
Lesson 1 - Why People Trade

INTRODUCTION

Economics

Because students often take part in activities such as athletic competitions where one side wins and one side loses, they may not recognize that both sides win in *voluntary trade*. This is true because anyone who does not expect to gain from a trade would not voluntarily agree to do it. *Trade* is the exchange of goods and services. People decide to trade because they expect to benefit from it. When one or both parties cease to reap benefits from an exchange, or when they believe they can no longer gain from trading, exchanges stop. The idea that both sides benefit from voluntary trade is one of the most important concepts in economics and leads to the conclusion that, typically, the benefits of free trade far outweigh the costs. This idea applies to exchange among individuals and businesses as well as to trade among nations.

Reasoning

The economic way of thinking implies that people judge their satisfaction from a trade by weighing the expected benefits against the expected costs. Economic reasoning also tells us that different people place different *marginal values* on goods and services, making benefits from trade possible. With voluntary trade, both sides expect that the value of what they gain will be greater than the value of what they give up. The benefits of trade should become clear from this lesson: that is, voluntary exchange can make both individuals and nations better off.

CONCEPTS

Barriers to trade
Benefits of trade
Incentives
Trade
Voluntary exchange
(Optional) Utility

CONTENT STANDARDS

4. People respond predictably to positive and negative incentives.
5. Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation, and among individuals or organizations in different nations.

OBJECTIVES

Students will

1. Participate in a trading activity and describe the incentives that encourage trade.
2. Explain the outcomes of voluntary trade.
3. Explain why there aren't any direct losers from voluntary trade.

LESSON DESCRIPTION

Students participate in a trading simulation and use this experience to discover the benefits of free trade. In a class discussion, they relate the simulation to concepts of regional versus universal trade, trade barriers and diminishing marginal value. They explain why both parties benefit from the trade.

TIME REQUIRED

45 minutes

MATERIALS

1. One brown paper bag for each student in the class
2. A large number of small items that are easy to exchange (miniature candy bars, small boxes of raisins, pencils, stickers, fruit, small boxes of juice, library passes). Before class, distribute the goods unequally in the bags; for instance, put only candy in some bags but give several items including candy to others. Give a few unlucky students only one or two less-popular items and give a few students an abundance of several different items such as candy, pencils and stickers. Try to create obvious contrasts among the contents of the bags.
(Optional) Instead of preparing bags, ask students in advance to bring from home one or more small items to trade that they no longer want.

PROCEDURE

1. Discuss the following situation with the class: Imagine that Donna, a teenage driver, pulls up to a local gas station and puts \$15 worth of gas in the tank. She then pays the station owner \$15. Point out that this is an example of an exchange or a trade because \$15 was traded for gas. Who gained and who lost in this situation?
One way of looking at this is that both people simultaneously gained something and lost or gave up something: The driver gave up \$15 worth of purchasing power but gained several gallons of gasoline. The station owner gave up several gallons of gas but gained \$15 in purchasing power.
Another way of looking at this is that both parties had overall, or net, gains. Both people likely feel better off because each now has something they value more than what they gave up: The teenager likely values the full tank of gas more than the \$15, while the station owner likely values the \$15 more than the gas. For each person,

the gains were greater than the losses. If this were not true, the teenager would have kept the money and the station owner would have kept the gas.

2. Tell students that in today’s class they will participate in a trading activity. The purpose of the activity is to explore the reasons people, organizations and nations trade.
3. Ask the class, “Why do people trade?” Compile a list of answers on the board. Do not discourage any answers at this point. Explain that these responses represent hypotheses. Now the class must find evidence to support or reject these hypotheses.
4. Distribute to each student a bag with small items to trade. Assure students that they may keep whichever items they still possess at the end of the simulation. While students are still in their seats, have everyone privately examine the contents of their bags. Tell them not to show the contents to anyone.

TRADING ROUND 1

5. Divide the class in half. Announce that students will now have the opportunity to trade. Explain that they may trade any or all of the contents of their bags, but they may trade only with people on their side of the room. No one is required to participate in a trade. Allow five to 10 minutes for students to trade.
6. At the end of this first trading round, call students back together. Ask the following questions:
 - A. How many students made a trade?
Responses will vary.
 - B. Ask everyone who made at least one trade to stand up. Why did they decide to trade? *Responses will vary but should point to the idea that the trades made them better off because they preferred*

what they got to what they gave up.

C. Ask for a show of hands: Of those who made trades, how many are better off as a result of the trades? *Generally, everyone who traded should be better off. Since trading was voluntary, if they did not expect to be better off, they should not have traded. This is the major point of this activity: Voluntary trade makes both parties who traded better off. Make sure this point is clear before going on.*

D. If anyone who traded said that he or she is not better off, ask him or her to explain why. *Sometimes students will say they thought they were trading for something better than what they actually got. Explain that this is a problem of poor information but not a problem of trading per se. Sometimes students will say they felt sorry for someone who didn't have as much as they did; so to help this person, they made a trade that caused them to be worse off. Explain that they probably feel better off as a result of helping others, so they have still gained. These situations do not contradict the point of the activity.*

E. Why did some students decide not to trade? *Responses will vary. Some students may say they were happy or satisfied with what they had and didn't want what others were willing to trade. This demonstrates that voluntary exchanges stop when both sides do not expect to gain. Some students will say they were not able to get what they wanted. However, everyone who does decide to trade is better off to some degree or they wouldn't have voluntarily traded.*

F. Did anyone trade more than once? Why? *Several students probably made numerous trades because they continued to become better off with each trade.*

G. Were any restrictions placed on trades? *Yes, students could trade only with people on their side of the room.*

H. How did this trade restriction affect trading decisions? *Many students will likely answer that they wanted to trade with someone in the other group. If anyone violated the rule that they could trade only with people on one side of the room, it points out a problem with trade barriers: When forces such as trade barriers interfere with people's incentives, there are incentives to violate the rules.*

TRADING ROUND 2

7. Announce that you will allow one more round of trading. This time there won't be any restrictions: Students may trade any item(s) with any other student(s) in the room if they choose to do so. Again, allow five to 10 minutes for trading.
8. Call students back together. Ask the following questions:
 - A. How many students made a trade in this round? *Responses will vary, but you should find that students made more trades after the restrictions were removed.*
 - B. How did the elimination of trade restrictions affect trading? *As trade was opened up, more students were able to find beneficial exchanges. This demonstrates the gains from free trade compared with restricted trade.*
 - C. Did anyone make more than one trade? *Again, this number is likely to be larger than in the first round.*
 - D. Why did you trade? *Answers will vary but should point to the fact that trade made them better off than before.*
 - E. Of those who made trades, how many are better off as a result of the trades? *All students who traded should be better off from the trade if the trades were voluntary. Point out that those who traded in both Round 1 and Round 2 should be even better off after Round 2 trades.*

F. Identify some students who had a large number of the same item. Did any one trade away some, but not all, of the item? *If this occurred, it is a demonstration of the law of diminishing marginal value (utility): The more you have of something, the less you value one more unit of it. For example, your tenth piece of candy is more easily given up than the only candy bar you possess; the marginal utility it provides is not as great as that of the first piece.*

G. Some people had more items – and more valuable items – to trade than others, just as with some countries. If you were one of the “poorer” students, were you able to trade? *Probably yes, unless some bags contained only items with no value to any student.*

H. Did any very poor students trade with any very “rich” students? *Probably yes. This demonstrates that people in wealthy nations aren’t the only ones who benefit from trade and that mutually beneficial trade can take place between people in wealthy countries and poor countries.*

I. Was everyone totally happy with his or her trades? *Probably not, but emphasize that this is not the point. Students who had little to trade may not have been as pleased as those with a larger number of items. Some students may have traded merely to avoid feeling left out. Some students may not have been able to find something they were interested in at all. Students who traded and then realized they missed a better trade may have been unhappy. Finally, students who underestimated the costs of trade or overestimated its benefits – or both – may have been unhappy. Trading doesn’t guarantee happiness. Economists merely maintain that trade will continue if people are better off after the trade than if they had not traded at all.*

J. Did your trading behavior support or disprove the class’s hypotheses about why

people trade? *Answers will vary. Refer to the hypotheses on the board and compare them with the reasons students gave for trading.*

K. What conclusions can you draw from this simulation? *Again, answers will vary but should include some mention of the gains from trade and the concept that both sides benefit and no one loses.*

9. **(Optional)** Here is an alternative way to conduct the trading activity that uses numbers to show gains from trade. Distribute the bags with the trading items to students as before. Ask students to rate, on a scale of one to five, their satisfaction with their bag’s contents, with five being very satisfied and one being dissatisfied. Instruct students to write the number on the bag. Explain that economists use the term *utility* to describe the satisfaction people receive from things – in this case, the contents of their bag. Ask for a show of hands and count how many students rated their utility at 5, 4, 3, 2 and 1, and keep a tally on the board.

After the Round 1 trading session, ask students to rate their satisfaction with the items they now have and to again record their satisfaction by writing a number from one to five on their bag. Survey the class regarding their utility and record the responses on the board. The numbers should be higher than before trading, demonstrating the benefits from trade.

After the Round 2 trading session, ask students to rate their satisfaction with the items they now have and to again record the number on their bag. Survey the class again regarding their utility and write the numbers on the board. Students who traded should rank their utility higher than they did in the first round of trading. Students should also note that the overall utility rankings for the class have increased with each trading round.

CLOSURE

Summarize the lesson by having students discuss how the trading sessions resembled trading in the real world. Some differences are obvious: Students didn't exchange money and they didn't have to work – i.e., incur production costs – to get the items they traded.

Compare this session with the gasoline scenario from the beginning of the lesson and notice the many similarities. You may wish to point out that an idea underlying free trade is that different people place different marginal values on items. People tend to give up items they value less than the item they are getting in exchange. In this way, students ended the activity with an item they valued more than the one they had when trading began.