Economic Systems

AP Microeconomics | Unit 1 | who decides, incentives, and property rights

Running example. A city of 10 million eats bread every morning. Nobody plans how many loaves to bake, of which kind, or where, and the shelves are full anyway.

1. Three questions every economy answers

Because resources are scarce, every society must decide:

What to produce?	which goods, and how much of each
How to produce it?	with which resources and methods
For whom to produce it?	who gets what is made

An *economic system* is a society's method for answering these three questions.

2. Command, market, mixed

	Command economy	**Market economy**
Who owns resources?	the government	individuals and firms
Who decides?	central planners	buyers and sellers, through prices
Typical problem	weak incentives; shortages and surpluses	market failures (e.g. pollution)

Mixed economy

Mostly markets, with government setting rules, collecting taxes and providing some services. **Every real economy is mixed**; they differ in how much of each.

3. Prices are signals and incentives

More people want sourdough. Nobody announces it: sourdough sells out → its **price rises** → baking it becomes more profitable → bakers switch to sourdough.

A price does two jobs

Signal: it carries information (this good has become scarce).
Incentive: it gives a reason to act (sellers produce more, buyers use less).

An *incentive* is a reward or a penalty that changes what people choose to do. A price fixed by a planner breaks both jobs: the signal goes silent and the reason to produce more disappears.

4. Why property rights matter

Property rights: the legal right to own, use and sell a resource.

© 2026 S&D Academy

Pasture owned by one farmer	overgrazing destroys her own asset, so she limits the herd
Pasture shared by everyone	each extra cow benefits its owner; the damage is shared, the land is ruined

Clear, *enforced* property rights give people a reason to look after resources, to invest in them, and to trade. Where they are missing, markets work badly (the tragedy of the commons, Unit 6).

5. Property rights and markets, deeper

- A full property right is a bundle: **use** the resource and keep others out (so you invest and conserve), **sell** it (resources move to whoever values them most; if titles cannot be sold, land stays with owners who value it least), **pledge** it as collateral (titled land secures loans and opens up credit).
- **Patents** are property rights to ideas: stop enforcing them and copying rises while innovation falls.
- **For whom** (market economy): goods go to those with purchasing power, from income earned in factor markets (wages, rent, interest, profit).
- **Profits** draw firms in; persistent **losses** make them exit and move resources to uses people value more.
- In a **command** economy managers rewarded for output quotas maximize volume and ignore quality: incentives follow the reward.
- A **mixed** economy uses markets for most goods and government for public goods (non-excludable, non-rival, such as national defense).

Where students lose points

1. Saying a market economy has no government at all.
2. Naming the system without saying who owns resources and who decides.
3. Treating a price as only a cost, not as a signal and an incentive.
4. Explaining behavior by "greed" instead of by the incentive.
5. Forgetting that property rights must be enforced to matter.

Now practise it

Theory sticks once you use it. On **sad-academy.com** you'll find practice questions for this exact subtopic in the AP format, and an AI that grades your free-response answers against the scoring guidelines, the way an AP reader would.

sad-academy.com

Data are hypothetical. AP® is a registered trademark of College Board, which is not affiliated with and does not endorse this material.

 © 2026 S&D Academy