

# The Market Economy

Name: \_\_\_\_\_

## The Economy

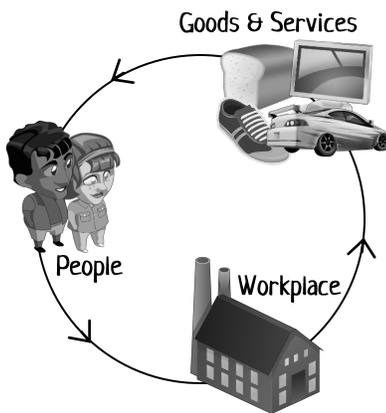
You've probably heard people say things like, "The economy is down," or, "Such-and-such would be good for the economy." Maybe you've figured out that the economy has something to do with money. But what is this big, scary "economy" everyone's always worried about? And how can you avoid it?

That was a trick question. You can't avoid the economy! An **economy** is the way goods and services are produced and consumed. Everyone is involved in the economy both by producing goods or services and by consuming them. There are different kinds of economies, and the kind of economy a country has determines how resources get distributed to the people.



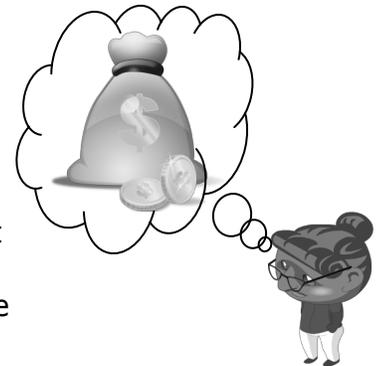
## Consumers, Producers, and the Market

Have you ever bought anything or paid someone to do something for you? Then you are a **consumer**—someone who acquires goods and services for his or her own personal use. Have you ever worked babysitting, walking dogs, or making fast-food tacos? Then you are a **producer**, too—someone who makes goods or offers services to others. In a **market economy**, producers are free to decide what to produce, and consumers are free to buy whatever they need and want. Unlike some economies, the government does not tell producers what to make or limit (for the most part) what consumers may buy. This selling and buying takes place in the **market**, which is not a physical place, but instead refers to the entire activity of buying and selling that takes place out in the world.



## Are You Motivated Yet?

So, why would anyone decide to produce and sell something? You guessed it—money! **Profit** is the financial gain received by selling something for more than it cost to make it. Producers are motivated by the profits they expect to gain from the goods or services they offer. Their **incentive** to produce—the thing that motivates them—is the idea that consumers will want or need what they are offering. Thus, someone who thinks people want phones that respond to voice commands has an *incentive* to produce such phones because they expect they will *profit* from selling them to lots of consumers.



But what about when two or more producers are offering the same goods or services? This results in **competition**—producers battling over who can make the most profit. Competition is a big motivator. Here's what can happen:

**Better Stuff.** Competition leads to **innovation**, which is the process of developing newer, better things. Think of iPhones, Android phones, and Windows phones: The producers constantly come out with new versions that have newer, better capabilities. Why? Because each producer wants you to spend your money on *its* phone instead of the other guys' phones.

**Good Deals.** Competition drives prices down. For a while, iPad was basically the only tablet on the market. Apple didn't have to worry about people buying other tablets because there weren't any real choices. But when other tablets came on the market at prices lower than iPad, Apple began to lower its price in order to compete. But deals have limits: Producers have no incentive to offer something for less money than it cost to make it.

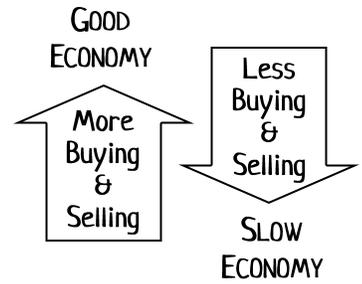


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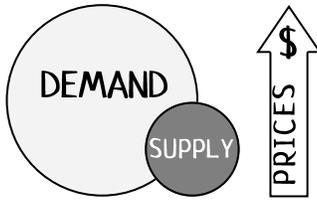
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## It's All About Supply and Demand

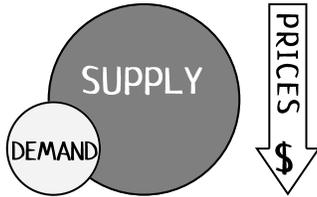
When a market economy is doing well, there is lots of buying and selling. During a "bad economy," buying and selling slows down. The cycle of ups and downs depends mainly on two things: **supply**, the amount of something that is available, and **demand**, the number of consumers who want it. Supply and demand are called **market forces** because they act to make the market function well or poorly.



## Supply and Demand Out of Balance



To keep everyone producing, making profits, and buying things, supply and demand must be balanced. Here's what can happen if there is *high demand* but *low supply*. Imagine there is a big freeze in Florida and orange trees are damaged. Fewer oranges are available. If there is still a big demand for oranges, the price will go up. Fewer oranges also means there aren't as many oranges to process. Some people who pick oranges and get them ready to sell might lose their jobs.



On the other hand, *too much supply* with *low demand* can also hurt. Imagine a coal producer is very busy over the summer and mines tons and tons of coal. Winter comes, but it doesn't get very cold. People don't use their furnaces as much as usual, so they don't need as much coal. All of that coal sits around unused—and they certainly don't need to mine any *more* coal. The price of coal will drop, and some people involved in producing coal could lose their jobs because there is already too much.

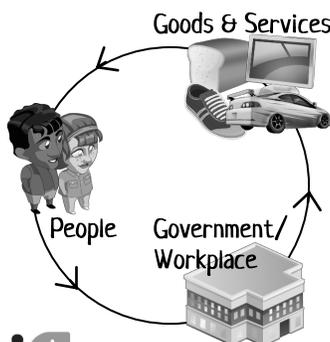
## Scarcity and Opportunity Cost

Imagine your class is deciding whether to sell candy or glow sticks for a fundraiser. Which will earn more money? People like sweets, so you decide to sell candy. In making that decision, your class gives up whatever benefit it might have gotten by choosing to sell glow sticks instead. The benefit you give up by choosing to do one thing instead of another is called **opportunity cost**. When you are in the process of making your choice, you try to determine which choice has more benefits and take a risk that you might be wrong.

The need to choose one thing over another exists because of **scarcity**—the limited amount of resources available. Why not sell candy *and* glow sticks? Probably because it would cost too much up front to buy both. If there were unlimited resources, everyone could have everything they want and need, and there would be no need to make choices. But because of scarcity, producers and consumers must make choices that are sometimes very difficult.



*You can't always predict the opportunity cost—but sometimes you can!*



## The Command Economy

The opposite of the market economy is the command economy, where the government decides what will be produced, how much will be produced, and how much goods and services will cost. Thus, the relationship between supply and demand does not determine what gets produced and consumed. Instead, the government makes those decisions. The government owns the equipment for production, so the government is everyone's employer. There is no private property in a pure command economy, so people can't sell things to make a profit. People are consumers, but they buy what the government produces.

# 6 TRAITS OF A MARKET ECONOMY

## Private Property

\_\_\_\_\_ something gives you the right to \_\_\_\_\_ and \_\_\_\_\_ it. Profit would be \_\_\_\_\_ without the right to own property. ("Property" here means both tangible \_\_\_\_\_ and land.)

## Markets & Prices

Buyers and sellers freely \_\_\_\_\_ goods and services on the \_\_\_\_\_. The market forces of \_\_\_\_\_ and \_\_\_\_\_ determine what \_\_\_\_\_ will be.

## Incentives/Self-Interest

People's own \_\_\_\_\_ motivates them to produce, in the hope of making a \_\_\_\_\_. Self-interest is also an incentive for \_\_\_\_\_, who seek to fulfill their \_\_\_\_\_ and \_\_\_\_\_ at the best price possible.

## Freedom of Choice

People are free to \_\_\_\_\_ what to \_\_\_\_\_ and what to \_\_\_\_\_. The choices producers and consumers make determines what \_\_\_\_\_ and \_\_\_\_\_ are available.

## Competition

Producers \_\_\_\_\_ with each other for \_\_\_\_\_ by trying to produce goods and services that will be most \_\_\_\_\_ to consumers. This leads to innovation (\_\_\_\_\_) and better \_\_\_\_\_.

## Limited Government Role

The \_\_\_\_\_ does not make rules about \_\_\_\_\_ and \_\_\_\_\_ gets produced. The government's main role is to make sure the market is \_\_\_\_\_ and producers have a chance to \_\_\_\_\_.

# PRICES UP, PRICES DOWN

## Producer says...

## Will the price go...

I manufacture the world's best cupcakes! I just heard a storm wiped out a lot of the sugar cane crop. Now there's going to be less sugar to meet everyone's demands!



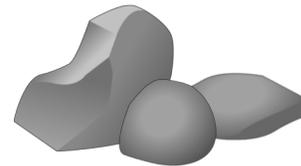
I make radios. I just installed a new, hi-tech machine that lets me make twice as many radios for half the price!



I own an oil refinery. Summer is coming, and people are going to be driving everywhere! They're going to need LOTS of gasoline.



I sell landscape rocks. I just ordered TONS, but a new gardening show has got everyone decorating with gnomes instead. What am I going to do with all these rocks??



I just invented the world's first self-folding chair! It folds itself up and puts itself away. Nobody else makes anything like it!



Self-folding chairs are so popular, I decided to make some, too. I can produce 9,000 self-folding chairs a day and distribute them to all the major stores.



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**A. Review.** Read each scenario. Match each label with the example that illustrates it.

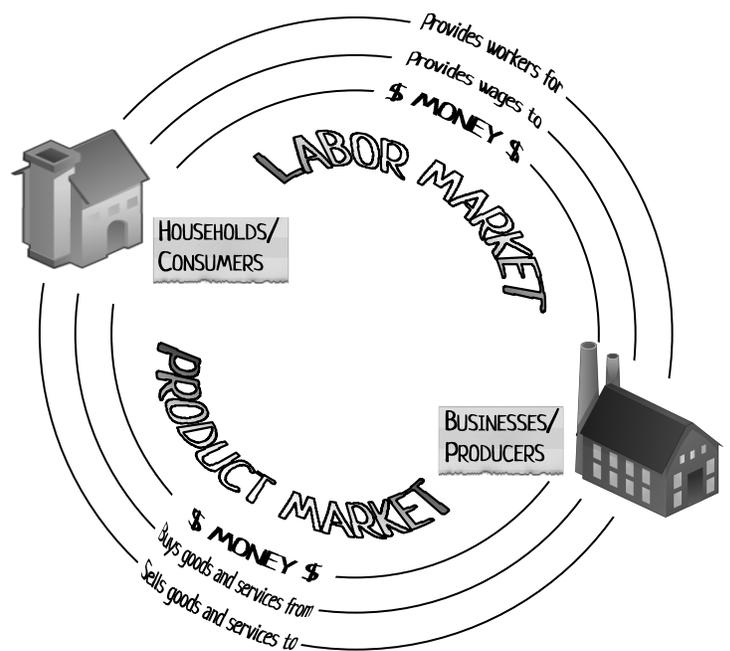
- \_\_\_ SUPPLY & DEMAND
- \_\_\_ COMPETITION
- \_\_\_ CONSUMER
- \_\_\_ SCARCITY
- \_\_\_ OPPORTUNITY COST
- \_\_\_ PROFIT
- \_\_\_ PRODUCER

- 1) Marla goes to the store and buys a new backpack.
- 2) Tyler mows lawns and does yard work for \$10 per hour.
- 3) Gas Station A sells gas for \$3.75/gallon. Across the street, Gas Station B sells it for \$3.74. Gas Station A lowers its price to \$3.74.
- 4) Liam spends \$10 on lemonade mix and ice. On a hot day, he sets up a lemonade stand in his yard. At the end of the day, he has sold \$20 worth of lemonade.
- 5) A car company made thousands and thousands of cars this year, but people haven't been buying as many cars. The car dealer lots are full.
- 6) Erin could make \$24 this afternoon babysitting, or she could attend her grandma's birthday party. She decides to attend the party. She doesn't get the money, but her grandma is thrilled.
- 7) It's holiday time, and the hottest toy of the year sells out. People are paying ten times what it's worth online.

**B. Motivated?** For each example, circle  if the person or business has an incentive to act and circle  if they don't.

1. Jason is thinking of getting some raspberries, but they're out of season and cost \$6 for a tiny box.  
2. Acme, Inc. is thinking of making touch-screen computers. It can make computers for \$500 each and sell them for \$2,000 each.  
3. Beta, Inc. is thinking of making cars that run on water. It will cost \$100,000 to make one car, but people won't pay more than \$40,000 to buy one.  
4. Ann's house needs a new roof. She is thinking of doing the project this weekend, and roof shingles just went on sale for half price.  
5. Dr. Smith is thinking of opening a dentist office in Centerville. Right now the nearest dentist is in the next town, 40 miles away.  

**C. A Circular Flow.** There is a circular flow of interaction between consumers and producers in the market. Draw an arrow at one end of each line in the circle to show which way the thing described on that line is flowing.



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**D. What's the Opportunity Cost?** For each situation, write the opportunity cost—what the person gave up by making the decision. (Hint: Don't worry about math. Describe the cost in words.)

**1) Clink or swim?**  
Sam's boss called to offer her an extra shift tonight. Sam wanted the money, but she's got a big swim meet tomorrow and needed sleep. She told her boss to offer the shift to someone else.  
The opportunity cost was:

**2) An Interest-ing Choice**  
Jason can put his money in a savings account and earn about 12 cents in interest this month, or he can loan it to Matt, who says he'll return the money plus \$20 at the end of the month. He loans it to Matt.  
The opportunity cost is:

**3) Risky Business**  
Lacey designs dresses. She can keep designing casual dresses that bring \$65 but are easy to sell, or she could design formal gowns that sell for \$500 but must be high fashion. She takes a risk on formal gowns.  
The opportunity cost is:

**4) An air-y hard decision**  
If Zephyr, Inc. spends \$2 million buying out its main competitor, it can earn \$3 million in new sales. If it spends \$2 million designing a new airship, it might make \$4 million if it can sell 10 ships. It buys the competitor.  
The opportunity cost is:

**E. Three Kinds of Economies.** You already know about market and command economies. A **traditional economy** exists in primitive cultures where most activity is focused on providing food. People follow the methods and traditions their ancestors have always used. Think about this, and read the statements below. Organize them into the comparison chart by writing the letter of each statement where it should go.

|                  | Market Economy | Command Economy | Traditional Economy |
|------------------|----------------|-----------------|---------------------|
| Private Property |                |                 |                     |
| Incentives       |                |                 |                     |
| What is Produced |                |                 |                     |
| Competition      |                |                 |                     |

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>A. The government decides what should be produced.</li> <li>B. The need to survive motivates people to hunt, gather, or farm.</li> <li>C. Producers don't compete because everyone works to meet the community's survival needs.</li> <li>D. The government sets wages, so people aren't motivated by profit.</li> <li>E. Producers compete with each other to make profits from customers.</li> <li>F. The government owns the property.</li> </ul> | <ul style="list-style-type: none"> <li>G. Producers decide what to make based on consumer demand.</li> <li>H. Private individuals own the property.</li> <li>I. The community's customs and traditions determine what is produced.</li> <li>J. Most property is shared by the community.</li> <li>K. The hope of profit motivates producers to develop new things.</li> <li>L. There is no competition because the government is the only producer.</li> </ul> |
|---|--|