are the common characteristics among these nations. Point out that in command economies, there is a centralized authority that makes most decisions about the three major economic questions – what to produce, how to produce and for whom, If you have used or plan to use the “Moscow on the Hudson” video (see resources section), this is an opportune time. The main character lives in the former Soviet Union and is used to having to wait in lines for unknown products. Once he gets to the head of the line, he finds his choices are limited by a “central authority”. The same character, once in the U.S., is astounded by the choices just about coffee.

Ask students to suggest reasons for centralizing decision-making. Common responses might include “greater efficiency,” “avoid bad decisions,” and “more fairness.” Ask students how satisfied they are when others make decisions for them. Do they want to make more or fewer decisions for themselves? Why?

A command economic system is sometimes confused with a dictatorship. A command economy often is run by a dictator such as Stalin or Castro, but democracies can also have large elements of command in the economy. The key is to remember that command decisions are made by government. These decisions are made by non-elected officials in a dictatorship *and* by elected officials in a democracy.<sup>3</sup>

3) In a market economy, supply and demand are major factors in how the three basic economic questions are answered. Have students identify examples of products for which the price fell because sellers did not sell all they had produced at the initial price; identify examples of other products for which the price rose because consumers wanted to buy more than producers were producing at the initial price. Explain what happens (and why) to the price of concert tickets purchased from scalpers when, at prevailing prices, many more people want to attend those events than the number of seats available.<sup>2</sup>

## **Lessons and Resources**

Capstone: Exemplary Lessons for High School Economics Lesson 6: Why Did Communism Collapse?

*Online*

EconEdLink Traditional Economies and the Inuit

<https://www.econedlink.org/resources/traditional-economies-and-the-inuit/>

## The Bead Game Simulation

<https://files.eric.ed.gov/fulltext/ED458175.pdf>

### *Video*

*Moscow on the Hudson* (DVD) – Chapter 1 (3:30 to 3:55), Chapter 3 (10:35 to 11:05), Chapter 17 (1:01:45 to 1:02:45)

“*Tradition*”, from *Fiddler on the Roof* (the first 3:50 of the clip are sufficient)

<http://www.youtube.com/watch?v=gRdfX7ut8gw>

## **Day 3 - The free market and the US economy**

### **Content Knowledge**

In market economies, there is no central authority that decides how many different kinds of sandwiches are provided for lunch every day at restaurants and stores, how many loaves of bread are baked, how many toys are produced before the holidays, or what the prices will be for sandwiches, bread, and toys. Students should understand that, instead, most prices in market economies are established by interaction between buyers and sellers. Understanding how market prices and output levels are determined helps people anticipate market opportunities and make better choices. <sup>2</sup>

Consumers wish to purchase goods and services so that they can satisfy their wants. Producers wish to supply goods and services to consumers in order to earn the profits with which producers can satisfy their own wants. Both sellers and buyers are better off when they willingly make exchanges in the market. To facilitate exchange, systems have evolved to coordinate the actions of suppliers and consumers. In the United States and many other countries, exchange and the setting of terms under which exchanges take place usually occur in markets. Markets are institutional arrangements that enable buyers and sellers to exchange particular amounts of goods or services at particular prices. Prices help buyers and sellers decide how to use their resources. Both buyers and sellers play a role in establishing prices and the quantities that are exchanged at various prices. <sup>3</sup>

### **Vocabulary**

**Market economy** – An economy that relies on a system of interdependent market prices to allocate goods, services, and productive resources and to coordinate the diverse plans of consumers and producers, each of them pursuing their own self-interest.

### **Virginia Board of Education Framework**

EPF.1e: In a market economy:

- consumers decide what will be produced by casting their “dollar votes”
- producers choose the most profitable method of production

- goods and services are consumed by those who are willing and able to pay the market price.

In a market economy, scarce goods and services are allocated through the influence of prices on production and consumption decisions.

A mixed economy is a combination. The United States is primarily a market economy; however, since it has some elements of government involvement (e.g., taxation and regulation) it is sometimes called a mixed economy.

Most of the world’s economies today are mixed economies and exist on a continuum between market and command. Some lean toward market; others lean toward command.

EPF.1f: Market economies are characterized by:

- private ownership of resources, which provides incentives for the owners of resources to weigh the value of present uses against the value of conserving the resources for future use
- competition among businesses, which tends to lower prices and raise quality
- prices determined in the marketplace through the interaction of supply and demand
- consumer sovereignty, the concept that consumers’ “dollar votes” tell businesses what to produce
- profit motive, an incentive for businesses to produce what consumers demand and to produce those goods and services efficiently—keeping costs down—in hopes of earning greater profit
- limited government that acts as a referee—protecting consumers, workers, the environment, and competition in the marketplace.

## Teaching Tips

1) Ask students whether they think the US is a market, command or traditional economy. Have students explain their answers. Point out that the US, as with most nations, is a mixed economy. There are parts of the economy that are very market-oriented, parts that are very command-oriented, and parts that are driven by tradition. Ask students to come up with examples of each type of economy that is present in the US system. For example, most nurses in the US are females, and most truck drivers are males, due to tradition. Enacting a law that prohibits smoking in restaurants is an example of a command decision.

2) Have students explain the effect a free market has on the following scenarios: Why there is usually a shortage of batteries in areas where forecasters predict a hurricane? Why there is often a late-season surplus of tickets available for the home contests of a baseball team that loses most of its games? Explain what will happen to corn prices during an unusually favorable growing season?

## Lessons and Resources

Middle School World Geography: Focus on Economics Lesson 5: Economic Freedom: How Important Is It?

Your Credit Counts Challenge Section 6: The Basics of a Market Economy

Economies in Transition Lesson 1: A Parking Lot Full of Incentives

EconEdLink Guess Who's Coming to Dinner

<https://www.econedlink.org/resources/guess-whos-coming-to-dinner/>

**EPF.1 The student will demonstrate knowledge of basic economic concepts and structures by**  
*f) identifying Adam Smith and describing the characteristics of a market economy*

## **Day 1 - Competition and the invisible hand**

### **Content Knowledge**

Adam Smith was the father of modern economics. He based his theory and understanding of the market on several ideas. First, he believed that rational, enlightened individuals would best benefit society by being allowed to pursue their own self-interest. (Self-interest is not the same as greed.) He came to this conclusion after years of philosophical work that indicated we are concerned about what others think of us and we are aware of our connection with others. Rational individuals realize that their best interests are tied up with the continued best interests of others, in the long-run.

In a market economy, there is no direct communication between producers and consumers - market sales and pricing do the “talking” for us. Smith referred to this indirect communication as an “invisible hand” guiding the market. Price and market transactions answer the questions of “what, how and for whom,” instead of the “visible” hand of government. However, Smith also believed that government and laws were necessary to keep markets running smoothly. These were necessary to protect property and profits that were legally and fairly obtained.

Finally, Smith believed in the value of trade over self-sufficiency. He demonstrated that individuals and nations who trade are richer and better off (have a higher standard of living) than those who restrict trade by erecting barriers or giving preferences. He felt this was true on a local, national, and international level.

#### **Vocabulary**

**Adam Smith** – He is the father of modern economics. He wrote *An Inquiry in the Nature and Causes of the Wealth of Nations* which was published in 1776 and explained the nature of economic exchange and the role of government in the economy.

**Private property** – A basic institution in a market economy, private property involves the right to exclusive use, legal protection against invaders and the right to transfer property to others. Property rights are defined, enforced and limited through the process of government.

#### **Virginia Board of Education Framework**

Adam Smith believed that people, acting in their own self-interest, would work hard and produce what consumers want as if directed by an invisible hand.

Smith argued for trade, saying it opened new markets where surplus goods could be sold and allowed for cheaper goods to be imported.

Smith believed that competition among businesses would keep prices in check.

Smith believed there was a limited but important role for government to do things such as enforce contracts, grant patents and copyrights, and provide public works such as roads.

Smith observed that specialization and division of labor in a pin factory allowed workers to produce many times more pins than if each worker had been working alone.

## Teaching Tip

Display the following quote: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love....—Adam Smith, The Wealth of Nations Adam Smith talked about “self-interest” (self-love) as the motivation for people to produce goods and services. Can someone have too much self-interest? When does self-interest turn to greed? Have students give examples of the difference between the two.

## Lessons and Resources

World History: Focus on Economics Lesson 8: Adam Smith and the Market Economy.

Capstone: Exemplary Lessons for High School Economics Unit 4, Lesson 20: Why Helping Yourself Helps Others

Wight, Jonathon. Saving Adam Smith. Prentice Hall, 2002. ISBN:0-13-065904-5.  
Saving Adam Smith website: <https://facultystaff.richmond.edu/~jwight/Adam/>

## Day 2 - Property rights

### Content Knowledge

Property rights refer to the legal ownership of resources. For many students, this definition stops with tangible goods – things they own that they can touch. Some students might also recognize the right of ownership that is conveyed on the intangible; for example – the property rights that belong to a musician when they create original music. And don’t forget that ownership of resources extends to your own labor. The right to your own labor is what gives you the right to be paid for your work.

Market systems cannot function well without clearly defined, well enforced property rights because property rights send clear signals on who is rewarded for caring for the resource and who is liable if it is used poorly. Property rights help insure that people bear the costs and reap the benefits of their decisions. Property rights and contract enforcement encourage investment by assuring investors that they will reap the rewards of deferring consumption and assuming risk if these investments perform well. Limiting individual liability and allowing people to pool their

investment resources through joint stock corporations also increases investment and future income.<sup>2</sup>

### **Vocabulary**

**Copyright** – Legal protection for the authors of literature and music, giving them the sole right to profit from the publication, distribution and other use of their work for a specific period of time. It also gives them the ability to transfer these rights to other people or entities.

**Patent** – Legal protection for the inventors of ideas, products and processes, giving them the sole right to profit from the production and distribution of their work for a specific period of time. It also gives them the right to transfer these rights to other people or entities.

**Property rights** – Legal protection for the boundaries and possession of property. Assigning of property rights to individuals, collectives or governments depends on the economic system.

### **Teaching Tips**

1) Predict what might happen if there were no legal way to settle boundary disputes or if every state had its own system of weights and measures.<sup>2</sup>

2) Reinforce the point that market systems cannot function well without clearly defined, well enforced property rights because property rights send clear signals on who is rewarded for caring for the resource and who is liable if it is used poorly. When property rights are unclear or not enforced, the resource will be overused in the marketplace. Examples such as the markets for elephant ivory and caviar demonstrate how a resource can be overused and depleted when property rights are not clear. Other examples like chickens and cattle demonstrate how a resource can be used aggressively but not depleted if property rights are clear.<sup>3</sup>

3) Begin by having students give examples of property. Common responses will include land, homes, cars, clothing, and electronics. Ask students if they believe they should have the right to buy and sell any of these types of property. Ask them if they believe there are or should be limits on what, how much and when certain types of property should be purchased and ask them to justify their answers. Ask them if they should be free to use other people's property or to profit from other people's property; or if other people should be free to use their property or profit from their property. Then have students explain why the rights to buy, sell, use and distribute property as one sees fit may differ between economic systems

Upon receiving answers, the instructor can develop the discussion further by asking about file-sharing. The instructor can also ask about the incentive to use a lot of resources to pursue an idea (research) and have that protected. This is where the instructor can introduce ideas of copyright and patent.

### **Lessons and Resources**

Economics in Action: 14 Greatest Hits for Teaching High School Economics

Lesson 4: Property Rights in a Market Economy

Focus: Institutions and Market Lesson 2: Property Rights and Contracts as Economic Institutions

The Verge Magazine: Metallica Sued Napster

<https://www.theverge.com/2015/4/13/8399099/metallica-sued-napster-15-years-ago-today>

*Music*

“Paperback Writer” The Beatles

## **EVALUATION DAY**