The Market Economy

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.

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.

The United States has a market economy, which is also called a capitalist economy. In this type of economy, the government does not tell producers what to make, and it does not 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 there’s a limit: Would you sell something for less than it cost to make?
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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.

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. 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.
Private Property
Owning something gives you the right to buy and sell it. Profit would be impossible without the right to own property. ("Property" here means both tangible items and land.)

Markets & Prices
Buyers and sellers freely exchange goods and services on the open market. The market forces of supply and demand determine what prices will be.

Incentives/Self-Interest
People’s own self-interest motivates them to produce, in the hope of making a profit. Self-interest is also an incentive for consumers, who seek to fulfill their wants and needs at the best price possible.

Freedom of Choice
People are free to choose what to produce and what to consume. The choices producers and consumers make determines what goods and services are available.

Competition
Producers compete with each other for profits by trying to produce goods and services that will be most attractive to consumers. This leads to innovation (new ideas) and better prices.

Limited Government Role
The government does not make rules about what and how much gets produced. The government’s main role is to make sure the market is fair and producers have a chance to compete.
A. Review. Read each scenario. Match each label with the example that illustrates it.

1) Maria 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.
Producer says...

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!

The price of sugar will go up, so the cupcakes will cost more to make. The price of cupcakes will go up.

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

The radios will be cheaper to make, so the price of the radios should go down.

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

Demand for gasoline is high during the summer vacation season. This usually causes the price of gas to rise.

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??

The producer has a supply problem. The rock supplier will lower the price of the rocks so people will be more likely to buy them.

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

New, one-of-a-kind technologies start out at a very high price because there is no competition (and often the item is costly to make).

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. The price will go down because they are cheaper to make and there is competition.