

LESSON TWO

WHO DECIDES?

INTRODUCTION

A basic difference between command and market systems is related to who owns and controls the productive resources of the economy; that is, who ultimately decides how these resources are to be used. The productive resources of an economy are its human (labor), capital, and natural resources. In a command economy where the state or government owns and controls most non-labor resources, a central planning committee is generally responsible for developing a plan on how resources are to be used. In a market economy where individuals own and control the productive resources, these decisions are made in the marketplace where resource owners are the sellers and businesses are the buyers. The businesses' demand for resources reflects consumers' demands for the goods businesses produce. Thus, it is ultimately the wishes of the consumers and the resource holders that determine how resources will be used. This lesson demonstrates how these systems work and evaluates the results of each.

CONCEPTS

- Allocative Efficiency
- Command Economy
- Economic Wants
- Market Economy
- Productive Resources: natural, human, and capital
- Resource Allocation
- Social Goals

OBJECTIVES

- ◆ Explain the differences between command and market economies with respect to resource ownership and control.
- ◆ Demonstrate how resources are allocated in command and market economies.
- ◆ Evaluate resource allocation under market and command economies according to social goals

LESSON DESCRIPTION

Members of the class play roles in two different economic systems. Some are the central planners of a command economy. The others are resource owners and producers in a market economy. Both groups are given the same endowment of a resource called "nech" and must ultimately determine how much of this resource will be devoted to each of two goods: vesto and carbo. The results are compared and evaluated on the basis of social goals, such as allocative efficiency and equity.

This simulation requires a minimum of 24 students — two Central Planning Committees (CPC) plus 20 market participants. With more students, add CPCs, CPC members, and/or vesto and carbo producers.

TIME REQUIRED

- ◆ One class period

MATERIALS

- Transparency of Visuals 1 and 2
- Enough copies of Activities 1, 2, and 3 to provide role cards for Central Planners, Necho Owners, Vesto Producers, and Carbo Producers (See procedure step # 2 for the number of cards needed.)
- 8 pencils or other small items to represent units of nech in the market simulation
- Enough copies of Activity 4 so that each producer has the amount listed on his/her card

PROCEDURE

1. Explain that students will participate in a simulation to learn how resources are allocated in command and market economies. Display Visual 1 to describe some basic characteristics of market and command economies. Discuss:
 - A. Point out that the first characteristic for each economy focuses on productive resources. What is a productive resource? (something used to produce goods and services)

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- B. Explain that there are three basic types of productive resources: natural, human and capital. Define and provide examples of natural, human, and capital resources. (natural: things that occur naturally in or on the earth, such as land, coal, oil, plants; human resources: people doing mental or physical work, such as teachers, farmers, mechanics, doctors; capital resources: things made by people and used to produce other goods and services, such as machine, tools, factories)
 - C. Ask students to compare the characteristics of the two types of economies.
 - D. What are social goals? (Social goals are the criteria used for evaluating an economic system.) Display Visual 2 and discuss.
2. Divide the class into five groups as follows.
 - A. Central Planning Committee #1 (2-5 students)
 - B. Central Planning Committee #2 (2-5 students)
 - C. Nech Resource Owners (8 students)
 - D. Vesto Producers (at least 6 students)
 - E. Carbo Producers (at least 6 students)
 3. Instruct each Central Planning Committee (CPC) to move to a different corner of the room. Give each CPC member a role card. Explain they will have 10-15 minutes in which to work. (Note: This is the only role card that CPC groups will receive.)
 4. Explain to the remaining groups that in order to produce vesto and carbo, producers must buy the nech resource from its owners.
 5. Give each nech owner a role card and a unit of nech.
 6. Give each vesto and carbo producer the appropriate role card and the amount of greenbuck\$ indicated on their cards. Instruct students to read their cards.
 7. Explain that nech owners and vesto and carbo producers will actually exchange nech for greenbuck\$. Ask students if they have any questions. (Note: The CPC groups do not participate in the exchange process.)
 8. Remind the nech owners that they are trying to get the highest price possible for their units of nech. Remind the producers they are trying to buy nech at the lowest price possible.
 9. Tell vesto, carbo, and nech students that they will have 10-15 minutes to engage in exchange. (Note: While the exchange takes place, the CPC groups should be making their decisions.) Near the end of the market session give a "one-minute warning" that the market is closing, and remind nech owners that this is their last chance to sell their units.
 10. End the exchange session. Discuss:
 - A. What type of economy did the CPCs represent? (command) Why? (The CPCs controlled and allocated the nech resources according to their social goals.)
 - B. What type of economy did the exchange simulation represent? (market) Why? (The nech resources were owned by individuals and allocated in the marketplace. Both consumers and producers were motivated by their self-interests.)
 11. Ask each CPC to report its resource decision to the entire class; that is, how much the committee allocated to vesto producers and how much to carbo producers. Record this information on the board.
 12. Ask each CPC to identify the criteria or goals it used in making its decision.
 13. Ask the market group how much nech was purchased by vesto producers and how much was purchased by carbo producers. (Given the values on the vesto and carbo cards, six units of nech

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should have been purchased by vesto producers and two by carbo producers.)

14. Ask students why they think more nech was purchased by vesto producers than carbo producers. (The vesto producers were, in general, willing and able to bid more for the nech because consumers were willing and able to pay more for vestos. Consumers valued vestos more highly than carbos.)

15. Discuss.

- A. Why would the two CPCs report different results? (The results of the CPCs depended upon what the planners thought most important. This could be different from one group of planners to another.)
- B. Why might the market results be different from one or both CPC results? (The market result is driven by what consumers are willing and able to pay for vesto and carbo. Since consumers placed a higher value on vesto production than on carbo production, more nech was allocated to vesto production.)

16. Explain that economists say that a society achieves allocative efficiency when it produces those goods and services that society values most, based on individual preferences, with the resources available. In the market simulation, more nech was allocated to the product most preferred by individuals, and less nech was allocated to the product least preferred by individuals.

17. Tell students that markets provide information about the value of goods and services in an economy; and resource owners act upon this information when allocating their resources.

18. Explain that each CPC could have arrived at the same result, but this would have occurred by chance. The planners had no information about the value of vestos versus carbos.

19. Discuss.

- A. In a market system, how would the allocation of nech resources change if most of the members of the society decided to live as nudists? (The demand for vestos would fall. As a result, the price of vestos would fall. At this lower price, vesto producers would only be willing to produce and sell a smaller quantity of vestos. As a result, fewer nech resources would be allocated to the production of vestos.)
- B. In a command system, how would the allocation of nech resources change if most of the members of the society decided to live as nudists? (It depends. The CPC would only respond to this change if it affected the achievement of the CPCs social goals.)
- C. What are the advantages and disadvantages of the resource allocation process in each system? (In a market system, consumers drive the production decisions of producers. Those decisions are based on how much power the consumers have in the market, which comes from how much income they have and what they want. Although this system allocates resources efficiently according to individual preferences, it may not be considered equitable — especially by people with low incomes. A command system may attempt to achieve economic equity, but it achieves this social goal by trading off some efficiency.)

CLOSURE

1. How is resource allocation determined in a market economy? (Markets provide information about the value of goods and services in an economy relative to the preferences of consumers. Resource owners act upon this information when allocating their resources.)

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2. How is resource allocation determined in a command economy? (Central planners determine which goods and services will be produced and which resources will be allocated to the production of those goods and services, based on the desired social goals.)

ASSESSMENT

1. Have students develop a chart listing the advantages and disadvantages of command and market economies.

2. Have students write an essay explaining the system under which they would prefer to live. They should include a discussion of the factors that are important to them in making such a decision.

3. Explain that newly independent states of the former Soviet Union are undertaking a transition from command to market economies. Ask students to predict how resource allocation mechanisms will change and what difficulties will be encountered. Have them identify who has the most to gain (lose) from the transition.

EXTENSION

Ask students to research Russian history and examine how resources were allocated under the feudal system.

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VISUAL 1

THE DIFFERENCES BETWEEN MARKET AND COMMAND ECONOMIES

MARKET ECONOMY

1. Productive resources are owned and controlled by individuals in the economy.
2. Decisions about how resources are to be used are made by numerous individual buyers and sellers in markets.
3. Individuals are motivated by their own self-interest.

COMMAND ECONOMY

1. Except for human resources, most productive resources are owned and controlled by the state or government.
2. Decisions about how resources are to be used are made by central planners of the government.
3. Central planners are motivated by the social goals they establish.

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VISUAL 2 BROAD SOCIAL GOALS OF AN ECONOMIC SYSTEM

ECONOMIC FREEDOM refers to such things as the freedom for consumers to decide how to spend or save their incomes, for workers to change jobs or join unions, and for people to establish new businesses or close old ones.

ECONOMIC EFFICIENCY refers to how well productive resources are allocated with respect to the costs and benefits of using those resources.

ECONOMIC EQUITY refers to people's sense of "fairness". Economic actions and policies must be evaluated in terms of what people think is right and wrong.

ECONOMIC SECURITY refers to protection against economic risks, such as work injuries, unemployment, inflation, business failures, and poverty.

ECONOMIC GROWTH refers to increasing the production of goods and services over time. The rate of economic growth is measured by changes in the level of real gross domestic product, and a target of 3 to 4% growth per year is generally considered to be a reasonable goal.

Source: *Focus: High School Economics*, National Council on Economic Education, 1996. Reprinted with permission.

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ACTIVITY 1

CPC ROLE CARDS

CPC Member

You are a member of the Central Planning Committee of Econoland. Your country has 8 units of the resource "nech" available this year. Nech becomes useless fairly quickly so these units must be used this year. Nech is used in producing two goods which are important to your country: carbo, a food product, and vesto, a type of clothing. With the current technology of your country, one unit of nech is needed to produce one unit of carbo and one unit of nech is needed to produce one unit of vesto. You must allocate the 8 units of nech to the producers of these two products. Decide how many units of nech each sector should get. Be ready to describe how you came to this decision.

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ACTIVITY 2

NECH OWNER ROLE CARDS

Nech Owner

You are the owner of one unit of nech. Nech is a resource used in producing carbo, a food product, and vesto, a type of clothing. Nech becomes useless fairly quickly so you are interested in selling your unit right away to the highest bidder. Try to get the highest price you can for your nech because you are also a self-interested, capitalist wealth-maximizer!

Nech Owner

You are the owner of one unit of nech. Nech is a resource used in producing carbo, a food product, and vesto, a type of clothing. Nech becomes useless fairly quickly so you are interested in selling your unit right away to the highest bidder. Try to get the highest price you can for your nech because you are also a self-interested, capitalist wealth-maximizer!

Nech Owner

You are the owner of one unit of nech. Nech is a resource used in producing carbo, a food product, and vesto, a type of clothing. Nech becomes useless fairly quickly so you are interested in selling your unit right away to the highest bidder. Try to get the highest price you can for your nech because you are also a self-interested, capitalist wealth-maximizer!

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ACTIVITY 3

VESTO/CARBO PRODUCER ROLE CARDS

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$16.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$24.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$12.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$20.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$8.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$18.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

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ACTIVITY 3 (Continued)

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$6.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$16.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$5.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$14.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$4.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$12.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

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ACTIVITY 3 (Continued)

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$3.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$10.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$2.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$8.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Carbo Producer

You are a producer of carbo, a food product. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$1.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

Vesto Producer

You are a producer of vesto, a type of clothing. You need one unit of nech to produce one unit of your product (and one unit is all you are able to produce). Given the demand for your product the maximum you are willing and able to pay for a unit of nech is \$6.00 but you are obviously looking for a lower price if you can get it. Try to make a deal with a nech owner!

ACTIVITY 4
GREENBUCK\$

Greenbuck\$	Greenbuck\$
Greenbuck\$	Greenbuck\$
Greenbuck\$	Greenbuck\$
Greenbuck\$	Greenbuck\$