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## LESSON ONE

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# LESSON ONE BROAD SOCIAL GOALS OF ECONOMIC SYSTEMS

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### INTRODUCTION

The same basic problem confronts different economic systems. How each nation deals with the fundamental economic problem of scarce resources and unlimited wants is determined by its economic system. All economic systems strive to achieve a set of broad social goals, usually including economic freedom, efficiency, equity, growth, and stability. How wisely these goals are chosen and assigned priorities, and how successful an economy is at achieving these goals through its laws, public policies, and system of economic incentives, determines how well it improves the quality of life for its citizens. Different nations and types of economic systems tend to value some goals more than others. At the beginning of the 21<sup>st</sup> century, however, more and more nations are moving away from command economies, and relying on market systems to allocate their scarce resources.

### CONCEPTS

Broad social goals (efficiency, equity, freedom, growth, stability)

Command economy

Market economy

### CONTENT STANDARDS

Different methods can be used to allocate goods and services. People, acting individually or collectively through government, must choose which methods to use to allocate different kinds of goods and services.

### BENCHMARKS

There are essential differences between a market economy, in which allocations result

from individuals making decisions as buyers and sellers, and a command economy, in which resources are allocated by a central authority.

### OBJECTIVES

◆ Students explain how economic systems can be evaluated using broad social goals.

◆ Students evaluate the relative importance of the social goals in different economic systems.

◆ Students analyze data to determine the success of various countries in achieving their broad social goals and improving the quality of life of their citizens.

### LESSON DESCRIPTION

Students create their own utopian society by rating five broad social goals. They learn about characteristics of command economies and market economies and make judgments about the goals that are most valued in each type of system. Finally, using data that measure various kinds of national economic performance, they evaluate the economic systems of different countries using the five social goals.

### TIME REQUIRED

One to two class periods.

### MATERIALS

- Activity 1: Broad Social Goals, one per student, and a visual
- Activity 2: Comparing Command and Market Economies, one per student
- Activity 3: Social Goal Achievement, one per student
- Activity 4: Economic Performance Indicators, one per student, and a visual

### PROCEDURES

1. Explain to students that each economic system deals with the same basic economic problem: deciding how to use available resources to satisfy some of its citizens' wants

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for goods and services, but knowing that it is impossible to satisfy all of those wants. The public policies that are implemented to address this basic economic problem in different nations will depend at least partly on the value or importance each nation assigns to a set of broad social goals. These goals are ultimately the criteria used to evaluate an economic system; but people in different nations and with different types of economic systems often disagree about which of these goals is most important.

2. Display a visual of Activity 1 and distribute copies to each student. Review the definitions for each goal and make the following points.

A. Total economic freedom is not possible. Some individual freedoms must be restricted to benefit the general welfare of society. For example, it is illegal to buy or sell some kinds of goods and services (such as heroin and votes), and the legal obligation to pay taxes restricts people's ability to decide how to spend some part of their incomes. The sale or purchase of other kinds of products is often partially restricted (such as the sale of alcohol and tobacco products to minors). All societies establish laws that sometimes enhance and sometimes restrict economic freedom.

B. Economic growth is measured by an increase in **real gross domestic product** (GDP), or the annual level of national income adjusted for inflation. **Real GDP per capita** is real GDP divided by a nation's population. This provides a basic measure of a country's standard of living. To increase GDP per capita while its population is growing or stable, a country must increase the number of goods and services produced each year. A target annual growth rate of 3 to 4 percent in real GDP is generally considered to be a reasonable and sustainable goal, as long as the economy

is investing in capital resources and the education and training of workers, and there is some level of technological progress. Economic growth is closely related to other broad social goals. For example, it can lead to more jobs and lower levels of unemployment, greater economic efficiency, and provide additional resources to assist low-income families to reduce poverty and promote greater equity. Higher rates of economic growth are sometimes not sustainable, and can result in inflation. When that happens, a nation may have to accept lower levels of growth for a time, in order to curb inflation.

C. When workers are unemployed for a month or a year the goods and services they could have produced during that period are lost forever. That means that countries with high unemployment rates are wasting some of their most important scarce resources. In market economies, however, not all unemployment is undesirable because workers are free to change jobs to find the most desirable jobs, workplaces, and places to live. In the U.S. economy today, this kind of **frictional unemployment** accounts for an unemployment rate of about 4-5%. Unemployment rates above this level represent a different and much more serious kind of problem in the economy, such as slowing or decreasing levels of total spending.

**Inflation and deflation** are changes (increases and decreases, respectively) in the average level of prices for the goods and services produced in the economy. Unexpected changes in the price level hurt some groups of people and help others. For example, unexpected inflation hurts people on fixed incomes and people who have loaned out money at fixed interest rates, but helps those who have borrowed money at fixed

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interest rates. When price levels are stable, people and businesses don't have to spend time and effort to look for ways to protect their incomes and investments from inflation or deflation. In other words, price stability improves both economic security and the overall climate for investment.

D. Economic equity concerns issues of fairness, and there are no economic or scientific procedures to prove that something is fair or unfair. Nevertheless, people's beliefs about what is right and wrong are extremely important in discussions about many kinds of public policies, such as the level and type of income-assistance programs for low-income families, and the rate at which people who earn different levels of income should be taxed to pay for government programs.

E. Economic efficiency means an economy is producing as much as possible to satisfy peoples' wants. The general rule economists use to decide whether it is efficient to make more of any kind of output is to compare the value of the additional benefits and costs entailed. If the additional benefits exceed the additional costs, it is efficient to do it. If the additional costs exceed the additional benefits, it is inefficient and should not be done.

3. Tell students that they now have an opportunity to create their own utopian society. Explain that each student has 100 points to allocate across these different broad social goals. Have students write the number of points they would allocate to each goal in the space provided on Activity 1. For example, if students value economic freedom more than any of the other goals, they would give it a higher number of points. If they place relatively little value on economic stability, they would assign it a

smaller number of points. Make sure all students assign a total of 100 points.

4. Ask several students to tell how they distributed their 100 points and to explain their decisions. There will probably be a wide range of distributions. Ask students why this occurred. (*Students' values and preferences differ.*) Ask students if political leaders at the local and national level would likely show similar differences of opinion about these broad social goals. (*Members of different political parties, and even members of the same political party, regularly express different ideas about the relative importance of these kinds of goals. That explains a large part of their disagreements about spending priorities and tax reforms.*)

5. Tally the total number of points students in the class allocated for each goal and write that number on the visual next to each goal. Tell students this represents the utopian society preferred by the overall class. Explain that preferences of individual citizens may be different from those of a nation. An individual's support for an economic system depends largely on his or her acceptance of the nation's targeted economic goals. Save this information to use in the assessment activity.

6. Point out that just as individual students differ in how they value broad social goals, so too do supporters of different kinds of economic systems. Distribute copies of Activity 2. Have students read the descriptions of the two types of economic systems. Refer to the introductory essay by George Horwich to provide further background on each point. Discuss how each of the economic systems values the broad social goals:

- A. Freedom (**Market:** *Individual freedom is highly valued, reflected by private ownership of most resources.*  
**Command:** *Government restricts individual freedom, with many decisions made by central planners and*

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*government ownership of most natural and capital resources.)*

B. Growth (**Market:** *Efficient use of resources results from individual and business incentives to produce more and avoid waste. Specialization and trade encourage higher levels of output. Investments in capital and workers' education and training promote future growth in productive capacity and output. Command:* Central planners set growth targets and assign output quotas for different industries and firms. The production of consumer goods and services may be curtailed if planners want to focus on other sectors (e.g., military). Incentives to reduce waste are weak. Plant and equipment maintenance are often significant problems.)

C. Stability (**Market:** *The federal government conducts monetary policies – in the United States, through the Federal Reserve System – and uses fiscal policies to promote full employment (the 4-5 percent unemployment rates in the United States reflect frictional unemployment). Command:* Planners set prices thus controlling official measures of inflation, although shortages can make effective prices significantly higher than the prices set by planners. If high employment is a key goal, virtually no unemployment – even frictional unemployment from workers changing jobs – will be accepted. Higher employment may be achieved through high labor/capital ratios, which can reduce productivity, efficiency, and growth.)

D. Equity (**Market:** *Evaluation of equity is based more on voluntary exchange and equality of opportunity rather than equality of outcomes. Income depends on the value of labor and other resources an individual has to sell.*

*Some U.S. government spending and tax programs provide modest redistribution of income, but less so than in most other Western market economies. Command:* Wages can be set by government to provide greater equality of income, which some view as more equitable. V.I. Lenin and other communist leaders often claimed that they were eliminating the capitalist "exploitation" of labor. In practice, many command economies have substantial income inequality, because of high salaries and other forms of compensation for key government or political party officials, and other selected professionals such as military leaders and "star" athletes. Even if official salaries are low, better housing and other services make real incomes higher for these groups.)

E. Efficiency (**Market:** *Most allocation decisions are made by consumers and private firms in markets. Extensive specialization and international trade increase productivity and competition. Firms and consumers promote their self-interest by taking actions whenever additional benefits exceed additional costs. Command:* Allocation decisions are made by central planners, with few or no effective market signals and incentives. A focus on eliminating unemployment can lead to inefficient mixes of labor and capital resources. State-owned enterprises that are inefficient are rarely, if ever, allowed to fail.)

7. Distribute Activity 3. Ask students to rate how effective they think each country's economic system is in achieving each broad social goal by using a rating scale of 1 (poor) to 5 (excellent). Discuss the following questions:

A. Which social goals receive the greatest emphasis in a command economy? (*Equality of outcome but not*

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*opportunity, stability, and growth as determined in production goals set by central planners.)*

- B. Which goals are most important in a market economy? (*Freedom, efficiency, growth, equality of opportunity but not outcome.*)

8. Distribute a copy of Activity 4 to each student and display a visual of Activity 4. Explain to students that the degree to which social goals have been achieved can be measured, up to a point, by using certain data. Review the various indicators that are used and their definitions. Some indicators may need explanation:

- A. **Gross National Product (GNP)** is the total market value of all final goods and services produced by a country in one year. (The final product of bread includes such intermediate products as flour and milk. The value of these inputs is already included in the value of the final product, bread, so only the price of the bread is counted in GNP, not the price of the bread plus the price of the inputs used to make the bread.)
- B. GNP PPP is gross national product data for several countries converted to a common currency (dollars), based on exchange rates for the different national currencies that reflect **purchasing power parity (PPP)**. PPP exchange rates determine the equivalent values for two currencies by considering prices for all goods and services in the two nations. This differs from exchange rates that are determined only by the prices for imports and exports, which are reported every day in the financial press.
- C. The **GDP Implicit deflator** measures the average annual rate of price changes in a nation's economy.
- D. The **Gini index** measures the degree of income equality for the distribution of income (or in some cases consumption expenditures) across individuals or households in an economy. A Gini index of zero indicates perfect equality, where each person or household has the same income. A Gini index of 100 indicates perfect inequality, which would mean that the richest person or household in the country received all of the income, and all other people or households received nothing. (See Lesson 12 in this volume for more on Gini measures of equality.)
- E. The Index of Economic Freedom is a ranking of the world's economies on 10 broad categories: banking, capital flows and foreign investment, monetary policy, fiscal burden of the government, wages and prices, trade policy, government intervention in the economy, property rights, regulation, and black markets. The lower the index score, the higher the degree of economic freedom in the country. The data for this entry in Activity 4 are for 2000.
9. Discuss:
- A. Which country has the most economic freedom? (*United States*) The least? (*India*)
- B. Which country has the highest GNP PPP and GNP PPP/capita? (*United States*) the lowest? (*India*) Which country has the highest standard of living? (*United States*) The lowest? (*India*)
- C. Which countries had the greatest economic stability – low unemployment and stable prices? (*United States and Japan*) The least stability? (*Russia*) Why is Germany's unemployment rate so high? (*After the unification of East and West Germany, many former East*

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*Germans lost their jobs when the government-owned factories in which they were employed could not compete and were closed. Also, higher unemployment rates are common across Western Europe because of wage regulations related to government policies such as unemployment insurance.)*

- D. What does the Gini index tell you about income distribution in these countries? *(The United States, China, and Russia have the least income equality.)*

- E. What generalization can be made from these data about the level of economic freedom in a country and the general welfare of its citizens? *(Countries with high degrees of economic freedom have higher rates of GNP and economic growth, and their citizens appear to enjoy higher standards of living. These countries also tend to have low unemployment, stable prices, and high literacy rates.)*

10. Using the information from Activity 4, instruct students to reevaluate their ratings for each country on Activity 3. Cross out any old ratings that change and record the new ratings.

11. Discuss:

- A. Why does the United States score so high and India so low? *(The broad social goals can be used as criteria to judge how well an economy is doing. The U.S. fares well on all the criteria; India does not.)* What could be some reasons why India fares so poorly? *(High incidence of poverty, high levels of government regulation and control.)*

- B. Ask students how their ratings were similar to or different from the actual performance of the countries. Why do

they think this occurred? *(Answers will vary.)*

- C. Point out that no economic system is a pure command or a pure market economy, but some have more market or command characteristics than others. Ask students to rate the countries from most market oriented to least.

### CLOSURE

1. What are the basic social goals that can be used to evaluate an economy? *(Efficiency, equity, growth, freedom and stability.)*

2. Review the definitions of the social goals. *(See Activity 1.)*

3. Describe how a command economy and a market economy value the broad social goals. *(People and political leaders in all types of economic systems are likely to view all of the goals as important, but there are some general differences to be noted. Command economies tend to value stability and equality of outcome more than market economies. Central planners set prices, output quotas, capital and investment allocations, and sometimes even wages to insure that everyone is employed. The emphasis on growth is determined by central planners. Economic freedom is sacrificed to achieve goals that planners determine are best for the general welfare of society. Market economies tend to stress freedom, efficiency, and growth, and equality of opportunity more than equality of outcome.)*

4. How well are the broad social goals met by alternative economic systems? *(Countries that are more market oriented tend to perform better than centrally planned command economies on a wide range of outcomes.)*

5. Why are so many countries in the world moving toward a more market-oriented economy? *(Market economies tend to have high levels of economic freedom, growth, and income, and do reasonably well in terms of*

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*stability as well. Though often debated, many people believe that market economies are also preferred to command economies on the basis of equity, particularly in terms of equality of opportunity.)*

### ASSESSMENT

1. Instruct students to return to Activity 1. Display the visual of Activity 1. Write the following on the board:

"Using *either* your individual *or* the class rankings for the social goals, determine if the utopian society would likely be more market or command oriented, and justify your answer. Be sure to predict how the economy would fare on each of the social goals, and discuss what that would mean for the citizens of this nation."

## Activity 1

### Broad Social Goals

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\_\_\_\_\_ **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 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 (GDP) or real gross national product (GNP).

\_\_\_\_\_ **Economic Stability** refers to stable prices and full employment. Price stability means avoiding inflation, a rise in the average price level, or deflation, a fall in the average price level. Full employment means using all of an economy's scarce resources, particularly labor.

\_\_\_\_\_ **Economic Equity** refers to concerns about fairness in economic dealings. These concerns usually arise in evaluating exchanges, or the overall distribution of income. Some people judge equity based on providing equal opportunity, others based on the equality of outcomes. Public policies are often evaluated in terms of what people think is right or wrong, even though people often disagree about what is fair or unfair.

\_\_\_\_\_ **Economic Efficiency** means not wasting scarce resources. For a national economy that entails two things: 1) producing the goods and services people want most, and 2) economizing resources in the production of goods and services, so that the real costs of production are as low as possible.



## Activity 2

### Comparing Command and Market Economies

<b>In Command Economies</b>	<b>In Market Economies</b>
Government ownership of all nonhuman resources	Private ownership of all types of resources
Primary allocation of resources determined by central planners	Market prices direct products and resources
Income equality promoted by wages that are set by planners. Zero unemployment. State enterprises never fail because of government subsidies, permission to raise prices, or exemption from tax liabilities.	Income depends on the resources an individual has to sell. Some forms of unemployment are tolerated because of people changing jobs, changes in skills sought by employers, cyclical fluctuations, and seasonal changes in demand.
Central planners make production decisions to meet social goals, with limited consideration of consumer preferences. Consumers have no influence on price, quantity or quality of products produced.	Consumer demand is the driving force behind firms' production decisions.
Limited foreign trade to maintain economic independence	International specialization promotes competition and holds production costs and prices down
Prices usually set below the market clearing price ensure that goods are sold and control officially measured inflation.	Prices adjust to keep consumption and production at market equilibrium levels.

## Activity 3

### Social Goal Achievement

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Evaluate how successful you believe each country has been in achieving the social goals listed. Rate each country on each goal using a scale of 1 (poor) to 5 (excellent).

<b>Goal</b>	<b>China</b>	<b>Germany</b>	<b>India</b>	<b>Japan</b>	<b>U.S.</b>	<b>Russia</b>
<b>Freedom</b>						
<b>Growth</b>						
<b>Stability</b>						
<b>Equity</b>						
<b>Efficiency</b>						
<b>Overall Rating</b>						

# Activity 4

## Economic Performance Indicators

Indicator	China	Germany	India	Japan	U.S.	Russia
GNP PPP \$ (billions) 1998	3,983.6	1,708.5	1,660.9	2,928.4	7,922.6	579.8
GNP PPP/capita \$ 1998	3,220	20,810	1,700	23,180	29,340	3,950
GNP/capita 1997-1998 average annual percent growth rate	6.5	-0.4	4.2	-2.8	2.8	-6.3
GDP implicit deflator 1990-1998	9.8	2.2	7.5	0.4	2.2	235.3
Index of Economic Freedom 2000 <sup>a</sup>	3.4	2.20	3.80	2.15	1.80	3.70
Unemployment rate 1998 est.	3% <sup>b</sup>	10.6%	NA	4.4%	4.5%	11.5% <sup>c</sup>
Infant mortality /1000 live births 1998	32	5	70	4	7	17
Percentage 15 and older who read and write	81.5	99	52	99	97	98
Gini index 1999	45	28.1	29.7	24.9 (1995)	40.1	48 (1994)
Foreign Trade as percentage of GDP PPP 1998	8.3	55	3.9	21.3	19.9	14
Central Govt. revenue as percentage of GDP 1998	4.8	31	12	20.9 (GNP 1995)	21.9	17.9 (1997)
Percentage existing on less than \$2 PPP/day	57.8 (1995)	...	87.5 (1994)	...	...	10.9

Sources: The World Factbook 1999, Central Intelligence Agency; 2000 World Development Indicators, The World Bank; Entering the 21st Century World Development Report 1999/2000, The World Bank.

<sup>a</sup>Source: 2000 Index of Economic Freedom, The Heritage Foundation and the Wall Street Journal.

<sup>b</sup>Officially 3 percent urban, probably 8-10 percent because of substantial unemployment and underemployment in rural areas.

<sup>c</sup>Considerable underemployment

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