TO THE TEACHER

The Economics: Principles and Practices Daily Lecture Notes booklet provides detailed outlines for each section of the student textbook, page number references, and discussion questions to encourage student participation in classroom activities. Each section begins with a short, high-interest “Did You Know” anecdote.
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DID YOU KNOW?

We witness scarcity with each year’s “hot” new toy. Inspired by hunter President Teddy Roosevelt, Americans coveted the teddy bear in 1906. Cabbage Patch dolls were big during the 1980s, as were Tickle Me Elmos in 1996. By 1999 Game Boy’s Pokémon was the rage with a 10-cent trading card. The most-prized first-edition pocket monsters were in such short supply that they commanded from $8 to $182.

PAGES 5-6

I. The Fundamental Economic Problem

A. Scarcity is the condition where unlimited human wants face limited resources.
B. Economics is the study of how people satisfy wants with scarce resources.
C. Needs are required for survival; wants are desired for satisfaction.
D. Someone has to pay for production costs, so There Is No Such Thing As A Free Lunch (TINSTAFL).

Discussion Question

Why do you think scarcity is an issue with the rich as well as the poor? (It is a human trait that few people, regardless of their economic status, are satisfied with what they have.)

PAGES 6-7

II. Three Basic Questions

A. What must we produce? Society must choose based on its needs.
B. How should we produce it? Society must choose based on its resources.
C. For whom should we produce? Society must choose based on its population and other available markets.

Discussion Question

How might the economic decisions of a mountainous island society differ from those of a mountainous landlocked society? (An island society has water resources to consider and likely a more limited population.)
III. The Factors of Production

A. Factors of production are resources necessary to produce what people want or need.
B. Land is the society’s limited natural resources—landforms, minerals, vegetation, animal life, and climate.
C. Capital is the means by which something is produced such as money, tools, equipment, machinery, and factories.
D. Labor is the workers who apply their efforts, abilities, and skills to production.
E. Entrepreneurs are risk-takers who combine the land, labor, and capital into new products.
F. Production is creating goods and services—the result of land, capital, labor, and entrepreneurs.

Discussion Question
Why are entrepreneurs an economy’s driving force? (Their abilities to start new businesses and introduce new products may re-energize a sluggish economy or strengthen a successful economy.)

IV. The Scope of Economics

A. Economics deals with the description of economic activity—Gross Domestic Product, unemployment rate, government spending, tax rates, etc.
B. Analysis looks at the “why” and “how” of economic activity—why prices go up and down, for example, or how taxes affect savings.
C. Explanation refers to how economists communicate knowledge of the economy and its activities to the society’s population.
D. Prediction refers to how yesterday’s and today’s economic activities advise us of potential future activity.

Discussion Question
What makes economics a social science? (Economics is a study of human behavior because it looks at the decisions people make and how they react to those decisions.)
**DID YOU KNOW?**

The 20 percent of the world’s people who live in the wealthiest nations consume 86 percent of the world’s goods and services. The 20 percent who live in the poorest nations consume just 1.3 percent.

**PAGES 12-13**

I. Goods, Services, and Consumers

A. Goods are items that are economically useful or satisfy an economic want. They are tangible and can be classified as consumer/capital and durable/nondurable.

B. Services are work performed for someone and are intangible.

C. Consumers use goods and services to satisfy wants and needs.

**Discussion Question**

Why do you think the United States has been called a “society of consumption”? *(Answers will vary. Students should support their opinions with examples.)*

**PAGES 13-14**

II. Value, Utility, and Wealth

A. Value is worth expressed in dollars and cents. Scarcity by itself is not enough to create value. For something to have value, it must also have utility.

B. Utility is a good’s or service’s capacity to provide satisfaction, which varies with the needs and wants of each person.

C. Wealth is the accumulation of goods that are tangible, scarce, useful, and transferable to another person. Wealth does not include services.

**Discussion Question**

Why might a wealthy society not have as much economic staying power as another wealthy society with a highly skilled labor force? *(Answers will vary. Students may indicate that wealth is usually based on limited natural resources, whereas labor can produce more goods and services.)*
III. The Circular Flow of Economic Activity

A. Markets are locations/mechanisms for buyers and sellers to trade. They are classified as local, regional, national, global, and cyberspace.

B. A factor market is where people earn their incomes. Factor markets center on the four factors of production: land, capital, labor, and entrepreneurs.

C. A product market is where people use their income to buy from producers. Product markets center on goods and services.

Discussion Question
How are landlords a part of a factor market? (They provide land or property [a factor of production] to consumers in exchange for rent money, which is the landlords’ source of income.)

IV. Productivity and Economic Growth

A. Productivity is a measure of the amount of output produced by the amount of inputs within a certain time. Productivity increases with efficient use of scarce resources.

B. Specialization and division of labor may improve productivity because they lead to more proficiency (and greater economic interdependence).

C. Investing in human capital improves productivity because when people’s skills, abilities, health, and motivation advance, productivity increases.

D. Economic growth depends on high productivity. Yet, an economy’s productivity may be affected by its interdependence—reliance on others and their reliance on us to provide goods and services.

Discussion Question
How may economic interdependence be a strength of an economy? A weakness? (Answers will vary. Students may indicate that the economy may gain larger, more diverse markets, leading to greater income and productivity. But the economic problems of those additional markets [customers or suppliers] may adversely affect the economy’s production output or customer base.)
Did You Know?

Economists reward their greatest for breakthrough discoveries. The 1999 Nobel Prize for Economics went to Robert A. Mundell, a Canadian economist at New York’s Columbia University, for his career-long work in international currency exchange rates, vital in today’s global marketplace. The prize is worth a million dollars in U.S. currency.

I. Trade-Offs and Opportunity Cost

A. Trade-offs are the alternative choices people face in making an economic decision. A decision-making grid lists the advantages and disadvantages of each choice.

B. Opportunity cost is the cost of the next best alternative among a person’s choices. The opportunity cost is the money, time, or resources a person gives up, or sacrifices, to make his final choice.

Discussion Question

Why do you think economists believe opportunity cost is an important factor to consider in addition to monetary cost? (The money, time, or resources given up when one choice is made rather than another are just as important as the monetary cost of the choice that was made.)

II. Production Possibilities

A. The production possibilities frontier diagram illustrates the concept of opportunity cost. It shows the combinations of goods and/or services that can be produced when all productive resources are used. The line on the graph represents the full potential—the frontier—when the economy employs all of these productive resources.

B. Identifying possible alternatives allows an economy to examine how it can best put its limited resources into production.

C. Considering different ways to fully employ its resources allows an economy to analyze the combination of goods and services that leads to maximum output.

D. An economy pays a high cost if any of its resources are idle. It cannot produce on its frontier and it will fail to reach its full production potential.

E. Economic growth made possible by more resources, a larger labor force, or increased productivity causes a new frontier for the economy.
Discussion Question

How might economic growth stimulate greater production possibilities? (Answers will vary. Students may indicate that with a larger labor force, more goods and services are created; newly discovered natural resources open up new products and services.)

III. Thinking Like an Economist

A. Building simple models helps economists analyze or describe actual economic situations.
B. Cost-benefit analysis helps economists evaluate alternatives by looking at each choice’s cost and benefit.
C. Taking small, incremental steps in implementing an economic decision helps economists test whether the estimated cost of the decision was correct.

Discussion Question

What behaviors and personality traits might you observe in the most successful economists? (Answers will vary. Students should support their opinions with a rationale.)

PAGES 23-24

IV. The Road Ahead

A. Studying economics will help us know how the economy works on a daily basis.
B. It helps us understand a free enterprise economy, where people and privately owned businesses rather than the government make the majority of the economic decisions.
C. The study of economics helps us to become better decision makers.
D. The world of economics is complex and dynamic, as is our society.

Discussion Question

What single economic goal have you set for yourself as a result of your study of economics? (Answers will vary. Students must indicate an economic goal rather than an educational goal.)
DID YOU KNOW?

In the United States, individuals usually make their own economic decisions. Sometimes, however, the government makes choices that override individual decisions. During World War II, for example, the government limited the production of such goods as washing machines, refrigerators, and automobiles so that the resources normally used to produce those goods could instead be used to make armaments and other goods essential to winning the war.

PAGES 33-35

I. Traditional Economies
   A. In a traditional economy, roles and economic decisions are defined by custom.
   B. Examples include the central African Mbuti, the Australian Aborigines, and northern Canada’s Inuits.
   C. The advantages of a traditional economy is that everyone knows which role to play and there is little uncertainty about WHAT, HOW, and FOR WHOM to produce.
   D. A disadvantage of a traditional economy is the discouragement of new ideas and new ways of thinking. This leads to a lower standard of living than in other societies.

Discussion Question

How would your life be different if you had grown up in a traditional economy? (Students should indicate that they would be able to make no economic decisions on their own.)

PAGES 35-36

II. Command Economies
   A. In a command economy, a central authority determines WHAT, HOW, and FOR WHOM to produce.
   B. Command economies include North Korea, Cuba, the former Soviet Union, and the People’s Republic of China.
   C. There are two advantages to a command economy: the ability to drastically change direction in a relatively short period of time and many basic health and public services are available at little or no cost.
   D. There are several disadvantages to a command economy: consumer needs may not be met; hard work is not rewarded; the necessary decision-making bureaucracy delays decisions; little flexibility to deal with day-to-day problems; and individual initiative goes unrewarded.
Discussion Question

In what ways are traditional and command economies alike? In what ways are they different? (In both, production decisions are already made and individual initiative is discouraged. In traditional economies, the individual’s role is defined by customs, while in command economies, a central authority defines the individual’s role.)

III. Market Economies

A. In a market economy, producers and consumers determine WHAT, HOW, and FOR WHOM to produce. In each market transaction, the consumer’s dollar acts like a “vote,” ensuring that producers continue to bring to market the goods and services that consumers want to buy.

B. Examples include the United States, Canada, Japan, South Korea, Singapore, and parts of Western Europe.

C. There are numerous advantages to a market economy: the ability to adjust to change; the high degree of individual freedom; the small degree of government involvement; the ability to have a voice in the economy; the variety of goods and services created; and the high degree of consumer satisfaction.

D. Disadvantages to a market economy include the inability of the market to meet every person’s basic needs. Markets also do an inadequate job of providing some highly valued services such as justice, education, and health care. Citizens of a market economy must also face a high level of personal uncertainty and the prospect of economic failure.

Discussion Question

In the 1990s, many countries, especially in Eastern Europe, moved from command economies toward market economies. What problems do you think they faced as they made this change? (Answers will vary. Students may say that command economies do not foster initiative or hard work, on which a market economy relies. This means that people would have to learn new attitudes toward work and new ways of working before a market economy could be successful.)
A minimum wage was mandated by the federal government with passage of the Fair Labor Standards Act in 1938. That federal law set the nation’s minimum wage at 25 cents per hour. About 40 states also have set minimum wages, but those usually are lower than the nationally set minimum wage.

The economic goals are:

I. Economic and Social Goals

   A. Economic freedom, or the freedom for people to make their own economic decisions, is a goal highly valued in the United States.

   B. Economic efficiency means that resources are used wisely and that the benefits gained are greater than the costs incurred.

   C. Economic equity is the social goal that explains why so many people support laws against wage and job discrimination.

   D. Economic security is a social goal that results in programs to help support the ill, the elderly, and workers who have lost their jobs.

   E. Most economic systems strive for full employment, or providing as many jobs as possible.

   F. Price stability, or freedom from inflation, is important to anyone trying to provide basic necessities on a limited income and for anyone planning their economic future.

   G. Economic growth is an important goal because populations tend to increase and existing populations tend to want more goods and services.

Discussion Question

In your opinion, which of these economic goals is most important? Why? (Answers will vary. Students may support their choices by explaining what would happen if the goal was not met.)
II. Trade-Offs Among Goals

A. When goals are at odds, people must compare costs to benefits before resolving the conflict.

B. Most of the time, people, businesses, and government are able to work out conflicts among goals.

C. The flexibility of the American economic system allows choices and compromises.

Discussion Question

The idea of a minimum wage supports the goal of economic equity. With which goals does the idea of a minimum wage conflict? (Students may say that a minimum wage conflicts with the goal of economic freedom, because business owners cannot freely choose what to pay their employees. It may conflict with the goal of full employment if the minimum wage leads to a loss of jobs. It also may conflict with the goal of price stability if business owners must raise prices to cover the costs of paying a minimum wage.)
Did you know?

Bill Gates is perhaps the nation’s most successful entrepreneur. In 1975 he cofounded Microsoft Corporation, and 20 years later that company made him the world’s richest man. But in 1998, the federal government took Microsoft to court. The government charged that the software giant used unfair practices to try to put its competition out of business. In 1999 the court agreed with the government and found Microsoft guilty of antitrust practices.

Pages 46-48

I. Competition and Free Enterprise

A. Capitalism is a market economy in which private citizens own the factors of production. In a free enterprise system, there is limited government interference and businesses are free to compete.

B. With economic freedom, people and businesses make their own economic choices.

C. The result of voluntary exchange, in which buyers and sellers are free to decide whether or not to complete a transaction, results in both buyers and sellers believing that the good or service obtained is of more value than the money or product given up.

D. Private property rights motivate people to succeed. Any rewards they earn are kept.

E. The profit motive encourages entrepreneurship and is largely responsible for the growth of a free enterprise economy.

F. Competition among sellers helps lower prices.

Discussion Question

In your opinion, which of the five characteristics of a free enterprise economy encourages entrepreneurship the most? (Answers will vary. Students should support their opinions with explanations regarding the importance of each characteristic of a free enterprise economy.)

Pages 48-49

II. The Role of the Entrepreneur

A. Entrepreneurs use land, capital, and labor to make a profit.

B. When an entrepreneur is successful, everybody benefits. Successful entrepreneurs attract other firms to the industry.

C. The entrepreneur’s search for profits leads to new products, greater competition, more production, higher quality, and lower prices for consumers.
Discussion Question
What would you find most attractive about owning your own business? What would be least attractive to you? (Answers will vary but may reflect the element of risk involved in entrepreneurship.)

PAGES 49-50

III. The Role of the Consumer

A. The consumer has much power in a free market economy. Consumer sovereignty describes the role of the consumer as ruler of the market.

B. Consumers in the American economy express their wants in the form of purchases in the marketplace. The dollars they spend are the “votes” used to select the most popular products.

Discussion Question
How are entrepreneurs and consumers dependent on each other? (Students may say that entrepreneurs make goods available to consumers, while consumers guide entrepreneurs regarding what will and will not successfully sell.)

PAGES 50-51

IV. The Role of Government

A. As a protector, a government may pass and enforce laws meant to prevent the abuse of consumers and workers.

B. Governments are both providers and consumers. The U.S. government provides education and welfare and is the second largest consuming group in the economy after consumers.

C. As a regulator, the government works to preserve competition.

D. The promoting of national goals is an important role of any government. In the United States, achieving economic equity and security has resulted in a mixed economy, or modified private enterprise economy.

Discussion Question
How would our economy be different if it were a pure free enterprise economy rather than a mixed economy? (Answers will vary. Students should support their opinions with examples.)
DID YOU KNOW?

In 1997 Dun & Bradstreet reported that corporation start-ups increased by 2 percent to reach a new high of 798,917. New corporations in Florida and New York represented 25 percent of that total.

PAGES 57-59

I. Sole Proprietorships

A. A sole proprietorship is a business run by one person. It is the smallest type of business organization in size, yet the most numerous and profitable.

B. The advantages to sole proprietorships are: ease of start-up; ease of management; owner gets all the profits; business itself pays no income taxes; taxes paid only on the owner's personal income; psychological satisfaction of owning one's business; ease of closing the business.

C. The disadvantages to sole proprietorships are: the owner has unlimited liability; it is hard to raise financial capital; owner may not be able to hire enough personnel or stock enough inventory to operate efficiently; owner may have limited managerial experience; hard to attract qualified employees; business has limited life and legally stops existing when the owner dies or sells the business.

Discussion Question

Why do you think so many business owners are sole proprietors despite the fact that they hold unlimited liability? (Answers will vary. Students should support their opinions with a rationale.)

PAGES 60-62

II. Partnerships

A. A partnership is a business jointly owned by two or more persons. It is the least numerous among business organizations and has the second smallest proportion of sales and net income.

B. General partnerships are a type of business in which all partners are involved in the management and finances. In a limited partnership, at least one partner is not involved in management. This partner may have helped to finance the business.

C. Articles of the partnership document spell out how the partners divide up the profits or losses.
D. The advantages of partnerships are: the ease of start-up; ease of management; no special taxes on a partnership; easier to raise capital through bank loans or new partner; larger size aids efficient operations; easier to attract skilled employees.

E. The disadvantages of partnerships are: partners are responsible for the acts of each and every partner, except in a limited partnership where the limits are spelled out; limited life of partnerships ends if a partner leaves; potential for partner conflicts.

**Discussion Question**

Which type of partnership would you favor—general or limited? *(Answers will vary. Students should support their positions with a rationale.)*

**III. Corporations**

A. A corporation is a business organization recognized by law as a separate legal entity with all the rights of an individual.

B. Corporations receive a charter, or government permission to create a corporation, which includes details about stock ownership.

C. Investors who buy common or preferred stock in a corporation become owners of the firm.

D. The advantages of corporations are: ease of raising capital; professionals may run the firm instead of the owners *(shareholders)*; owners have limited liability; business's life is unlimited; easy to transfer ownership.

E. The disadvantages of corporations are: a charter is expensive; ownership and management are separated so shareholders have little say in running the business; corporate income is taxed twice; subject to government regulation.

**Discussion Question**

Who are really the owners of a corporation? *(stockholders)*

**IV. Government and Business Regulation**

A. Federal and state governments regulate interest rates and utility rates.

B. State governments may offer industrial development bonds to help industries relocate or tax credits to draw investments.

**Discussion Question**

What are some recent examples of business development incentives in your state or community? *(Answers will vary. Students should describe what the proposed benefit offers.)*
DID YOU KNOW?
The federal government’s Bureau of Economic Analysis reported that, in contrast to the American public’s suspicions, U.S.-based multinational companies do not establish most of their manufacturing affiliates in low-wage countries. In 1996, 87 percent of U.S. multinational affiliates’ employment was reported in relatively high-wage countries, primarily in Europe.

PAGES 68-69
I. Growth Through Reinvestment
   A. Business revenue can be used to invest in factories, machinery, or new technologies.
   B. Before reinvesting, a business must estimate its cash flow. The business first records its total sales and then subtracts all expenses, taxes, and depreciation. The result is the business’s net income.
   C. Depreciation is added back to net income to get cash flow, or the bottom line—the real measure of business profit.
   D. Business owners then decide whether part of the cash flow should be reinvested in the business to generate additional sales and more profits.

Discussion Question
What do you predict may happen when a business has little or no cash flow? (Answers will vary. Students should indicate that without additional machinery and newer technologies, the business will eventually lose business to its competitors.)

PAGES 69-73
II. Growth Through Mergers
   A. When firms merge, one gives up its separate legal identity.
   B. A company may merge with another to grow faster; become more efficient; acquire or deliver a better product; eliminate a rival; or change its image.
   C. A horizontal merger is the joining of firms that make the same product. A vertical merger is the joining of firms involved in different stages of manufacturing or marketing.
   D. A conglomerate is composed of four or more businesses, each making unrelated products, none of which is responsible for a majority of its sales.
   E. A multinational is a corporation with manufacturing and service operations in several countries, which are subjected to each nation’s business regulations.
Discussion Question

Why have some multinational companies been criticized? (Answers may include: paying low wages to workers, exporting scarce natural resources, driving out local businesses. Discuss with students that economists believe the advantages of multinationals outweigh the disadvantages.)
DID YOU KNOW?

The National Center for Charitable Statistics reported that nearly 1.5 million organizations had registered with the federal government in 1997 as tax-exempt, private nonprofit organizations. Because some organizations do not need to register with the Internal Revenue Service, this number does not include all types of nonprofit organizations described in Section 3.

PAGES 75-76

I. Community and Civic Organizations

A. A nonprofit organization is in business to promote its members’ collective interests, not to seek financial gain.

B. Many nonprofit organizations incorporate to take advantage of a corporation’s unlimited life and limited liability.

C. If the nonprofit organization has money after its expenses are paid, its board of directors may apply the surplus to other projects that further the organization’s mission.

一口Discussion Question

How might a hospital’s board of directors decide to spend a year’s surplus? (Answers will vary. Students should support their examples with how the product or service benefits a hospital’s mission of helping the sick.)

PAGE 76

II. Cooperatives

A. A cooperative is voluntary association of people who carry on an economic activity that benefits its members.

B. Consumer cooperatives buy food and other necessities in bulk. Members donate time to the co-op, and members pay lower prices for goods.

C. Service cooperatives, such as credit unions, offer services to its members at lower rates.

D. Producer cooperatives help members, such as farmers, promote or sell their products.

一口Discussion Question

Why might a credit union member qualify for a car loan from the credit union in a shorter time than for a car loan from a car dealer or a bank? (The loan approval officer likely knows the member much better than the dealer or the banker does.)
III. Labor, Professional, and Business Organizations

A. Labor unions represent workers’ interests and negotiate with management through collective bargaining.

B. Professional associations set standards for those in the profession and influence government policies on issues concerning members’ interests.

C. Business associations are industries or trade associations that represent specific kinds of businesses. Some business associations, such as the Better Business Bureau, help protect the consumer.

Discussion Question
The National Council for the Social Studies is a professional association for social studies teachers. What might it offer its members? (Answers will vary, but students may indicate publications with social studies lesson plans, standards for social studies courses, and conferences for teachers.)

IV. Government

A. Government plays a direct role in the economy when its agencies produce and distribute goods and services to consumers such as the Tennessee Valley Authority (electricity), and the U.S. Postal Service (stamps and mail delivery).

B. Government corporations have boards of directors, but Congress’s money rather than investors’ money supports their work.

C. Government plays an indirect role when it regulates public utilities or when it grants money to people in the form of Social Security and student financial aid.

Discussion Question
National and local security come under the jurisdiction of the federal and local governments. How do national defense and local police protection directly and indirectly impact the economy? (The labor and goods purchased to run a police department or support the military have a direct influence on the economy. Indirect influences include the expectation among citizens that their wealth and belongings will be protected.)
DID YOU KNOW?

In summer 1999, the American Automobile Association announced that gasoline prices in Illinois had reached a 20-month high. A spokesperson for the gasoline industry explained that this rise in prices had several causes, including unexpected problems at refinery plants and decisions from oil-producing countries to cut back on production. Regardless of the reasons, it was expected that people living in Illinois would respond to the higher prices by limiting the time they spent driving, thus reducing their demand for gas.

PAGES 89-91

I. An Introduction to Demand

A. Demand is the desire, ability, and willingness to buy a product.

B. An individual demand curve illustrates how the quantity that a person will demand varies depending on the price of a good or service.

C. Economists analyze demand by listing prices and desired quantities in a demand schedule (chart). When the demand data is graphed, it forms a demand curve with a downward slope.

Discussion Question

Think about something you have been wanting to buy. What is its price? At what price would you be willing to buy the item? (Answers will vary, but students should demonstrate an understanding of the concept of demand.)

PAGES 91-92

II. The Law of Demand

A. The Law of Demand states that the quantity demanded of a good or service varies inversely with its price. When price goes up, the quantity demanded goes down; when price goes down, the quantity demanded goes up.

B. A market demand curve illustrates how the quantity that all interested persons (the market) will demand varies depending on the price of a good or service.

Discussion Question

Why is price a consumer’s obstacle to buying? (Answers will vary but may include that a consumer’s money is limited, and the price of a product forces the consumer to determine how much his or her demand is for the product.)
III. Demand and Marginal Utility

A. Marginal utility is the extra usefulness or satisfaction a person receives from getting or using one more unit of a product.

B. The principle of diminishing marginal utility states that the satisfaction we gain from buying a product lessens as we buy more of the same product.

Discussion Question

You have read about buying a cola as an example of diminishing marginal utility. What is another case in which more product gives less satisfaction? (Answers will vary, but students should demonstrate an understanding of the concept of diminishing marginal utility.)
DID YOU KNOW?

In 1983, the first audio compact discs were introduced to U.S. consumers. Within five years, record companies had begun to phase out the vinyl albums on which music was traditionally played because sales figures had shown that consumers preferred CD technology.

PAGES 95-96

I. Change in the Quantity Demanded
   A. The change in quantity demanded shows a change in the amount of a product purchased when there is a change in price.
   B. The income effect means that as prices drop, consumers are left with extra real income.
   C. The substitution effect means that price can cause consumers to substitute one product with another similar but cheaper item.

Discussion Question

Imagine you have a weekly budget for groceries. When you shop one week, certain items you needed were on sale, and after you paid the cashier, you had $20 left. What would you do with the extra money? (Answers will vary. Students should explain how their responses illustrate the income effect.)

PAGES 96-99

II. Change in Demand
   A. A change in demand is when people buy different amounts of the product at the same prices.
   B. A change in demand can be caused by a change in income, tastes, a price change in a related product (either because it is a substitute or complement), consumer expectations, and the number of buyers.

Discussion Question

Although CDs are by far today’s most popular form of musical recording, interest in “vinyls” (the word people now use to refer to the old vinyl albums) is growing. What might happen to the demand for vinyls as interest increases? (Students should indicate that increased interest probably will lead to an increase in demand for vinyls.)
**DID YOU KNOW?**

The drugs needed to get or stay well can take a large portion of a consumer’s income, especially if that income is fixed. However, the use of generic drugs has offered consumers a cheaper alternative to drugs with brand names. After the founding drug company’s patent on a brand-name drug has expired, another drug company can create a generic drug.

**PAGES 101-103**

I. Demand Elasticity

A. Elasticity measures how sensitive consumers are to price changes.

B. Demand is elastic when a change in price causes a large change in demand.

C. Demand is inelastic when a change in price causes a small change in demand.

D. Demand is unit elastic when a change in price causes a proportional change in demand.

**Discussion Question**

What are examples of items for which an increase in price would cause you or your family to reconsider buying them? (*Answers will vary but should illustrate an understanding of elastic demand.*)

**PAGES 103-105**

II. The Total Expenditures Test

A. Price times quantity demanded equals total expenditures.

B. Changes in expenditures depend on the elasticity of a demand curve—if the change in price and expenditures move in opposite directions on the curve, the demand is elastic; if they move in the same direction, the demand is inelastic; if there is no change in expenditures, demand is unit elastic.

C. Understanding the relationship between elasticity and profits can help producers effectively price their products.

**Discussion Question**

What are examples of items for which a drop in price would not encourage you to buy more of an item? (*Answers will vary but should reflect an understanding of the relationship between demand and elasticity.*)
III. Determinants of Demand Elasticity

Demand is elastic if the answer to the following questions are “yes.”

A. Can the purchase be delayed? Some purchases cannot be delayed, regardless of price changes.

B. Are adequate substitutions available? Price changes can cause consumers to substitute one product for a similar product.

C. Does the purchase use a large portion of income? Demand elasticity can increase when a product commands a large portion of a consumer’s income.

Discussion Question

What are some things you buy for which price is not the issue? (Answers will vary but should reflect items whose purchases cannot be delayed, regardless of price.)
The energy crisis of the 1970s encouraged countries to look to nuclear reactors, fueled by uranium, as a new energy source. When public utility companies stockpiled uranium, uranium prices rose as they competed to get adequate supplies. Rising prices for uranium stimulated uranium exploration. Entrepreneur-explorers discovered deposits in Australia, Africa, and North America. Yet, slow expansion of nuclear power along with burgeoning stockpiles of uranium caused uranium prices to fall by the late 1980s to one eighth of the highest price offered ten years before.

I. An Introduction to Supply

A. Supply is the amount of a product that would be offered for sale at all possible prices in the market.

B. The Law of Supply states that suppliers will normally offer more for sale at high prices and less at lower prices.

C. An individual supply curve illustrates how the quantity that a producer will make varies depending on the price that will prevail in the market. A market supply curve illustrates the quantities and prices that all producers will offer in the market for any given product or service.

D. Economists analyze supply by listing quantities and prices in a supply schedule (table). When the supply data is graphed, it forms a supply curve with an upward slope.

Discussion Question

How do you explain that prices and quantities move in the same direction in a supply schedule? (Producers will produce high quantities at the highest prices and low quantities at the lowest prices.)

II. Change in Quantity Supplied

A. A change in quantity supplied is the change in the amount offered for sale in response to a change in price.

B. Producers have the freedom, if prices fall too low, to slow or stop production or leave the market completely. If the price rises, the producer can step up production levels.
Discussion Question
What steps do you suppose a producer must go through in setting an introductory price for a product it brings to the market for the first time? (Answers will vary but students may indicate that the producer must study the pricing system for similar products and risk that competing producers, in short order, will offer a like product at a lower price.)

III. Change in Supply
A. A change in supply is when suppliers offer different amounts of products for sale at all possible prices in the market.
B. Factors that can cause a change in supply include: the cost of inputs; productivity levels; technology; taxes or the level of subsidies; expectations; and government regulations.

Discussion Question
Why does using new technology almost always increase supply? (It generally leads to greater efficiency, which lowers production costs, even though producers must initially train workers and adapt or create new production processes that accommodate the new technology.)

IV. Elasticity of Supply
A. Supply is elastic when a small increase in price leads to a larger increase in output—and supply.
B. Supply is inelastic when a small increase in price causes little change in supply.
C. Supply is unit elastic when a change in price causes a proportional change in supply.
D. Determinants of supply elasticity are related to how quickly a producer can act when the change in price occurs. If adjusting production can be done quickly, the supply is elastic. If production is complex and requires much advance planning, the supply is inelastic. Another factor is substitution: if substituting for a given product is easy, the supply is elastic; if it is difficult to substitute, the supply is inelastic.

Discussion Question
What is the difference between demand elasticity and supply elasticity? (Both measure the way quantity [whether bought or produced] adjusts to a change in price.)
DID YOU KNOW?

Industrial production managers held about 255,418 jobs in 2000. In many plants, one production manager is responsible for all aspects of production. In large plants with several operations, managers are in charge of each operation, such as machining, assembly, or finishing. Many have a college degree in business administration or industrial engineering. Some have a master’s degree in business administration (MBA). Some have worked their way up the ranks after having worked as supervisors in other industries.

PAGES 122-123

I. Law of Variable Proportions

A. In the short run, output will change as one variable input is altered, but other inputs are kept constant.

B. The Law of Variable Proportions looks at how the final product is affected as more units of one variable input or resource are added to a fixed amount of other resources.

C. Economists prefer that only a single variable be changed at any one time so the impact of this variable on total output can be measured.

Discussion Question

Imagine you have a sales job in which you are evaluated on the number of sales transactions you make per shift. What changes could you make in your “labor” that might improve the number of sales you generate? (Answers will vary. Students should explain how their recommendations illustrate the Law of Variable Proportions.)

PAGES 123-124

II. The Production Function

A. This concept illustrates the Law of Variable Proportions within a production schedule or a graph.

B. It describes the relationship between changes in output to different amounts of a single input while others are held constant.

C. Total product is the total output the company produces: a production schedule shows that, as more workers are added, total product rises until a point that adding more workers causes a decline in total product.

D. Marginal product is the extra output or change in total product caused by adding one more unit of variable input.
Discussion Question
From your experience in working in groups for a class assignment, how many students make up a productive team? When is adding more group members likely to "cause a decline in total product"? (Students should support their opinions with examples.)

III. Three Stages of Production

A. In Stage I (increasing returns), marginal output increases with each new worker. Companies are tempted to hire more workers, which moves them to Stage II.

B. In Stage II (diminishing returns), total production keeps growing but the rate of increase is smaller; each worker is still making a positive contribution to total output, but it is diminishing.

C. In Stage III (negative returns), marginal product becomes negative, decreasing total plant output.

Discussion Question
What skills and personality traits would help make an effective production manager? (Answers will vary. Students should support their answers with a rationale as to how each skill or trait relates to analyzing production inputs, outputs, and total product.)
DID YOU KNOW?

During the early 1990s, the hotel-motel industry faced major revenue challenges. The sluggish economy of 1991 meant mediocre occupancy rates of only 60.1 percent. The market allowed only slight room price increases in line with inflation. A limited-service hotel-motel industry gained popularity, keeping prices competitive. To ride the times out, the full-service hotel-motel industry employed several cost-cutting strategies—it moderated salary raises among its top executives (fixed costs), refinanced debt at lower interest rates, and kept other variable costs down.

PAGES 127-129

I. Measures of Cost

A. Fixed costs are those that a business has even if it has no output. These include management salaries, rent, taxes, and depreciation on capital goods.

B. Variable costs are those that change when the rate of operation or production changes, including hourly labor, raw materials, freight charges, and electricity.

C. Total cost is the sum of all fixed costs and all variable costs.

D. Marginal cost is the extra (variable) costs incurred when a business produces one additional unit of a product.

Discussion Question

What are the fixed costs of running a high school? The variable costs? (Answers will vary, but students should consider fixed costs as including expenses during the months that school is not in session.)

PAGES 129-130

II. Applying Cost Principles

A. A self-service gas station is an example of high fixed costs with low variable costs. The ratio of variable to fixed costs is low.

B. E-commerce is an example of an industry with low fixed costs.

Discussion Question

What might be among an e-seller’s fixed costs? (Answers will vary but may include: computer equipment and software, training in Web site development, Internet connection, and hosting fees.)
III. Measures of Revenue

A. Total revenue is the number of units sold multiplied by the average price per unit.

B. Marginal revenue is the extra revenue connected with producing and selling an additional unit of output.

Discussion Question

Why do you think marginal revenues may start high but then decrease as more units are produced and sold? (Answers will vary, but students should demonstrate an understanding of marginal revenue and potential effects of worker productivity.)

IV. Marginal Analysis

A. Marginal analysis is comparing the extra benefits to the extra costs of a particular decision.

B. The break-even point is the total output or total product the business needs to sell in order to cover its total costs.

C. Businesses want to find the number of workers and the level of output that generates maximum profits. The profit-maximizing quantity of output is reached when marginal cost and marginal revenue are equal.

Discussion Question

Imagine you need extra money for an upcoming special event. Conduct a marginal analysis, comparing the costs of selling more of your labor to the benefits of earning more money. (Answers will vary, but students should demonstrate an understanding of the concept of marginal analysis by considering the activities they must give up or postpone as they work more hours.)
DID YOU KNOW?

During the oil crisis in the early 1970s, the proposed gas rationing program raised serious differences of opinion among Americans. Some people argued that every adult American should get the same number of gas rationing coupons. Others argued that owners of newer, more fuel-efficient cars would not need as many coupons as owners of older, gas-guzzling models. Those who lived in western states believed they should receive more coupons than Easterners because they traveled longer distances. Some people called for every car owner to receive a certain number of coupons; others said this plan discriminated against families with several drivers who shared one car.

I. Advantages of Prices
   A. Prices are neutral because they do not favor the buyer or the consumer. They are the result of competition.
   B. Prices are flexible, allowing for the “shocks” of unforeseen events and changes in the market.
   C. Prices have no administration costs.
   D. Prices are familiar and easily understood.

Discussion Question

In your opinion, why does the neutrality of prices stimulate competition? (Student answers will vary but should indicate an understanding that buyers pay the price because they choose to accept it; otherwise, they would go to another producer with a lower price and buy there.)

II. Allocations Without Prices
   A. Rationing, or the system where the government decides everyone’s “fair” share, leads to the question of fairness.
   B. Rationing leads to high administrative costs.
   C. Rationing leads to fewer incentives to work and produce.
Discussion Question

Imagine that no matter how much you studied, you already knew you were going to get a “B” in Economics. How would this affect your incentive to study? (Students should indicate that in school, the grade is often the incentive; therefore, knowing the grade beforehand could be detrimental to the student.)

III. Prices as a System

Together, prices comprise a system that helps buyers and sellers allocate resources between markets, linking all markets in the economy.

Discussion Question

Why do you think rebates were not enough to reenergize the big-car market during the 1970s energy crisis? (Students should indicate that the rebates did not solve the problems of getting and paying for the additional gasoline the larger cars required. In addition, the additional costs of gasoline could well add up to the rebate amount over the life of the car.)
DID YOU KNOW?

In spring and summer 1988, drought hit the United States, drying out a broad band of the country from the eastern Appalachian Mountains all the way to the Pacific coast. Parts of Iowa, Illinois, and other North Central farm states went for months with little or no rain. By the end of June, more than 1,300 counties in 30 states had been declared drought-disaster areas. The drought resulted in a grain shortage (typical harvest dropped by almost one-third, but stored grain eased the blow), as well as a meat shortage (farmers had to slaughter livestock early because they had no grain for the animals). By year’s end, food prices were up 5.2 percent.

PAGES 142-146

I. The Price Adjustment Process

A. Together, demand and supply make a complete picture of the market.

B. Price adjustments help a competitive market reach market equilibrium, with fairly equal supply and demand.

C. Surpluses occur when supply exceeds demand.

D. Shortages occur when demand exceeds supply.

E. The equilibrium price is the price at which supply meets demand.

Discussion Question

Imagine that you want to go to a concert but you find it is sold out at ticket outlets. What effect will this shortage of tickets have on the price of any remaining concert tickets? (Their price will increase.)

PAGES 146-148

II. Explaining and Predicting Prices

A. A change in price is normally the result of a change in supply, a change in demand, or both.

B. Even small changes in an inelastic supply can create big changes in price.

C. Elastic supply and demand help keep prices from changing dramatically.
Discussion Question

U.S. soybean farmers had a record-high harvest in 1998. What likely effect did the increase in the supply of soybeans have on their price? (Students should indicate that the price of soybeans dropped dramatically.)

A. The theory of competitive pricing represents a set of ideal conditions and outcomes; it serves as a model to measure market performance.

B. In theory, a competitive market allocates resources efficiently.

C. To be competitive, sellers are forced to lower prices, which makes them find ways to keep their costs down.

D. Competition among buyers keeps prices from falling too far.

Discussion Question

Why do experts say that a market economy is one that “runs itself”? (A market economy offers a climate where buyers and sellers set prices; there is no need for a bureaucracy or planning commission.)
DID YOU KNOW?

During the nation’s Great Depression, prices for farm products tumbled. Farmers lost much money, and many even lost their farms. At the same time, the farms produced surplus crops. To combat this, in 1933, the government passed the Agricultural Adjustment Act. In part, this act authorized payments to farmers who agreed to reduce the acreage they farmed. This effectively reduced the crop surplus and boosted farmer income.

PAGES 151-152

I. Distorting Market Outcomes

A. Achieving equity and security (two of the seven broad economic and social goals) usually requires policies that distort market outcomes.

B. One way to achieve these goals is to set “socially desirable” prices, which interferes with the pricing system.

C. Setting price ceilings affects the allocation of resources.

D. The minimum wage is an example of a price floor.

Discussion Question

Do you agree with economists who argue that the minimum wage actually contributes to unemployment rates? Why or why not? (Answers will vary but should reflect an understanding of the purpose of price floors.)

PAGES 153-155

II. Agricultural Price Supports

A. Government loan support was offered in the 1930s through the Commodity Credit Corporation to help stabilize agricultural prices. The CCC loan program led to food surpluses.

B. The CCC switched to deficiency payments, which prevented the government from holding surplus food and had farmers sell their crops on the open market.

Discussion Question

In your opinion, which kind of price support provides farmers with the most incentive to sell their crops at the highest possible price? (Answers will vary but students may point out that government makes up the price difference, offering little incentive to farmers.)

III. When Markets Talk

A. Markets “talk” when prices move up or down dramatically.

B. Buyers and sellers respond to changes in the market through their decisions.

Discussion Question

Think of the last item you decided not to buy. What message did your decision send to the manufacturer? (that something about the product or its value was not worth the price)
DID YOU KNOW?

Advertising Age reported that Microsoft Corporation responded to the federal court’s 1999 ruling of its monopolistic power in the software industry by launching its largest advertising campaign, designed to portray the company’s humility, humanness, and humor. Microsoft wants its customers to know that the company “empathizes with the situations customers find themselves in,” especially in facing “the practical realities of the Internet.”

PAGES 164-166

I. Perfect Competition

A. Perfect competition is when a large number of buyers and sellers exchange identical products under five conditions.

1. There should be a large number of buyers and sellers.
2. The products should be identical.
3. Buyers and sellers should act independently.
4. Buyers and sellers should be well-informed.
5. Buyers and sellers should be free to enter, conduct, or get out of business.

B. Under perfect competition, supply and demand set the equilibrium price, and each firm sets a level of output that will maximize its profits at that price.

C. Imperfect competition refers to market structures that lack one or more of the five conditions of perfect competition.

Discussion Question

Imagine that your town had an open farmers’ market during the spring and summer. How would it meet each condition for a perfectly competitive market? (Students should indicate that it would draw many buyers and sellers; the products would be farm-grown vegetables and fruits; prices would be set based on the week’s harvest (supply) and buyers’ demand; buyers examine and select products firsthand; and buyers may choose not to purchase and sellers may choose not to participate or not to offer all farm products.)
II. Monopolistic Competition

A. Monopolistic competition meets all conditions of perfect competition except for identical products.

B. Monopolistic competitors use product differentiation—the real or imagined differences between competing products in the same industry.

C. Monopolistic competitors use nonprice competition, the use of advertising, giveaways, or other promotional campaigns to differentiate their products from similar products in the market.

D. Monopolistic competitors sell within a narrow price range but try to raise the price within that range to achieve profit maximization.

Discussion Question

What are some examples of how different jean companies differentiate their products? (Answers will vary but may include style, available sizes, fabric, younger market, etc.)

III. Oligopoly

A. Oligopoly is a market structure in which a few very large sellers dominate the industry.

B. Oligopoly is further away from perfect competition (freest trade) than monopolistic competition.

C. Oligopolists act interdependently by lowering prices soon after the first seller announces the cut, but typically they prefer nonprice competition because their rivals cannot respond as quickly.

D. Oligopolists may all agree formally to set prices, called collusion, which is illegal (because it restricts trade).

E. Two forms of collusion include:
   1. price-fixing, which is agreeing to charge a set price that is often above market price;
   2. dividing up the market for guaranteed sales.

F. Oligopolists can engage in price wars, or a series of price cuts that can push prices lower than the cost of production for a short period of time.

G. Oligopolists’ final prices are likely to be higher than under monopolistic competition and much higher than under perfect competition.
Discussion Question

Why do you suppose oligopolists rarely protest when a rival raises its prices? (Answers will vary but students should imply that oligopolists know that a higher price by one of its competitors will eventually lead to its own higher profits.)

IV. Monopoly

A. Monopoly is a market structure with only one seller of a particular product.

B. The United States has few monopolies because Americans prefer competitive trade, and technology competes with existing monopolies.

C. Natural monopoly occurs when a single firm produces a product or provides a service because it minimizes the overall costs (public utilities).

D. Geographic monopoly occurs when the location cannot support two or more such businesses (small town drugstore).

E. Technological monopoly occurs when a producer has the exclusive right through patents or copyrights to produce or sell a particular product (an artist’s work for his lifetime plus 50 years).

F. Government monopoly occurs when the government provides products or services that private industry cannot adequately provide (uranium processing).

G. The monopolist is larger than a perfect competitor, allowing it to be the price maker versus the price taker.

Discussion Question

Why are monopolies unappealing to Americans? (Answers will vary but students should indicate an understanding of the benefits of the free enterprise system and economic and social goals.)
**DID YOU KNOW?**

Two VCR formats were once available to consumers. The first, Betamax, was introduced by Sony in 1975 and had product features that surpassed the now dominant VHS format. By cutting back on advertising dollars the optimistic Sony allowed JVC, the company that engineered VHS, to gain control of the market. The demise of Betamax soon followed.

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**PAGE 174**

I. Inadequate Competition

A. Decreases in competition because of mergers and acquisitions can lead to several consequences that create market failures.

B. Inefficient resource allocation often results when there’s no incentive to use resources carefully.

C. Reduced output is one way that a monopoly can retain high prices by limiting supply.

D. A large business can exert its economic power over politics.

E. Market failures on the demand side are harder to correct than failures on the supply side.

**Discussion Question**

Imagine you are on a city council and a leading auto manufacturer that employs thousands demands a reduced tax rate or it will relocate. What alternatives might there be to granting or refusing the tax break? *(Students should recommend compromises that acknowledge the company’s economic power in the community yet save the taxpayers’ burden.)*

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**PAGES 174-175**

II. Inadequate Information

A. Consumers, businesspeople, and government officials must be able to obtain market conditions easily and quickly.

B. If they cannot, it is an example of market failure.

**Discussion Question**

What resources would you check to find out how the weather has affected the citrus industry this year? *(Answers will vary but may include annual reports of citrus growers in Florida and California, National Weather Service, U.S. Department of Agriculture reports, national news stations and newsmagazines, and agricultural journals.)*
III. Resource Immobility

A. Resource immobility occurs when land, capital, labor, and entrepreneurs stay within a market where returns are slow and sometimes remain unemployed.

B. When resources will not or cannot move to a better market, the existing market does not always function efficiently.

Discussion Question

What is unrealistic about the condition of resource mobility in an ideal free enterprise system? (Answers will vary but students may indicate that resource mobility is an economic factor, and that people are also influenced by social and cultural concerns.)

IV. Externalities

A. Externalities are unintended side effects that either benefit or harm a third party.

B. Negative externalities are harm, cost, or inconveniences suffered by a third party.

C. Positive externalities are benefits received by someone who had nothing to do with the activity that created the benefit.

D. Externalities are market failures because the market prices that buyers and sellers pay do not reflect the costs and/or the benefits of the action.

Discussion Question

Should parents pay an extra fee when they purchase a ticket for one of their children? (Answers will vary but students should support their opinion with a rationale.)

V. Public Goods

A. Public goods are products everyone consumes.

B. The market does not supply such goods because it produces only items that can be withheld if people refuse to pay for them; the need for public goods is a market failure.

Discussion Question

Which of the four conditions of a competitive free enterprise economy does the need for public goods fail to meet? (reasonable pricing)
DID YOU KNOW?

The Federal Trade Commission also regulates e-commerce. In 1999 it charged the owners of an Internet mall, which hosts sellers of various goods and services, with falsifying the earnings potential investors might make from their Internet-based business. Among the FTC rulings, the owners were barred for life from selling on any Internet-based business and barred for 10 years from selling franchises.

PAGES 178-179

I. Antitrust Legislation

A. The antitrust laws prevent or break up monopolies, preventing market failures due to inadequate competition.

B. The Sherman Antitrust Act (1890) was the first U.S. law against monopolies.

C. The Clayton Antitrust Act (1914) outlawed price discrimination.

D. The Federal Trade Commission (1914) was empowered to issue cease and desist orders, requiring companies to stop unfair business practices.

E. The Robinson-Patman Act (1936) outlawed special discounts to some customers.

Discussion Question

Why was the Federal Trade Commission necessary? (No part of the government had the authority to enforce the antitrust laws until the FTC was created.)

PAGES 179-181

II. Government Regulation

A. Government’s goal in regulating is to set the same level of price and service that would exist if a monopolistic business existed under competition.

B. The government uses the tax system to regulate businesses with negative externalities, preventing market failures.

Discussion Question

Imagine you are the manager of the local cable television provider. You must speak to the city to gain approval for a rate increase. What would you say to persuade this regulatory body? (Answers will vary but students should include ideas that address the public’s needs as well as the cable company’s needs.)
III. Public Disclosure

A. Public disclosure requires businesses to reveal information about their products or services to the public.

B. The purpose of public disclosure is to provide adequate information to prevent market failures.

C. Corporations, banks, and other lending institutions must disclose certain information. There are also “truth-in-advertising” laws that prevent sellers from making false claims about their products.

**Discussion Question**

What are some examples of public disclosure? (*ingredient labels of food products, financial and operating information to shareholders, and lending rates to consumers*)

IV. Indirect Disclosure

A. Indirect disclosure includes government’s support of the Internet and the availability of government documents on government Web sites.

B. Businesses post information about their own activities on their own Web sites.

**Discussion Question**

How can consumers utilize the Internet before making a purchase? (*talk to other consumers in chat rooms, participate in user forums, read product reviews before making a purchase*)

IV. Modified Free Enterprise

A. Government intervenes in the economy to encourage competition, prevent monopolies, regulate industry, and fulfill the need for public goods.

B. Today’s U.S. economy is a mixture of different market structures, different kinds of business organizations, and varying degrees of government regulation.

**Discussion Question**

How does government regulation help prevent businesses from seeking economic gain at the expense of other citizens? (*Answers will vary, but students should indicate an understanding of protecting individuals within the free enterprise system.*)
**DID YOU KNOW?**

The stock market crash on October 29, 1929, signaled the start of the Great Depression. In that year, national income was more than $87 billion. By 1933, just four years later, national income had plummeted by more than 50 percent, to just over $40 billion. More than 80,000 businesses had failed, and nine million savings accounts had been cleaned out.

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**I. Early Union Development**

A. The nation’s first unions were comprised of skilled workers.

B. After the Civil War, as industry expanded, the labor force became more unified.

C. Two types of unions developed—the trade union and the industrial union.

D. Unions used strikes, pickets, and boycotts to help members get better pay, better hours, and job security.

E. Employers resisted unions through lockouts, firings, and even setting up company unions.

F. Historically, the courts have viewed unions with hostility.

**Discussion Question**

Webster’s Dictionary says that to conspire is “to join in a secret agreement to do an unlawful or wrongful act or an act which becomes unlawful as a result of the secret agreement.” Do you agree with those who viewed unions as conspiracies against business? Why or why not? *(Answers will vary but should focus on the conflict between unions and business.)*

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**II. Labor During the Great Depression**

A. Unemployment and cut wages marked the decade of the Great Depression and encouraged unions to organize workers.

B. The government began to pass laws protecting unions.

**Discussion Question**

Why do you think the government began to protect unions during the Great Depression? *(Answers will vary, but students may indicate that workers suffered during the Depression and the unions promised some relief.)*
III. Labor Since World War II

A. After World War II, new laws began to limit union activity.
B. The AFL-CIO was created when two powerful unions joined forces.
C. Independent unions are those that do not belong to the AFL-CIO.

Discussion Question

Do you see any correlation between the strength of the nation's economy and the government's attitude toward unions? Explain your answer. (Students should use some of the facts presented in this section to support their answers.)
DID YOU KNOW?
The National Labor Relations Act of 1935 guaranteed U.S. workers the right to form unions and to participate in collective bargaining. In 1998, about nine million people in the private sector worked under 100,000 contracts, each one a result of collective bargaining agreements.

I. Kinds of Union Arrangements
   A. In a closed shop, the employer agrees to hire only union members.
   B. In a union shop, most workers belong to a union.
   C. In a modified union shop, workers cannot be made to join the union.
   D. In an agency shop, workers must pay union dues, whether or not they are union members.

Discussion Question
Do you think agency shops are unfair? Why or why not? (Answers will vary, but students should consider the need for a union and how unions can fail to work if all people are not involved. They should also consider how agency shops could be taking away a worker's right to choose.)

II. Collective Bargaining
   A. When labor and management agree to mediation, a neutral person helps settle the dispute.
   B. With arbitration, labor and management agree to abide by a third party's decision.
   C. Disputes also can be resolved through fact-finding, in which a neutral third party presents non-binding recommendations.
   D. The government also can get involved in labor disputes by issuing injunctions or resorting to seizures.
   E. The president can intervene by publicly appealing to both parties to resolve their differences, by firing federal workers who have broken their oath not to strike (1981 air traffic controllers), and in some cases by using emergency powers (1997 American Airline pilots).

Discussion Question
Imagine that you are a union member. Which form of collective bargaining do you think would be most effective? Would your answer be different if you were a business owner? Why or why not? (Answers will vary but should reflect an understanding of the four methods of collective bargaining discussed here.)
DID YOU KNOW?
In the first quarter of 1997, full-time U.S. workers in the bottom 10 percent of the wage range actually made an average of $6.48 an hour, despite the fact that the federal minimum wage was set at $4.75 an hour. In fact, during that time of low unemployment rates, wages for those lowest-paid workers actually increased at a faster rate than the wages of workers in the middle wage range.

PAGES 205-206
I. Categories of Labor
   A. Unskilled laborers make some of the lowest wages.
   B. Semiskilled workers do jobs that require a minimum amount of training.
   C. Skilled workers hold jobs that require experience and training.
   D. Professional workers do jobs that require a high level of knowledge-based education and managerial skills.

Discussion Question
In your opinion, should a higher investment in human capital be rewarded with higher wages? Why or why not? (Answers will vary but should reflect an understanding of the relationship between human capital and levels of knowledge and skills.)

PAGES 206-207
II. Noncompeting Labor Grades
   A. People must have the ability, the initiative, and the money to obtain additional education and training.
   B. Sometimes people are faced with a lack of opportunity for additional training and education.
   C. Sometimes people lack the initiative they need to get ahead.

Discussion Question
Which do you think is most critical in moving from one labor category to another—ability, initiative, or money? (Answers will vary but should reflect an understanding of the importance of all these elements in the ability to move on to other labor categories.)
III. Wage Determination

A. The traditional theory of wage determination says that supply and demand together will determine the equilibrium wage rate.

B. The theory of negotiated wages uses organized labor’s bargaining strength to help explain wage differentials.

C. According to the signaling theory, employers are willing to pay more for those people with certain indicators of superior ability.

Discussion Question

Do you think it is fair that professional athletes have one of the nation’s highest wage rates? Why or why not? (Answers will vary. Students may say that the pay received by professional athletes is a result of supply and demand determining the equilibrium wage rate.)

IV. Regional Wage Differences

A. Wages can vary when demand for certain skilled positions exceeds supply.

B. Employers tend to offer higher wages in areas where the cost of living is higher than normal.

C. People sometimes are willing to accept lower wages if the location of the job is attractive to them.

Discussion Question

What factors might you be willing to compromise if it meant you could get a job in the place you most want to live? (Answers will vary but should illustrate some of the factors that contribute to differences in wage rates.)
DID YOU KNOW?

In 1991 Congress established the Glass Ceiling Commission. In 1995, the Commission observed that 95 to 97 percent of all big businesses’ top management were men. Although women held almost half the nation’s management and professional positions, they were usually in government, health care, or social welfare—fields that traditionally pay lower wages than jobs found in the private sector.

PAGES 211-213
I. Decline of Union Influence
   A. Union membership has declined because of unfriendly businesses, new workers with little loyalty to organized labor, and cutbacks in production by unionized companies.
   B. Businesses are using givebacks, bankruptcy claims, and two-tier wage systems to lower union-negotiated wages.

   □ Discussion Question
What events could prompt workers to rejoin a union? (Answers will vary but should reflect an understanding of the basic goals of union membership.)

PAGES 213-215
II. Lower Pay for Women
   A. Women, on the whole, have less experience and education to bring to the working world than their male counterparts.
   B. Some higher paying jobs have a larger percentage of male workers, while some lower paying jobs have a larger percentage of female workers.
   C. The glass ceiling is an example of the discrimination women face in the workplace.
   D. The Equal Pay Act and the Civil Rights Act both work to prevent wage and salary discrimination.
   E. Some states hope to close the gender income gap by defining jobs of comparable worth (equal pay for equal work).
   F. Set-aside contracts are contracts that will be made only with a specific group.

   □ Discussion Question
In what ways could a two-tier wage system contribute to lower pay for women? (Students may say that since women are newcomers to certain fields, they will receive the lower pay on the tier.)
III. Part-Time Workers

A. Part-time workers cost employers less in benefits.

B. Critics say part-time employment’s low wages and lack of benefits make it difficult for workers to earn a decent living.

Discussion Question
Do you agree with the critics of part-time employment? Why or why not? (Answers will vary, but students should examine the criticism and support their opinions with examples from the textbook.)

PAGES 216-218

IV. The Minimum Wage

A. Opponents claim the minimum wage does not promote economic freedom.

B. In current dollars, the minimum wage appears to have risen over time.

C. Measurements in real dollars take inflation into account.

D. The ratio of minimum wage to manufacturing wage has been steadily decreasing for the past 30 years.

Discussion Question
Why does looking at manufacturing wages help to understand the minimum wage? (Student answers should indicate that it helps to compare the buying power of those making minimum wage to the buying power of those making manufacturing wages.)
**DID YOU KNOW?**

To help the ailing yacht industry, which suffered great losses after the 1991 luxury tax was imposed, Representative Patrick J. Kennedy introduced into the House of Representatives the Boat Building Investment Act of 1999. Its goal was to allow a personal tax credit for the purchase of a new U.S.-made luxury yacht. The new owner would receive a credit of 20 percent of the cost, up to two million dollars. Kennedy’s hope was that this change in the income tax code would once again encourage yacht construction in the United States.

**PAGES 223-226**

I. Economic Impact of Taxes

A. Taxes affect the factors of production and, therefore, resource allocation.

B. A tax placed on a good at the factory raises production costs (supply curve shifts to the left); if demand stays the same, the equilibrium price goes up.

C. Taxes affect the economy by encouraging or discouraging certain activities.

D. A sin tax is a high-percentage tax that raises revenue while reducing consumption of a socially undesirable product.

E. Taxes affect productivity and economic growth by changing the incentives to save, invest, and work.

F. The incidence of a tax is the final burden of the tax: it is easier for a producer to shift the incidence of a tax to the consumer if the demand is inelastic; the more elastic the demand, the more likely the producer will absorb a greater portion of the tax.

**Discussion Question**

In your opinion, how effective is a sin tax? *(Answers will vary. Students should support their opinion with examples of sin taxes.)*

**PAGES 226-227**

II. Criteria for Effective Taxes

A. Taxes are effective when they are equitable, simple, and efficient.

B. Criterion 1: equity or fairness; fairness is subjective, but taxes are considered fairer if they have fewer loopholes—exceptions, deductions, and exemptions.

C. Criterion 2: simplicity; tax laws should be easy to understand.

D. Criterion 3: efficiency, which means it is easy to administer and is successful at generating revenue.
**Discussion Question**

How might Congress have better analyzed the potential efficiency of the 1991 luxury tax on yachts and small aircraft before passing the tax law? *(Students should consider studies Congress might have conducted on numbers of yachts and aircraft, employment in each industry, etc.)*

**PAGES 227-229**

III. Two Principles of Taxation

A. The benefit principle states that those who benefit from government goods and services should pay in proportion to the amount of benefits they receive.

B. The limitations of this principle are that many government services provide the greatest benefit to those who can least afford them and that benefits are hard to measure.

C. The ability-to-pay principle is the belief that people should be taxed according to their ability to pay, regardless of the benefits they receive.

D. The ability-to-pay principle is based on two ideas: that societies cannot always measure the benefits derived from government spending, and that people with higher incomes suffer less discomfort in paying taxes than people with lower incomes.

**Discussion Question**

How would you measure the benefits for a proposed tax? *(Answers will vary. Students should support their answers with a rationale.)*

**PAGE 229**

IV. Types of Taxes

A. A proportional tax is one that imposes the same percentage on everyone, regardless of income.

B. A progressive tax is one that imposes a higher percentage of tax on persons with higher incomes.

C. A regressive tax is one that imposes a higher percentage on low incomes than on high incomes.

**Discussion Question**

What benefits does the government enjoy in having a progressive income tax? *(As Americans become more successful and earn higher incomes, the government’s revenue increases—for example, stock market dividends are taxable, leading to higher government collections.)*
DID YOU KNOW?

The Tax Reform Act of 1981 actually used taxes to encourage savings. It provided Americans of all income brackets with an individual retirement arrangement (IRA), or account, to which they could contribute a portion of their income without paying income taxes. What Congress had not counted on was that IRAs were far more popular with the wealthiest rather than the poorest Americans. As a result, the Tax Reform Act of 1986 put a ceiling on the income level of individuals who would qualify for tax-free contributions.

I. Individual Income Taxes
   A. The federal government collects about 45 percent of its revenue from the individual income tax.
   B. Taxes are typically withheld from individual’s paychecks, with employers sending the taxes directly to the Internal Revenue Service.
   C. Individuals file a tax return on or before April 15 each year; if taxes withheld are more than the taxes owed, the individual receives a refund; if not, the individual makes a payment of the tax balance.
   D. The individual income tax is a progressive tax because individuals earning higher incomes pay higher tax rates.

Discussion Question
Why do you suppose the individual making $100,000 per year pays about the same tax rate as the person making $35,000 per year? (Answers will vary but the students should demonstrate an understanding of the current progressive tax policy’s complexity, with the wealthy taking advantage of many exemptions and other loopholes.)

II. FICA Taxes
   A. The Federal Insurance Contributions Act (FICA) tax pays for Social Security and medicare.
   B. FICA it is the second largest source of government revenue.
   C. The FICA tax is a regressive tax. Social Security is partly a proportional tax and partly a regressive tax.
Discussion Question

Why do you think some Americans call the Social Security tax the “tax of the middle and lower classes”? (Answers will vary, but students may indicate that because it is a partly regressive tax, these economic classes bear more of the burden of Social Security taxes than the wealthy class.)

III. Corporate Income Taxes

A. Corporations pay a tax on their profits because they are considered legal entities.
B. Corporate tax is the third largest source of government revenue.

Discussion Question

How would you evaluate the effectiveness of the corporate income tax based on the fairness, simplicity, and efficiency test? (Answers will vary, but students should support their opinions with rationales.)

IV. Other Federal Taxes

A. The excise tax is a regressive tax on the manufacture or sale of selected items.
B. The estate tax deals with the transfer of property when a person dies.
C. The gift tax is placed on large donations of money or wealth and is paid by the donator.
D. A customs duty is a charge levied on goods brought in from other countries.
E. The Reagan administration implemented user fees for the use of goods or services.
F. User fees are an example of taxation based on the benefit principle.

Discussion Question

Why do you suppose customs duties are no longer a large source of government revenue? (Answers will vary, but students may indicate that the United States government encourages international trade and heavy customs duties would discourage such trade.)
Ohio ranks fourth in the nation for lottery ticket sales and revenues, after New York, Texas, and Massachusetts. In 1998 it reported total expenses and payments of $2,192,761,403. Since the lottery started in 1974, it has contributed $9 billion to the state’s public educational system.

I. State Government Revenue Sources
   A. Intergovernmental revenues are funds collected by one level of government that are distributed to another level.
   B. Intergovernmental revenues are the largest source of revenues for state and local governments—about one-fourth of all state revenues.
   C. A sales tax is one levied on consumer purchases for nearly all products.
   D. Employee retirement contributions make up the third largest source of income.
   E. Individual income tax revenues make up the fourth largest source of income.
   F. Other sources of revenue include interest earnings on surplus funds; fees from state-owned colleges, universities, and schools; corporate income taxes, and hospital fees.

**Discussion Question**

Why is the sales tax an easy way for states to collect from consumers? *(The tax is collected by the seller from the buyer at the site of the purchase, and the seller sends the funds into the government on a regular basis.)*

II. Local Government Revenue Sources
    A. Intergovernmental revenues are generally earmarked for education and public welfare; they make up the largest source of local government revenue.
    B. Property taxes are levied on tangible and intangible products; they make up the second largest source.
    C. Local governments receive revenues from government-owned public utilities and state-owned liquor stores.
    D. Some towns and cities have a sales tax, which is collected along with the state’s sales tax.
    E. Other sources of local income include hospital fees, personal taxes, and public lotteries.
Discussion Question
For what government expenses are your local property taxes earmarked? What do you think of these allocations? (Answer will vary, students should look up this information and consider if they think the allocations are productive uses of the money.)

III. Examining Your Paycheck

A. Looking at your payroll withholding statement will help you identify many of your state and local governments’ revenue sources.

B. Additional deductions can be added to payroll for retirement contributions, purchases of savings bonds, or credit unions.

Discussion Question
To what levels of government do you pay income taxes? (Answers will vary. Students who have a part-time job should note Social Security and other taxes.)
**DID YOU KNOW?**

Congress's Joint Economic Committee reported that a flat income tax could raise the same amount of government revenue as the current income tax. The Congressional Budget Office calculated in 1995 that the progressive income tax with its hundreds of exemptions, credits, loopholes, and deductions could be replaced by a flat income tax of 13.1 percent.

**I. Tax Reform**


B. By the mid-1980s, Americans believed the tax code favored the rich and powerful.

C. In 1986 Congressional tax reform limited the tax brackets to 15 percent and 28 percent.

D. The Omnibus Budget Reconciliation Act of 1993 added two higher income tax brackets, but its goal was more to assist in balancing the federal budget than in adjusting rates for income levels.

E. By 1997 the government had high tax revenues, so the Taxpayer Relief Act was passed giving tax credits for children and educational expenses, and reduced rates to people with capital gains from long-term investments in stocks and bonds.

F. In 2003, to offset the recession, the Bush administration and Congress made the 2001 tax cuts effective immediately, reducing the top four tax brackets, the upper limit for lower-income taxpayers, and the capital gains tax.

**Discussion Question**

What were some components of the 2003 tax reform? *(reduced top four tax brackets, increased the upper limit for low-income taxpayers, increased child tax credit, and reduced capital gains tax)*

**II. The Value-Added Tax**

A. A value-added tax (VAT) places a tax on the value that manufacturers add to a good at each stage of production.

B. Advantages to the VAT: the tax is levied on the total amount of sales less the cost of inputs; the incidence of the tax is widely spread among the manufacturers involved; it is easy to collect; it would encourage people to save.

C. Disadvantages of the VAT: taxpayers are unlikely to notice increases in VAT taxes; it would compete with state sales taxes; politicians would lose some power in promoting pet projects.
Discussion Question

Which tax do you favor—the income tax or the value-added tax? Explain your choice. *(Answers will vary but students should indicate why the advantages of the tax they cite make it a more favorable choice.)*

III. The Flat Tax

A. A flat tax is a proportional tax on individual income after a specified income threshold has been reached.

B. Advantages of the flat tax: it would be simple to report; it would close or minimize tax loopholes; it reduces the need for tax accountants and much of the IRS; it could lead to savings of up to $100 billion.

C. Disadvantages of the flat tax: it removes the behavior incentive in the tax code; it benefits those with high incomes; it shifts tax policy away from the ability-to-pay principle.

Discussion Question

How would a 15 percent flat tax hurt homeowners? *(They could no longer deduct mortgage interest payments.)*

IV. The Inevitability of Future Reforms

A. The complex tax code guarantees future attempts to simplify it.

B. Unexpected economic slowdowns, such as the 2001 recession, can cause tax revenues to fall and budget deficits to occur.

C. Unexpected political events may require unplanned expenditures, such as Congress voting to spend $40 billion to rebuild New York City and the air traffic system after September 11, 2001.

D. Tax reform is likely to continue because each political administration abruptly changes policies to suit its agenda.

E. Politicians are reluctant to give up the power they have in adjusting the current complex system.

Discussion Question

What advice would you give your congressperson about future tax reforms? *(Answers will vary, but students should support their advice with a rationale.)*
DID YOU KNOW?

Between 1962 and 1993, federal transfer payments to people eligible for benefits because of poverty rose from under 1 percent of the nation’s Gross Domestic Product (GDP) to just about 2.5 percent. In contrast, at the height of World War II (the early 1940s), federal spending on defense was 40 percent of GDP. In 2001 the total government expenditures at all levels amounted to about 30 percent of GDP.

I. Government Spending in Perspective

A. Total government expenditures at all levels was almost $3 trillion in 2003—about $10,300 for every American.

B. Government spending did not begin to increase until the 1940s for three reasons: (1) high costs of World War II; (2) the Great Depression changed public opinion about the government assisting in everyday economic affairs and in improving Americans’ economic welfare; and (3) the success of large-scale public works projects.

C. Debate continues over the role government should play in the economy. Government promotes the broad social and economic goals of Americans, but the benefits of a government policy should outweigh its costs.

Discussion Question

What government services do you think might be better provided by the private sector? (Answers will vary. Students should support their opinions.)

II. Two Kinds of Spending

A. Government spending is for the purchase of goods and services and payments to disadvantaged Americans.

B. Goods and services that the government buys includes everything from tanks for the nation’s defense to paper and soap for its employees.

C. Transfer payments include Social Security, welfare, and unemployment compensation. Two kinds of transfer payments exist. If the payment is made from one level of government to another, it is called a grant-in-aid. Subsidies are payments made to individuals or entire industries to encourage or protect a certain economic activity.
Discussion Question
To cut governmental spending, what types of reduction would you most likely support: the cutting of governmental spending on goods and services or a reduction in transfer payments? Explain your answer. (Students should support their opinion with examples and a rationale.)

III. Impact of Government Spending

A. Government spending affects resource allocation because purchase decisions, subsidies, and transfer payments either stimulate economic activity or affect the factors of production.

B. Government spending influences income distribution when transfer payments increase family incomes, federal projects provide or take away jobs, and subsidies give income support to American workers.

C. Government spending creates competition with the private sector.

Discussion Question
What standard do you think the government should use to determine if it should compete with the private sector in producing a good or offering a service? (Answers will vary. Students should support their answers with a rationale that takes public welfare into consideration.)
DID YOU KNOW?

In January 1999 President Clinton presented to Congress the federal budget for 2000, a balanced budget that anticipated a federal surplus. Clinton recommended that Congress spend the surplus on sustaining Social Security and improving medicare. He cited measurable signs that the nation’s economy was strong and prosperous—17 million new jobs; the lowest rate of unemployment in 40 years; and the lowest number of people on welfare in 25 years. He acknowledged that, to streamline government, his administration had cut 365,000 civilians from the federal work force, making it the smallest federal workforce since 1933.

PAGES 260-262

I. Establishing the Federal Budget

A. The federal budget consists of (1) mandatory spending, which includes interest payments on borrowed money, Social Security, and medicare (two-thirds of the budget); and (2) discretionary spending, which includes programs that Congress must approve annually (one-third of the budget).

B. The government’s fiscal year is from October 1 to September 30.

C. The first step toward adopting a budget is executive formulation—the president confers with his advisors and drafts a budget which he submits to Congress.

D. The second step is House action—Congress has the power to approve, modify, or disapprove the president’s proposed budget. The House sets budget targets for each category of the discretionary budget, then assigns appropriations bills to various subcommittees where subcommittee members study and debate each bill. If the bill is approved in subcommittee, it is sent to the full House Appropriations Committee. If approved there, it goes to the entire House for a vote. All these congressional steps must be completed by September 15 each year.

E. The third step is Senate action—the Senate may approve the House bill or it may draft its own version. If differences exist, a joint House-Senate conference committee works out a compromise bill.

F. The last step is final approval—the House and Senate send the bill to the president for his approval or veto. Once signed, it becomes the official budget for the new fiscal year.

Discussion Question

What problems may arise when the president and the majority of Congress are from different political parties? (As witnessed during the Clinton administration, congressional leaders may have spending priorities that widely differ from the president’s priorities, resulting in budget delays, several versions of appropriations bills, and potential government shutdowns as the two branches work out a compromise budget.)
II. Major Spending Categories

A. Mandatory spending categories include: Social Security; income security; medicare; interest on the federal debt; some health programs; and veterans’ benefits.

B. Discretionary spending categories include: education, employment, social services, transportation, administration of justice, natural resources, and the environment.

[[Discussion Question]] Why has the administration of justice become the fastest-growing category of expenditures since 1980? (Expenses include the federal government’s intensified war on crime and drugs and maintaining a large federal prison inmate population.)
**DID YOU KNOW?**

The Transportation Action Network in 1997 analyzed how states spent the flexible funds the federal government gave them for highway construction and repair. TAN calculated a state’s Pothole Index by dividing its spending on highway repair by the number of the state’s highway miles in poor or mediocre condition. Arkansas, Maryland, Colorado, North Carolina, and Oklahoma had the highest Pothole Index. TAN’s analysis showed that, with 1996–1997 funds, states chose to spend more than half of their flexible federal funds on new highways rather than repairing existing highways in poor condition.

**PAGES 267-268**

I. Approving Spending

A. Most states approve their budgets using a process similar to the federal government’s process.

B. Some states have a balanced budget amendment that requires annual spending not to exceed revenues.

C. Local governments empower representatives—the mayor, city council, or county judge—to approve the budget.

**Discussion Question**

Why do you think our state has (or does not have) a balanced budget amendment? *(Answers will vary. A balanced budget amendment can help citizens control the spending of their elected officials. However, it can sometimes prove very costly if money can’t be raised to address problems when they are small.)*

**PAGE 268**

II. State Government Expenditures

Eighty percent of state spending is directed toward intergovernmental expenditures, public welfare, insurance trust funds, higher education, highways, hospitals, and interest on the public debt. The other 20 percent is spent on a variety of expenses, such as corrections, health, natural resources, and utilities.

**Discussion Question**

What state universities does our state budget support? *(Answers will vary.)*
III. Local Government Expenditures

A. Local governments include counties, municipalities, townships, school districts, and other special districts.

B. The largest categories of spending (about two-thirds of the total) include: elementary and secondary education; public utilities; hospitals; police protection; interest on debt; public welfare; and highways. The other third includes such expenses as housing and community development, fire protection, and parks and recreation.

Discussion Question

What local highways would you suggest the local government improve? *(Answers will vary.)*
DID YOU KNOW?

The accounting system of the Bureau of the Public Debt, a part of the Department of the Treasury, announces the “public debt outstanding” at about 11:30 A.M. daily. The system takes into consideration 50 different reporting sources to determine how much the federal government owes on any particular day. The public can monitor the debt by checking the Bureau’s Web site at www.publicdebt.treas.gov/opd/opdpenny.htm

PAGES 272-276

I. From the Deficit to the Debt

A. Throughout United States history, the federal government has practiced deficit spending, or spending more than the revenues it collected. In 1998 the federal budget had its first surplus in 29 years.

B. Historically, the largest federal deficits happened during World War II. The budget, however, had a surplus by 1947, which lasted until the 1980s, when the Reagan administration increased defense spending and cut taxes. It was not until after the Omnibus Budget Reconciliation Act of 1993 that the deficit began to shrink.

C. When the budget runs a deficit, the Treasury Department sells bonds to the public to raise money. The federal debt is the total amount the government has borrowed from investors to finance its deficit spending over its long history.

D. The total federal debt had grown to $6.74 trillion by 2003. About $1.9 trillion is trust fund money the government owes itself, which economists do not include in the total as economically significant.

E. The federal debt differs from private debt because: (1) we owe most of the federal debt to ourselves, whereas private debt is owed to others; (2) private debt typically has a repayment deadline, but federal debt does not; the government just issues new bonds; (3) private debt means individuals give up their purchasing power as they pay down their debt; but when the federal government repays a debt, the funds transfer to others who gain purchasing power (unless payments are to foreign investors).

Discussion Question

What is the difference between the federal deficit and the federal debt? (The deficit is the shortage between revenues collected and federal expenditures any one fiscal year; the federal debt is the accumulated balance the government owes to investors for its many years of deficit spending.)
II. Impact of the National Debt

A. The federal debt causes a transfer of purchasing power from the private to the public sector. The larger the federal debt, the larger the interest payments, and the more taxes the government must pay.

B. If taxes are increased to make the federal debt’s interest payments, it may diminish incentives for Americans to work, save, and invest.

C. In selling bonds to raise money, the federal government competes with the private sector for scarce resources, leading to higher-than-normal interest rates.

Discussion Question

Why should the federal debt be of concern to Americans? (Answers will vary but students may indicate the effects the debt has on income distribution, purchasing power, and diminishing incentives.)

III. Taming the Deficit


B. The Budget Enforcement Act required that Congress must “pay as it goes.” It must offset any new spending with making reductions elsewhere. BEA failed.

C. The Omnibus Budget Reconciliation Act of 1993 only succeeded in reducing the rate of growth of the deficit, not the total deficit. The act combined spending reductions with tax increases, leading to the surplus by 1998.

D. Congress gave the president a line-item veto, but the Supreme Court found it unconstitutional. The Balanced Budget Agreement of 1997 followed, with rigid spending caps so Congress could balance the budget by 2002. In 1999 Congress increased defense spending and cut taxes; as a consequence, they had to cut popular programs such as health, education, and veterans’ programs.

E. Due to the 2001 recession, September 11th, the war on terrorism, and the continued growth of entitlements, the government is facing record budget deficits.

Discussion Question

Economists do not think that political leaders have accepted the reality of “TINSTAAFL.” What evidence is there that they may be correct? (Answers will vary, but students may cite how politicians promise to increase spending and cut taxes, without creating a deficit or adding to the long-standing federal debt.)
DID YOU KNOW?

On January 1, 1999, most Europeans began using a new currency called the euro. Eleven countries—Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain—replaced their individual national currencies with the new currency so trade among the countries would be less cumbersome. Denmark, Greece, Sweden, and the United Kingdom, who are part of the European Union, chose not to adopt the euro currency.

PAGE 286

I. Functions of Money

A. Money is accepted by all parties as payment for goods and services.
B. Money can be used to express worth in terms that most people can understand.
C. Money holds its purchasing power until the buyer needs it.

Discussion Question

Why is trade in a moneyed economy easier than trade in a barter economy? (In a barter economy a buyer must find a seller in search of the exact goods that he or she has to offer. Money is universally accepted.)

PAGE 287

II. Money in Early Societies

The use of money developed in ancient times because it made life easier. A good like compressed tea leaves is known as commodity money. Fiat money is made valuable by government decree.

Discussion Question

What did America’s native peoples use as money? (Students may indicate crops, berries, and other natural goods.)

PAGES 287-289

III. Money in Colonial America

A. Tobacco and wampum were once accepted forms of currency.
B. States passed laws allowing individuals to print paper currency, which was backed in local banks with gold and silver deposits.
C. During the American Revolution, Continental dollars were issued but without gold or silver backing, which made them virtually worthless by the end of the war.

D. Specie, or gold and silver coins, were commonly used in the colonies. Because they were in limited supply, they had more value than paper currency.

**Discussion Question**

Why do you suppose colonial taxes were collected in coins whenever possible? *(The coins, which were most often English shillings, Spanish pesos, or Austrian talers, were either made of silver or some other mineral. They were in limited supply and, thus, had value.)*

**IV. Origins of the Dollar**

A. When the nation began, the most plentiful coin in circulation was the Spanish peso.

B. Benjamin Franklin and Alexander Hamilton differentiated the dollar system from the pesos by dividing the dollar into tenths rather than the peso’s pieces of eight.

**Discussion Question**

How was triangular trade an example of the transition between a barter economy and a money economy? *(Products were exchanged for other products as well as for coins.)*

**V. Characteristics of Money**

A. Money must be portable, or easily transferred from one person to another.

B. Money must be durable so it lasts when handled or stored for long periods.

C. Money must be divisible to facilitate all types of transactions.

D. Money must be in limited supply to retain its value.

**Discussion Question**

In recent years pennies have been in short supply, and many Americans shunned the use of silver dollars. Both types of coins met the four characteristics of money. Why do you suppose Americans were reluctant to use either? *(Pennies have so little value that they are often removed from circulation. Silver dollars are bulky compared to paper currency and easily confused with quarters.)*
DID YOU KNOW?

Gold was losing its favor worldwide as a monetary standard by the early 1900s. In 1914, World War I broke out, and the United States and other nations were cut off from international trade. Nations no longer trusted shipping gold as payments for international debt; it stayed in the nations’ vaults. During such tenuous wartime conditions, gold lost most of its monetary importance.

PAGES 292-293

I. Privately Issued Bank Notes

A. A monetary standard keeps the money supply portable, durable, divisible, and limited in supply. The United States has had several standards throughout its history.

B. Continental currency after the Revolutionary War was worthless, so Americans only trusted coins. The United States Constitution gave the federal government the power to coin money and prevented the states from doing so. Private banks produced paper money.

C. By 1811 the nation had about 100 state banks, which had a charter from the state governments. People could exchange the paper notes for gold or silver.

D. Each bank had its own currency design so hundreds of different notes were in circulation. Counterfeiting became a problem. Because some currencies did not have silver or gold backing, some merchants were wary to accept all forms of currency.

Discussion Question

Is it important that paper currency be backed with gold or silver? (Answers will vary. Students should support their opinions with a rationale.)

PAGES 294-296

II. The Greenback Standard

A. To finance the Civil War, Congress authorized in 1861 the printing of $60 million of demand notes. They had no silver or gold backing, but the government declared them legal tender. By 1862, Congress authorized a new federal currency. Both of these currencies were called greenbacks because of their green ink.

B. In time, people feared that greenbacks had little value, like Continental dollars, and they avoided using them. Congress then created a National Banking System (NBS) of national banks, which were privately owned but chartered by the federal government. These banks issued National bank notes, backed by United States government bonds. State banks withdrew their notes.
C. In 1863 the federal government issued gold certificates backed by gold, in large
denominations for banks to exchange with one another. In 1886, it issued silver
certificates backed by silver.

Discussion Question
Have you ever been told that you must accept a certain form of payment for a debt owed
to you? (Answers will vary. Students should strive to perceive the difficulty of a government
trying to create a new national currency.)

III. The Gold Standard

A. In 1900, Congress passed the Gold Standard Act, making the basic currency unit, the
dollar, equivalent to a specific amount of gold. It did not change the use of greenbacks
or notes, but Americans could exchange them for gold whenever they wanted.

B. The advantages of the gold standard are: (1) the security Americans felt about their
money; and (2) it prevents the government from printing too much paper currency.

C. The disadvantages of the gold standard are: (1) the gold stock may not grow fast
enough to support a growing economy; (2) people may decide to convert their paper to
gold, draining the government’s gold reserves; (3) the price of gold will respond to the
market and it may lose substantial value; and (4) the political risk of failure exists.

D. The gold standard remained in effect until the Great Depression.

Discussion Question
Why do you suppose the United States went off the gold standard in 1934? (The Great
Depression brought to the forefront the serious disadvantage such a monetary standard.)

IV. The Inconvertible Fiat Money Standard

A. Since 1934 the United States has been on an inconvertible fiat money standard.

B. The money supply of the United States is managed by the federal government.

C. The tangible component of modern money consists of coins and Federal Reserve
notes. The intangible components include travelers’ checks, and checking and savings
accounts.

D. Modern money must also be portable, durable, and divisible.

Discussion Question
How does a check fit the same criteria for money as a dollar bill? (A check is portable,
durable, and perfectly divisible.)
**DID YOU KNOW?**

Even though Congress created the Federal Reserve System, the Fed is financially independent of politicians and never has to go to Congress for money for its operations. Actually, the Fed pays its expenses with the interest income it makes when the U.S. Treasury pays the interest on the federal debt. And, oddly enough, if the Fed earns more interest income than it needs to cover its expenses, it is required to turn over any unspent income to the U.S. Treasury as a “donation” toward the federal debt.

**I. Revising the Banking System**

**A.** The National Banking Act (1863) strengthened the nation’s financial system by creating a system of national banks.

**B.** By 1907 the NSB needed further reforms as the nation experienced financial crises and recessions.

**Discussion Question**

How would the creation of a system of national banks regain the public’s trust? *(Answers will vary. Students may note that a system of banks allows for conformity and stability.)*

**II. The Federal Reserve System**

**A.** Congress responded to the call for reform with the Federal Reserve System, or the Fed, the nation’s first true central bank—a bank that lends to other banks in need.

**B.** The Fed was set up as a corporation and any bank that joined the system had to purchase shares of stock in the system; as a result, privately owned banks own the Fed, not the government. The Fed, however, is publicly controlled. The president appoints and Congress approves the Fed’s Board of Governors.

**C.** Banks were overextended during the 1920s, and many failed after the Great Depression hit in 1929. Banks did not have deposit insurance for their depositors, causing depositors’ rush on banks to withdraw funds. As a result, many more banks failed.

**D.** The Federal Deposit Insurance Corporation insured customer deposits in the event of a bank failure.
Discussion Question

What are the advantages of the Federal Reserve System being a privately owned institution that is publicly controlled? What are the disadvantages? (Answers will vary, but students may indicate that the nation’s private and public sectors work together to ensure the safety of the nation’s collective funds. The public welfare as well as a profit motive are considerations.)

III. Other Depository Institutions

A. Most of the first American banks were commercial banks that catered to business and commerce. They had the authority to issue checking or demand deposit accounts. A thrift institution, on the other hand, accepted the deposits of small investors but could not offer demand deposit accounts (until the 1970s).

B. The mutual savings banks were the oldest thrift institutions in the United States. They catered to the small wage earner, particularly those who lived in the industrial northeast and the Pacific northwest. In 1972 a savings bank introduced the Negotiable Order of Withdrawal, or NOW accounts, which were checking accounts that paid interest. Commercial banks opposed these accounts, but they proved popular with consumers.

C. A savings and loan association invested the majority of its funds in home mortgages. They began as cooperative clubs for homebuilders. In the 1930s the Federal Home Loan Bank Board began supervising and regulating savings and loan associations.

D. A credit union is a nonprofit service cooperative that is owned by and operated for the benefit of its members. Contributions are generally deducted directly from a worker’s paycheck.

Discussion Question

Why do you suppose credit unions are able to offer lower interest rates on loans than commercial banks? (Commercial banks are for-profit, so the interest rates include a profit margin; credit unions are nonprofit, and keep costs to members as low as possible.)
IV. Crisis and Reform

A. Financial institutions were closely regulated from the Great Depression through the 1970s. Federal regulations included setting maximum rates of interest and restricting how institutions could lend their funds. The Reagan administration deregulated the financial system, ushering in a period of competition, crisis, and reform.

B. Deregulation led to more competition. Any financial institution could offer NOW accounts. All depository institutions could borrow from the Fed, not just commercial banks.

C. Deregulation led to a crisis among savings and loan associations, which were not experienced in competing in the marketplace. Several bad loans could force an S & L out of business because they kept only about half the reserves that commercial banks kept. Deregulation led to fewer federal inspectors, encouraging some institutions to engage in fraud, which drained the Federal Savings and Loan Insurance Corporation (FSLIC) of funds paid out in insurance claims to depositors.

D. In 1989 Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act, which abolished the savings and loan industry and its supervisory agency, the FHLBB. The FSLIC was dissolved and the FDIC took over insurance responsibilities. Some savings and loan associations survived the crisis.

E. The 1980s were years of more bank failures, many due to poor management. Failed banks made loans without adequate collateral, others failed to keep expenses under control, and others fell victim to the weak economy.

F. The 1990s were years of caution after the turbulent 1980s. Stronger federal regulations were enacted, and all financial institutions were required to strengthen their capital reserves. Banks merged with stock and security brokerage firms. By 2000 financial institutions were healthier.

Discussion Question

Imagine you are a banker whose bank survived the deregulating practices of the 1980s. What lessons that you learned about deregulation might you share with a young banker? (Answers will vary but students should support their opinions with examples.)
DID YOU KNOW?

As of March 2001, the three largest banks in the United States (in terms of total assets) were Bank of America, Citibank, and The Chase Manhattan Bank.

I. Saving and Capital Formation
   A. Saving money makes economic growth possible.
   B. One person’s savings can represent another person’s loan.
   C. Savings make investments possible.

Discussion Question

What would happen if no one saved? (People would not be able to invest. Only projects that could be financed out of current income would be possible.)

II. Financial Assets and the Financial System
   A. A financial system consists of a network of savers, investors, and financial institutions that work together to transfer savings to investors.
   B. Financial assets include savings accounts, certificates of deposit, and government and corporate bonds.
   C. Financial assets represent claims on the borrower.
   D. Financial intermediaries are financial institutions that bring together savers and lenders.
   E. The circular flow of funds shows how funds are transferred from savers to borrowers.
   F. Any part of the economy can supply and borrow savings, but governments and businesses are the largest borrowers.

Discussion Question

How do financial intermediaries transfer funds from savers to borrowers? (People who save money invest it in financial assets. Banks and other financial intermediaries take these savings and lend them to borrowers.)
III. Nonbank Financial Intermediaries

A. Nonbank financial institutions are nondepository institutions that channel savings to borrowers.

B. Finance companies buy installment contracts from merchants, who sell goods on credit, and make the loans directly to consumers.

C. Many finance companies offer bill consolidation loans to consumers who use these loans to pay off other bills immediately, and then pay off the finance company over time.

D. Life insurance companies receive money by selling life insurance for a premium, monthly, quarterly, or annual fee.

E. Life insurance companies can then invest these funds with institutions.

F. Mutual funds are companies that sell shares of their own stock to individual investors and invest the money they receive in corporate stocks and bonds.

G. Mutual funds give people the ability to invest in the market at low risk.

H. Pension funds receive money from employers and invest the money in corporate stocks and bonds to be disbursed among the employees eligible for retirement, old-age, or disability.

I. Real estate investment trusts (REIT) borrow money from banks and lend it to construction companies that build homes.

Discussion Question

What do most nonfinancial intermediaries do with the money they receive? Why? (Most invest the money in corporate stocks and bonds or lend it to institutions or large companies. Only finance companies make loans available to consumers. They do this as a way to make a profit while providing another investment option for the consumer.)
“Junk bonds” are very risky bonds. The market for these bonds has grown dramatically in recent years. For example, in 1995, Comcel, a cellular telephone company in Bogotá, Colombia, issued $150 million in junk bonds to pay off a bridge loan. In Brazil, NetSat, a direct broadcast satellite company, raised $200 million. With analysts becoming increasingly more sophisticated in evaluating the projects of emerging countries, junk bonds will continue to attract investors seeking high yields.

**DID YOU KNOW?**

**I. Basic Investment Considerations**

A. High risk investments pay higher rates of return than low risk investments.

B. The type of investment chosen depends on the goals of the investor.

C. Consistent investing can yield large returns.

D. Investors should avoid complex investments they do not understand.

E. A 401(k) plan is a tax-deferred investment plan that acts as a personal pension fund for employees.

**Discussion Question**

What factors should be considered when investing money? (*an investor’s tolerance for risk and goals*)

**II. Bonds as Financial Assets**

A. Bonds have three main components: the coupon, the maturity, and the par value.

B. Bond prices are determined by supply and demand.

C. The current yield on a bond is the annual interest rate divided by the purchase price.

**Discussion Question**

What is a bond? (*a long-term obligation by the government or a corporation to pay a fixed amount of interest every year for a specified number of years*)
III. Bond Ratings

A. Most bonds are rated on the financial health of the issuer, the ability to make future coupon and principal payments, and the issuer's past credit history.

B. Bond ratings, ranging from D (lowest) to AAA (highest), indicate the quality of the bond.

C. If a bond is in default, it means the issuer has not kept up with the interest or the par value payments.

Discussion Question

What characteristic do bonds and other investments have in common? (the higher the risk on the bond, the bigger the return)

IV. Financial Assets and Their Characteristics

A. Certificates of deposit are issued by financial institutions and are the most common form of investments available.

B. Corporate bonds are issued by corporations and are usually used for long-term investment because they can be liquidated quickly.

C. Municipal bonds are bonds issued by state and local governments and are regarded as a safe, tax-exempt investment.

D. Savings bonds are low-denomination, nontransferable bonds issued by the federal government and are very attractive because they have a virtually no risk of default.

E. Treasury notes and bonds are large long-term obligations issued by the federal government and are seen as the safest of all financial assets.

F. Treasury bills are large short-term obligations issued by the federal government.

G. Individual Retirement Accounts (IRAs) are long-term, tax-sheltered time deposits intended for retirement.

Discussion Question

What types of investments are available to an investor with less than $1,000 or less? (certificates of deposit, savings bonds, and IRAs)
V. Markets for Financial Assets

A. Capital markets are markets in which money is loaned for more than one year.

B. Money markets are markets in which money is loaned for less than one year.

C. Primary markets are markets in which only the original issuer can repurchase or redeem a financial asset.

D. Secondary markets are markets in which financial assets can be resold to new owners.

Discussion Question

Would a company seeking funds with which to expand its facilities look for capital market or money market funds? Why? (capital market funds, because the company will need the funds for several years)
DID YOU KNOW?

The 30 stocks included in the Dow-Jones Industrial Average represent about a fifth of the $8 trillion-plus market value of all U.S. stocks and about a fourth of the value of stocks listed on the New York Stock Exchange.

I. Market Efficiency
   A. The Efficient Market Hypothesis states that it is not possible to “beat the market” regularly.
   B. Instead of trying to beat the market, investors should diversify their portfolios by holding a large number of stocks, or enlist the assistance of a stockbroker.

Discussion Question

Why do some people claim it is not possible to beat the market? (At least 1,000 professional stock analysts are studying each stock. Private investors cannot possibly know as much as people who spend all their time researching and studying individual companies.)

II. Organized Stock Exchanges
   A. The New York Stock Exchange (NYSE) lists the shares of about 2,800 large companies, and has 1,400 seats or memberships with access to the trading floor.
   B. The American Stock Exchange (AMEX) lists the shares of about 750 companies.
   C. Regional stock exchanges list shares that are too small or too new to be listed on the NYSE or the AMEX.
   D. Global stock exchanges include stock exchanges around the world.

Discussion Question

What happens on the floors of stock exchanges? (Shares are bought and sold. Brokers from around the country and around the world place orders with their head offices, which execute the trades on the floor of the stock exchange on which the stock is traded.)
III. The Over-the-Counter Market
   A. Most shares are not traded on exchanges but in electronic over-the-counter (OTC) trades.
   B. NASDAQ lists information on companies traded OTC.

Discussion Question
How are OTC trades executed? (Investors trade OTC shares in just the way they trade shares listed on stock exchanges—by calling a broker or making the trade themselves over the Internet.)

IV. Measures of Stock Performance
   A. The Dow-Jones Industrial Average is an index made up of 30 stocks.
   B. Standard & Poor’s 500 is an index made up of 500 representative stocks.
   C. A bull market is a market in which prices are rising; a bear market is a market in which prices are falling.

Discussion Question
What does the S&P 500 show? (how the market as a whole is performing)

V. Trading in the Future
   A. A spot market is a market in which transactions are made at the prevailing price.
   B. A futures market is a market in which futures contracts are bought and sold.
   C. Futures contracts are agreements to sell at a specific date at a predetermined price.
   D. An options market is a market in which put and call options are bought and sold.
   E. A call option gives the owner the right to buy a share of stock at a specified price some time in the future.
   F. A put option gives the owner the right to sell a share of stock at a specified price in the future.

Discussion Question
Why do futures markets exist? (Some people simply like gambling on the future price of a commodity or stock. Others need to lock in a firm price.)
DID YOU KNOW?

The United States has the highest Gross Domestic Product in the world. In 2001 its GDP reached $9.4 trillion, up from $9.1 trillion in 2000.

PAGES 341-344

I. GDP—The Measure of National Output

A. Gross Domestic Product (GDP), a measure of national output, is computed by multiplying all final goods and services produced in a 12-month period by their prices.

B. Intermediate goods, secondhand sales, and nonmarket transactions are excluded from GDP.

C. GDP tells nothing about the composition of output or the impact of production on quality of life.

D. Despite its limitations, GDP is still the best measure of overall economic health.

Discussion Question

What does an increase in GDP indicate? (that the country experienced economic growth)

PAGES 344-346

II. GNP—The Measure of National Income

A. Gross National Product (GNP) is equal to GDP plus all payments that Americans receive from outside the United States minus all payments made to foreign-owned resources inside the United States.

B. Net National Product (NNP) is equal to GNP minus depreciation.

C. National Income (NI) is equal to NNP minus all taxes paid by businesses other than the corporate profits tax.

D. Personal Income (PI) is the total amount of income received by individuals before taxes.

E. Disposable Personal Income (DI) is PI less taxes.

Discussion Question

Which measure of national income would you be interested in if you were trying to forecast sales of consumer goods? (disposable personal income, which reflects the amount of money individuals have to spend)
III. Economic Sectors and Circular Flows

A. The consumer sector includes individuals/households.
B. The investment sector includes businesses.
C. The government sector includes local, state, and federal levels of government.
D. The foreign sector includes all consumers and producers outside the United States.

Discussion Question
Which sector includes defense spending? The exports of U.S.-made goods? (the government sector; the foreign sector)

IV. The Output-Expenditure Model

A. The output-expenditure model is a macroeconomic model used to show aggregate demand by all the economic sectors.
B. The equation for the output-expenditure model is GDP = C+I+G+F.
C. Each sector spends its income on different types of goods and services.

Discussion Question
Why is the output-expenditure model important? (It allows the economist to measure the entire output and expenditures of all the sectors of the economy at once.)
DID YOU KNOW?

In 1999, classrooms around the country helped create a market basket of goods and services used by teenagers. The data was used to create a Teenage Consumer Price Index (TCPI).

I. Constructing a Price Index
   A. A price index is used to measure changes in prices over time.
   B. A price index is created by selecting a base year and a representative market basket of goods.

   Discussion Question
   What do price indices show? *(the change in price relative to a base year)*

II. Major Price Indices
   A. The consumer price index (CPI) reports changes in the prices of 80,000 consumer goods and services.
   B. The producer price index (PPI) reports changes in prices received by domestic producers for 3,000 commodities.
   C. The GDP price deflator is an index of average prices for all goods and services.

   Discussion Question
   Why are price indices broken down into subcategories? *(to give consumers and businesses a better idea of how prices in industry have changed)*

III. Real vs. Current GDP
   A. Real GDP is calculated by dividing current GDP by the implicit GDP price deflator and multiplying by 100.
   B. Converting current GDP into real GDP is useful for comparing GDP over time.

   Discussion Question
   Why is it desirable to compare real GDP figures rather than current dollar figures? *(Current dollar figures reflect inflation. Only by comparing real GDP can real changes in economic growth be identified.)*
DID YOU KNOW?

By April 2000, the population of the United States stood at about 281.4 million people. According to the Census Bureau, that figure will rise to 380 million people by 2050.

PAGES 356-357

I. Population in the United States
   A. A census is an official count of all people, including their places of residence.
   B. The Census Bureau conducts surveys every month and a full census every 10 years.
   C. The Census Bureau tabulates and presents its data in two classifications: the urban population and the rural population.
   D. The rate of population growth in the United States has been declining since at least 1860, falling to just 0.9 percent by 2002.
   E. The Census Bureau tracks geographic distribution of population and reports that the population is growing in the West and South and shrinking in the Northeast and Central Plains regions.
   F. The Census Bureau tracks the shifts in the center of population, or the point where the country would balance if it could be laid flat and people all weighed the same.

Discussion Question

Why do you think the rate of population growth has fallen? (People have smaller families today than they once did; the level of immigration is much lower than it once was.)

PAGES 358-361

II. Projected Population Trends
   A. Factors that affect population are the fertility rate, life expectancy, and net immigration.
   B. The dependency ratio will rise as a result of the aging of the baby boom generation.
   C. Factors that affect population will also affect the racial and ethnic makeup of the United States.

Discussion Question

What do you think accounts for the changes in the ethnic and racial makeup the Census Bureau forecasts for 2050? (immigration and higher birthrates among minorities than among whites)
DID YOU KNOW?

Beginning in 1991, the United States enjoyed the longest period of prosperity in its history, with the economy growing at a robust 3.9 percent in 1999.

I. Economic Growth in the United States
   A. Economic growth is best measured by real GDP per capita.
   B. Real GDP per capita has grown somewhat more slowly than total real GDP.

Discussion Question
Why is it important to look at per capita rather than total GDP? *It shows how much output increased per person. If the population grows more rapidly than the economy, per capita GDP will fall and people will be worse off on average than they were the previous year, even if the economy grows.*

II. Importance of Economic Growth
   A. Economic growth increases the standard of living.
   B. Economic growth increases the tax base, allowing the government to provide more and better-quality public services.
   C. Economic growth helps reduce poverty and related problems.
   D. Economic growth increases U.S. demand for imports, which helps create jobs and generate income in foreign countries.
   E. Economic growth in the United States encourages other countries to adopt market economies.

Discussion Question
How does economic growth increase the standard of living? *When the economy grows, unemployment falls and incomes rise. The standard of living rises because people are able to purchase more goods and better services.*
III. Factors Influencing Economic Growth

A. Natural (and renewable) resources, including land and minerals, contribute to economic growth.
B. A high capital-to-labor ratio contributes to economic growth.
C. Skilled and growing labor force contributes to economic growth.
D. Entrepreneurs contribute to economic growth.

Discussion Question
How many factors influencing economic growth does the United States have? *(The United States has all four.)*

IV. Productivity and Growth

A. Productivity has increased in the United States since 1959, with large increases occurring since 1996.
B. Declines in productivity hurt the economy.

Discussion Question
How do economists explain the very large increase in productivity over the past several years? *(Information technology, including computers and the Internet, have made businesses more efficient.)*
DID YOU KNOW?

The average recession in the United States lasted 15 months and reduced output by 8.7 percent. The average expansion lasted 46 months and increased output by 22.5 percent.

PAGES 375-378

I. Business Cycles in the United States
   A. The business cycle consists of two phases: expansion and recession.
   B. Recession begins with a peak and ends with a trough.
   C. Expansion is the recovery from a recession.
   D. If a recession becomes very severe, it can turn into a depression.
   E. The worst depression in U.S. history was the Great Depression, which began in 1929.
   F. The Great Depression was caused by various factors, including excessive borrowing in the 1920s and global economic conditions.
   G. Since the Great Depression, the United States has experienced several recessions, but each was short compared with the recovery that followed.

Discussion Question

What happens during a depression? (Production slows, output declines, unemployment rises, and the standard of living falls.)

PAGES 378-379

II. Causes of the Business Cycle
   A. Businesses reduce their capital expenditures once they decide they have expanded enough.
   B. Businesses cut back their inventories at the first sign of an economic slowdown.
   C. Businesses cut back on investment after an innovation takes hold.
   D. Tight money policies of the Federal Reserve System slow the economy.
   E. External shocks, such as increases in oil prices and international conflicts, can cause business cycles.
Discussion Question

Why do businesses cut back on their inventories when they think the economy is turning down? (Because they fear sales will decline.)

PAGES 379-380

III. Predicting Business Cycles

A. Econometric models are macroeconomic models that use algebraic equations to describe how the economy behaves.

B. The index of leading indicators is a monthly statistical series that helps economists predict the direction of future economic activity.

Discussion Question

Why is it important to predict business cycles? (Businesses and the government are better able to plan their actions if they know how the economy is likely to perform. A business that had planned to expand its plant, for example, might delay construction if it believed the economy was about to enter a recession.)
DID YOU KNOW?
At the peak of the Great Depression, one out of every four people was unemployed. Between 1929 and 1933, real net national product, wholesale prices, and the money supply all declined by more than one-third.

PAGES 382-384

I. Measuring Unemployment
   A. The unemployment rate shows the percentage of unemployed people divided by the total number of people in the civilian labor force.
   B. The unemployment rate understates unemployment because it does not include “discouraged” workers or people who are working part-time because they cannot find full-time work.

Discussion Question
What is a “discouraged” worker? (Someone who has given up trying to find a job and is, therefore, not included in the unemployment rate.)

PAGES 384-386

II. Kinds of Unemployment
   A. Frictional unemployment occurs when workers are between jobs.
   B. Structural unemployment occurs when a fundamental change in the economy reduces the demand for workers and their skills.
   C. Cyclical unemployment is related to changes in the business cycle.
   D. Seasonal unemployment results from changes in the weather or changes in demand for certain products.
   E. Technological unemployment results from technological improvements that make some jobs obsolete.

Discussion Question
What kinds of unemployment are likely to affect construction workers? (cyclical unemployment, because construction slows in an economic downturn, and seasonal unemployment, because construction slows in the winter)
III. The Concept of Full Employment

A. Full employment is the lowest possible employment rate when the economy is growing and all factors of production are being used as efficiently as possible.

B. Full employment is achieved when the unemployment rate falls below 4.5 percent.

Discussion Question

How can the economy be considered at full employment when some people are still unemployed? (Some people are always unemployed because of frictional employment. When a two-income family moves, for example, both spouses do not always find jobs right away.)
DID YOU KNOW?

Hyperinflation was so severe in Germany in the 1920s that it completely wiped out the savings of many middle-class Germans. By the end of 1923, $1 was worth four trillion German marks.

I. Inflation in the United States

A. The inflation rate is determined by comparing the price level at the beginning and end of a period.

B. Sometimes deflation can occur when there is a decrease in the general price level.

C. Creeping inflation is inflation in a range of 1 to 3 percent annually.

D. Galloping inflation is when inflation can go as high as 100 to 300 percent annually.

E. Inflation of more than 500 percent a year is known as hyperinflation.

Discussion Question

What are some of the consequences of hyperinflation? (Money loses its value, people have difficulty comparing prices, and bartering takes place.)

II. Causes of Inflation

A. Demand-pull inflation occurs when all sectors of the economy try to buy more goods and services than the economy can produce.

B. Sometimes demand-pull inflation is caused by the federal government’s deficit spending.

C. Cost-push inflation occurs when input costs, especially labor, drive production costs up.

D. The wage-price spiral occurs when higher prices force workers to demand higher wages, forcing producers to raise their prices even more.

E. Excessive monetary growth can cause inflation.

Discussion Question

How can demands for higher wages by unions contribute to inflation? (Higher wages increase a company’s production costs, forcing it to raise its prices.)
III. Consequences of Inflation

A. When inflation occurs the dollar buys less.

B. Inflation hurts people with fixed incomes.

C. Inflation can cause people to change their spending habits, which disrupts the economy.

D. Inflation tempts some people to speculate heavily to take advantage of the higher price level.

E. Inflation alters the distribution of income.

Discussion Question

Why does inflation hurt people on fixed incomes more than other people? (People who earn wages or salaries see their incomes rise when prices go up. In contrast, people on fixed incomes must pay more for the things they buy without an increase in their incomes.)
DID YOU KNOW?

In 1999, the U.S. poverty guidelines for a family of four set a maximum income level of $20,880 for people living in Alaska, $19,210 for people living in Hawaii, and $16,700 for people living in the 48 contiguous states and the District of Columbia.

I. The Distribution of Income
   A. The Lorenz curve shows how the actual distribution of income differs from an equal distribution.
   B. Since 1980 the distribution of income in the United States has become more unequal.

Discussion Question
What are some of the possible negative consequences of a very unequal distribution of income? (Crime can increase, and poor people can become bitter and disillusioned.)

II. Reasons for Income Inequality
   A. Level of education affects people’s ability to get high-paying jobs.
   B. Differences in wealth lead to differences in income.
   C. Discrimination reduces the incomes of women and minorities.
   D. Differences in abilities allow some people to earn more than others.
   E. Monopoly power allows some groups, such as doctors, to maintain high incomes.

Discussion Question
What are some of the reasons why a person from a lower-income family might end up earning less than a person from a higher-income family? (The lower-income person might receive less education or they might face discrimination based on gender or ethnicity.)
III. Poverty

A. Poverty is defined as having an income below a certain level (poverty guidelines).

B. Poverty in America is extensive: more than 12 percent of the population lives in poverty.

C. Poverty has increased as a result of the growing gap in the distribution of income because of structural changes from a goods production to a service production economy, the widening gap between well-educated and poorly educated workers, declining unionism, and the changing structure of the American family.

Discussion Question
Why do poverty guidelines vary across different parts of the country? (The cost of living differs. On average, it is more expensive to live in Hawaii and Alaska than in the rest of the United States.)

IV. Antipoverty Programs

A. Income assistance provides cash to people in need.

B. General assistance provides noncash assistance, such as food stamps, to people in need.

C. Social service programs provide assistance with family planning, job training, child abuse prevention, and other problems affecting lower-income people.

D. The earned income tax credit provides federal tax credits and/or cash to low-income workers.

E. Enterprise zones provide jobs in poor neighborhoods.

F. Workfare programs require welfare recipients to work in order to receive benefits.

G. A negative income tax would replace welfare programs by providing cash to people living below the poverty line.

Discussion Question
Do you think people who receive government assistance should have to work in order to receive benefits? (Answers will vary, but students should consider all aspects of these programs and the people who use them when making their arguments.)
Did You Know?

Alan Greenspan was first appointed Federal Reserve Board Chairman by Republican President Ronald Reagan in 1988. He was re-appointed by the Republican President George Bush and then again by the Democratic President Bill Clinton. The business community gives Greenspan high ratings and some argue that, aside from the president, Greenspan is the most powerful man in Washington, D.C.

I. Structure of the Fed

A. The Federal Reserve System is owned by its member banks.
B. The Board of Governors establishes policies for the Federal Reserve and member banks to follow, regulates certain operations, and controls the money supply.
C. The 12 Federal Reserve district banks and 25 branch banks are located near the commercial banks they serve.
D. The Federal Open Market Committee (FOMC) makes decisions about the growth of the money supply.
E. The Federal Advisory Council, the Consumer Advisory Council, and the Thrift Institutions Advisory Council advise the Board of Governors.

Discussion Question

What is the main function of the Federal Reserve? How does the Fed perform this function? (The function of the Fed is to control the money supply. The primary instrument the Fed uses to affect the money supply is the FOMC.)

II. Regulatory Responsibilities

A. The Fed monitors member banks’ reserves.
B. The Fed oversees bank holding companies.
C. The Fed oversees foreign banks operating in the United States as well as the international operations of U.S. member banks and holding companies operating abroad.
D. The Fed approves bank mergers.
Discussion Question

Why might the Fed disapprove of a merger between two large banks? *(because it might limit competition)*

III. Other Federal Reserve Services

A. The Federal Reserve is responsible for check clearing.

B. The Federal Reserve is responsible for extending truth-in-lending disclosures to millions of individuals who purchase or borrow from corporations, retail stores, automobile dealers, and lending institutions.

C. The Federal Reserve is responsible for issuing paper currency.

D. The Federal Reserve is responsible for providing financial services to the federal government.

Discussion Question

Why is it important that the Federal Reserve remain politically independent? *(Since the Fed provides financial services for the government, it should be independent and not be influenced by politics.)*
DID YOU KNOW?

Every piece of paper money issued in the United States has the name of one of the 12 Federal Reserve banks on it. Most money in a region will bear the name of the closest Federal Reserve bank.

PAGES 415-418

I. Fractional Bank Reserves

A. The Federal Reserve requires that member banks keep a certain percentage of their deposits in the form of legal reserves.

B. A bank’s balance sheet shows its assets, liabilities, and net worth. Balance sheets are sometimes referred to as T-accounts, because the accounts form a T when written.

C. Every time a bank customer makes a deposit, the bank must set aside a portion of the deposit as reserves.

D. Banks earn money by lending out that portion of their deposits that need not be held as reserves.

E. To earn its profits, a bank usually needs to charge 2–3 percent more for its loans than the rate of interest it pays for its saving accounts and time deposits, interest bearing deposits that cannot be withdrawn by check.

Discussion Question

How are loans affected when the Federal Reserve raises the reserve requirement? (The money available for loans declines. Changing the reserve requirement is one of the tools the Fed can use to increase or decrease the money supply.)

PAGES 418-419

II. Fractional Reserves and Monetary Expansion

A. A system of fractional reserve banking allows banks to make a large volume of loans.

B. A change in the money supply is equal to the change in reserves divided by the reserve requirement.
Discussion Question
How much would the banking system as a whole lend if it received deposits of $10,000 and the reserve requirement was 15%? ($10,000 ÷ .15 = $66,666)

PAGES 419-424

III. Tools of Monetary Policy

A. The Fed can affect the money supply by changing the reserve requirement.
B. The Fed can affect the money supply by buying and selling government securities (open market operations).
C. The Fed can affect the money supply by changing the discount rate, the interest rate the Fed charges on loans to financial institutions.
D. The Fed can affect the money supply by changing margin requirements.
E. The Fed can affect the money supply through moral suasion and selective credit controls.

Discussion Question
What is the main instrument by which the Fed affects monetary policy? (open market operations)
DID YOU KNOW?

Over the past 35 years, the Fed funds rate (the rate banks charge each other for short-term funds) ranged from a low of 1.6 percent in 1958 to a high of 16.4 percent in 1981. In 2001, the rate was 3.88 percent.

PAGES 426-427

I. Short-Run Impact
   A. Changes in the money supply affect interest rates.
   B. Sometimes the Fed's long-term objectives force it to keep interest rates above or below the desired level in the short run.

Discussion Question

How do changes in the money supply affect interest rates? (When the Fed expands the money supply, banks have plenty of money to lend and have to lower interest rates in order to lend all of the money in circulation. When the Fed contracts the money supply, banks have to ration the money they have, which is done by raising interest rates.)

PAGES 427-429

II. Long-Run Impact
   A. Changes in the money supply affect the general level of prices.
   B. Monetizing the government's debt means creating enough extra money to offset deficit spending in order to prevent interest rates from changing.
   C. In 1980 the Fed decided to control inflation by restricting the growth of the money supply.
   D. The real rate of inflation is the market rate of interest minus the rate of inflation.

Discussion Question

Why does an increase in the money supply raise the price level? (With more money in circulation, people spend more. Unless the economy can expand, the increased spending raises the price level.)
III. Other Monetary Policy Issues

A. A tight monetary policy can hurt some industries, like homebuilding and automobiles, more than other industries.

B. High interest rates encourage people to forgo consumption today and increase their savings; low interest rates encourage people to borrow money today, which will reduce their ability to consume in the future.

C. M1 includes traveler’s checks, coins, currency, demand deposits, and other checkable accounts; M2 includes M1 plus small denomination time deposits, savings deposits, and money market funds.

Discussion Question

Why is it difficult for the Fed to use monetary policy to fine-tune the economy? (The effects of the Fed’s policies are not always felt right away.)

IV. The Politics of Interest Rates

A. The Fed is an independent monetary authority, but it comes under political pressure to raise or lower interest rates.

B. The president and Congress can affect the Board of Governors by appointing new members when governors’ terms expire.

Discussion Question

If the economy was in a recession, what might the president want the Federal Reserve to do? (increase the money supply in order to lower interest rates so that businesses would borrow money to expand)
DID YOU KNOW?

The “misery index” (the sum of inflation plus the unemployment rate) in the United States was below 8 percent at the end of the twentieth century, far lower than the 14 percent rate in Israel or the 22 percent rate in Spain.

PAGES 437-438

I. The Economic Costs

A. The GDP gap measures the difference between actual GDP and the GDP that could have been achieved had all resources been fully employed.

B. The misery index is the sum of monthly inflation and unemployment rates.

C. Uncertainty increases when real GDP declines.

Discussion Question

Do you think the GDP gap is large today? (Answers will vary but should indicate students’ awareness that the economy is growing rapidly and that unemployment is below the full employment rate.)

PAGES 439-440

II. The Social Costs

A. Economic instability results in wasted labor, capital, and natural resources.

B. Economic instability can lead to political instability.

C. Economic instability is associated with increased crime, lower levels of police protection and municipal services, and less willingness by companies to hire disadvantaged people or provide on-the-job training.

Discussion Question

How could economic instability affect you and your family? (Answers will vary but could include the facts that one or both parents could lose their jobs, municipal programs could be cut, and it could be difficult to find an after-school or summer job.)
DID YOU KNOW?
In 1997, exports by the United States increased aggregate demand by $689 billion. Imports to the United States increased aggregate supply by $871 billion.

I. Aggregate Supply
   A. The aggregate supply curve shows the amount of real GDP that could be produced at various price levels.
   B. When costs fall, the aggregate supply curve shifts to the right.
   C. When costs rise, the aggregate supply curve shifts to the left.

Discussion Question
How did the fall in the cost of computers in the last 20 years affect aggregate supply? (It shifted the aggregate supply curve to the right, increasing the supply of computers.)

II. Aggregate Demand
   A. Aggregate demand shows the quantity of real GDP that would be purchased at various price levels.
   B. A decrease in savings, expectations of a strong economy, an increase in transfer payments financed through deficit spending, or a reduction in taxes shifts the aggregate demand curve to the right.
   C. An increase in savings, expectations of a weak economy, a decrease in transfer payments financed through deficit spending, or an increase in taxes shifts the aggregate demand curve to the left.

Discussion Question
What would happen to aggregate demand if average income in the United States rose? (It would increase.)
III. Macroeconomic Equilibrium

A. Macroeconomic equilibrium is achieved when aggregate supply equals aggregate demand.

B. Although aggregate supply and demand curves do not provide exact predictions about the economy, they are useful for analyzing macroeconomic trends.

Discussion Question

What happens when the economy is not in equilibrium? (If aggregate demand exceeds aggregate supply, unemployment may fall and prices may rise. If aggregate supply exceeds aggregate demand, unemployment may rise and the economy may contract.)
DID YOU KNOW?

John Maynard Keynes (1883–1946) was one of the most influential economists of the twentieth century. In addition to revolutionizing economic thinking about fiscal policy, he played a central role in the Bretton Woods Conference of 1944, which created the International Monetary Fund and the World Bank.

I. Demand-Side Policies

A. The multiplier effect means that a change in investment spending will have a magnified effect on total spending.

B. When a change in investment is caused by a change in overall spending, a downward economic spiral may begin. This is known as the accelerator effect.

C. According to Keynes, only the government is large enough to offset changes in investment spending.

D. Unemployment insurance and federal entitlement programs work as automatic stabilizers, automatically increasing government spending whenever changes in the economy threaten people’s incomes.

E. In the long run, all attempts by the government to increase aggregate demand merely increase the price level without increasing real GDP.

Discussion Question

How would supporters of fiscal policy help pull the economy out of a recession? (by cutting taxes or increasing government spending)

II. Supply-Side Policies

A. Hopes that reducing tax rates would actually increase tax collections failed to materialize in the 1980s.

B. Successful supply-side policies can shift aggregate supply, moving the economy into equilibrium.

C. Supply-side policies seek to promote economic growth rather than economic stability.
Discussion Question

What was the Laffer curve? (The Laffer curve is based on the belief that a reduction in tax rates would raise rather than lower total tax collections. It was proposed that the lower rates would stimulate so much growth that the increase in revenues would more than make up for the decrease in tax rates. The hypothetical relationship was not borne out by experience in the 1980s, when tax rates and tax revenues fell.)

III. Monetary Policies

A. Monetarists believe the money supply should be allowed to grow at a slow but steady rate in order to control inflation and permit economic growth.

B. Monetarists believe that expanding the money supply cannot permanently affect the rate of employment.

Discussion Question

Why do monetarists oppose daily monitoring of the money supply? (Monetarists think the economy is too complicated to fine tune. Instead, they support a steady constant increase in the money supply.)
**DID YOU KNOW?**

Martin Feldstein, former chair of the Council of Economic Advisers writes that people are frequently surprised to learn how small the Council actually is. They hear the word “council” and think of a dozen or more people sitting around a conference table when, in fact, the CEA has only a chairman and two additional members. Talking with senior economic officials from around the world, Feldstein also discovered that the institutionalized appointment of a professional economist to a country’s president or leader is rare. In other countries economists rarely have direct and regular access to the head of the government, nor are they able to participate as an equal in all cabinet-level discussions.

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**PAGES 456-458**

I. The Changing Nature of Economic Policy

A. For a variety of reasons, discretionary fiscal policy is used less today than it once was.

B. Passive fiscal policy, like automatic stabilizers and a progressive income tax, contribute to the stability of the American economy.

C. Structural fiscal policies are designed to strengthen the economy in the long run rather than deal with temporary problems, such as unemployment or inflation.

D. Declining discretionary fiscal policy has increased the influence of monetary policy.

E. Though often the target of criticism, most members of Congress believe that the power to create money should remain with an independent agency, not elected officials.

**Discussion Question**

Why is it difficult to use fiscal policy to deal with short-term changes in the economy? *(Fiscal policy cannot be implemented quickly. By the time a tax cut or an increase in government spending is approved, the economy may already be recovering.)*

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**PAGES 458-459**

II. Why Economists Differ

A. Economists choose policies that reflect their sense of which economic problems are most critical.

B. Economists are affected by the economic conditions prevailing in their lifetimes.
Discussion Question

How might living through a period of hyperinflation affect an economist’s thinking? (It might make him or her more likely to focus on controlling inflation, even at the expense of some unemployment.)

III. Economic Politics

A. The Council of Economic Advisers advises the president of the United States on economic policy.

B. Economists have contributed a great deal to the understanding of economic activity. They can help policy makers prevent another Great Depression, stimulate growth, or help disadvantaged groups. It is unlikely, however, that they can help a country avoid minor recessions.

Discussion Question

Why do you think politicians are concerned about the economy? (Answers will vary but could include the fact that voters tend to choose their politicians based on their sense of economic well-being.)
**DID YOU KNOW?**

As the Industrial Revolution spread across Europe, its nations began to build colonial empires in Asia and Africa so that they would have a reliable supply of the raw materials they needed for their factories. Former colonies had to end European colonialism in order to benefit from the exportation of their own natural resources.

**PAGES 468-469**

I. The U.S. and International Trade

A. The sheer volume of exports and imports indicates that international trade is beneficial.

B. Nations trade because they believe the products they receive (imports) are worth more than the products they sell (exports).

C. Without international trade, many products would not be available on the world market.

D. Many imports to the United States are necessities that would be unavailable without trade.

**Discussion Question**

Think about what would happen if the United States could not obtain oil on the world market. What would the United States have to do in order to get more oil? (*The country’s industries would either have to find a domestic source, find an equally useful substitute, or stop producing certain products. Whatever the scenario, there would probably be increased production costs and a reduction in supply.*)

**PAGES 469-470**

II. The Basis for Trade

A. A country has an absolute advantage when it can produce a product more efficiently than another country can.

B. Even when one country enjoys an absolute advantage, trade between it and another country is still beneficial because of comparative advantage.

C. A country has a comparative advantage when it produces a product relatively more efficiently. Relative efficiency is determined by the opportunity cost of producing one product over another.
Discussion Question

Both pants and skirts sell for $10 apiece. You can make six skirts in a day, or four pairs of pants. Should you trade your skirts with someone who can make three pairs of pants in a day? (Yes. Though you will have one less pair of pants then if you made pants yourself, you can instead put your time into making skirts and be much better off.)

III. The Gains from Trade

A. Each country must produce more of the good in which it has a comparative advantage and then exchange the extra output for the extra output of its trading partners.

B. Comparative advantage is based on the assumption that a country should produce a product that has a low opportunity cost.

Discussion Question

Think of a product that is produced in our state. What factors contributed to our state's comparative advantage? (Factors might include climate, fertile soil, population density, an experienced labor force, and transportation.)
DID YOU KNOW?

International trade benefits port cities—those with harbors—as well as cities with extensive industry. Ports in Louisiana, Texas, New York, and New Jersey together handle over 109 million tons of exports, based on 1997 figures.

PAGES 472-474

I. Restricting International Trade

A. Two major ways of restricting trade are through a tariff, or tax placed on imports, and a quota, a limit on the quantities of a product that can be imported.

B. A protective tariff is one that is high enough to protect less efficient domestic industries.

C. A revenue tariff is one high enough to generate revenue.

D. Most quotas are used to reduce the supply of a product and keep prices high for domestic producers.

E. Other barriers to trade include rigorous health inspections and difficult licensing requirements.

Discussion Question

Current trade agreements give country A the right to retaliate with trade barriers if country B restricts country's A products. Do you think that's a good idea? Why or why not? (Answers will vary. It does provide a mechanism for enforcement, however, and could lead to further barriers. Mediation is sometimes a more effective response.)

PAGES 474-476

II. Arguments for Protection

A. Protectionists are people who favor trade barriers that protect domestic industries and offer various arguments to defend their position.

B. According to one argument, a country could become so specialized that it would end up being dependent enough on other countries that it would affect national defense.

C. The infant-industries argument is the belief that new industries should be protected from foreign competition.

D. Some argue that tariffs and quotas protect domestic jobs from cheap foreign labor.

E. The argument for keeping the money at home claims that limiting imports will keep American money in the United States.
F. The balance of payments argument suggests that protection would keep down the difference between the money a country pays to and what it receives from other nations.

Discussion Question
Which argument for protection seems most convincing? Most suspect? (Answers will vary. Most economists believe that carefully considered national defense protectionism is warranted. Suspect is the keep-the-money-at-home argument that discounts the benefits of comparative advantage and downplays the importance of jobs provided by a strong export industry.)

PAGES 476-479

III. The Free Trade Movement

A. Trade barriers work only if other countries do not retaliate, causing all countries to suffer.
B. Restrictive legislation in the past nearly halted international trade.
C. Various trade agreements have allowed countries to reduce tariffs in cooperation with other nations.
D. The World Trade Organization (WTO) and the North American Free Trade Agreement (NAFTA) are examples of international agencies for promoting freer trade.

Discussion Question
What, if anything, should a country’s political system have to do with a trade agreement? For example, should a country receive most favored nation status from the United States if it is suspected that some of its workers are slave laborers? Why or why not? (Many people feel the United States should take a moral stand against any country that does not promote democratic standards. Others feel that economic exchanges expose the population of less democratic countries to Western standards of democracy and improve the likelihood of their pressing for change.)
Archaeologists can track the trade routes of ancient civilizations, such as that of the Phoenicians, by the distinctive goods with which they traded. Merchant records also provide clues into both their languages and their cultures.

I. Financing International Trade
   A. Foreign exchange is the buying and selling of the currencies of different nations.
   B. The foreign exchange rate is the price of one country’s currency in terms of another country’s currency.
   C. Exchange rates are fixed or flexible.
   D. Flexible exchange rates, commonly used today, establish the value of each currency through the forces of supply and demand.

**Discussion Question**

What kind of major news events, reported worldwide, might drive the value of a country’s currency up or down? (events such as a change in interest rates, the discovery of a major energy source, a disaster that destroyed a major industrial area, a military takeover, or a war)

II. Trade Deficits and Surpluses
   A. Whether a country has a trade deficit or surplus depends in part on the international value of its currency.
   B. The trade-weighted value of the dollar is an index that shows the strength of the dollar against foreign currencies.
   C. A strong dollar can lead to a trade deficit because American goods become too expensive, and imports become relatively inexpensive.
   D. A weaker dollar buys fewer foreign goods.
   E. Deficits and surpluses tend to be self-correcting.

**Discussion Question**

When would it be most economical for Americans to travel abroad: when the dollar is weak or when it is strong? Why? (A strong dollar allows American dollars to buy more of foreign goods and services because other currencies are weaker by comparison.)
DID YOU KNOW?

The word capital, meaning “wealth,” comes from the Latin word caput, meaning “head,” and a time when someone’s wealth was based on how many head of cattle that person owned. The term per capita, meaning “per head,” comes from the same source.

I. Capitalism

A. The means of production are privately owned.
B. Supply and demand determine prices.
C. Businesses are free to direct resources into profitable activities.
D. Advantages of capitalism include efficiency, freedom, decentralization, a smaller role for government, and a high degree of consumer satisfaction.
E. Capitalism has some disadvantages. It does not provide for the production of many public goods, produces only for those who have the resources to pay for products and services, and is often uncertain and unstable.

Discussion Question

Consider some of the goals you have for yourself. What characteristics of capitalism will help you reach them? Which might make it more difficult? (Answers will vary. Some students may cite the freedom to choose their goals with a minimum of government interference and the ability to enjoy the rewards of their work. Others may feel that they lack the resources to pay for the products and services they need. There are also no guarantees that once they reach their goals they will be able to maintain their positions.)

II. Socialism

A. Government owns and runs some of the basic productive resources in order to distribute output to meet social goals.
B. Advantages of socialism include the distribution of benefits throughout a society and people using their electoral power to influence economic decisions.
C. Some disadvantages of socialism include lowered efficiency, high taxes, the government substituting its judgment for the judgment of the market, and the tendency for special interests to become entrenched.
**Discussion Question**

Given the amount of government involvement in economic decisions, can economic socialism and political democracy coexist? *(In a true socialist society, government is responsive to the electoral power of its people.)*

**III. Communism**

**A.** Theoretically, communism is a selfless society in which the needs of the individual are subservient to the needs of society.

**B.** In reality, communism is often a rigid command-type economy in which the state owns all economic goods.

**C.** State officials, rather than the forces of the market, answer the basic questions of what, how, and for whom to produce.

**D.** Communism has some disadvantages. Individual freedom is lost, as is the incentive for people to work hard. This system usually fails to meet the needs and wants of consumers. Centralized planning is inefficient and lacks the flexibility to deal with day-to-day changes.

**Discussion Question**

What are the worst consequences to individual workers of centralized economic planning in a communist economy? *(They may have little say as to the role they play in the economy. No matter how hard they work, they are not rewarded. Because decisions are made elsewhere, they are not likely to show initiative or care about the quality of their work.)*
DID YOU KNOW?

Though Lenin, the architect of the communist government, was exiled to Siberia because of his socialist activities, he later spent time in Western Europe (1900–1917). Ironically, there he had the freedom to write and edit revolutionary periodicals to be circulated in Russia and plan the overthrow of the czar.

I. The Economy Under Lenin and Stalin
   A. Lenin took large estates from the rich and gave them to the peasants, outlawed private property, and turned factories over to workers.
   B. Since workers did not have skills to manage factories, Lenin eventually reintroduced some capitalist methods.
   C. Stalin’s Five-Year Plan centralized the economy to achieve rapid industrialization.
   D. Stalin instituted collectivization, the forced common ownership of all enterprises.
   E. By the end of World War II, economic plans concentrated on defense building, space exploration, and the production of some consumer goods.

- Discussion Question
What differences do you see between Lenin’s approach to managing the economy and that of Stalin? (For the sake of productivity, Lenin was willing to back off somewhat from communist ideals and allow some capitalism to flourish. Stalin moved forcibly and cruelly to force complete collectivization.)

II. The Soviet Economy after Stalin
   A. The real force in the Soviet Union was the Communist Party.
   B. Gosplan was the central planning authority, with local plant managers and workers having almost no say in how things were done.
   C. The agricultural sector—made up of state and collective farms—was one of the major problems for the economy.
   D. The government was not able to make its agriculture as efficient as agriculture in many capitalist countries.
Discussion Question

Karl Marx believed that capitalism was an economic system that would inevitably lead to communism. Lenin and Stalin tried to forcibly speed that evolution. Did their failure disprove the theories of Karl Marx? (Answers will vary. Some students may argue that the failure was a true test of the philosophies. Others may believe that the wealth of a capitalist society is a necessary prerequisite to test Marx’s theories.)

III. The Soviet Economy Collapses

A. Industrialization in the Soviet Union had made considerable progress but never caught up to the United States, and it lagged much farther behind in consumer goods.

B. Incentive programs, such as the use of piecework, led to the setting of unrealistic goals and poor quality work.

C. Quotas also failed and worsened the economy’s reputation for producing poor goods.

D. In the 1970s and 1980s the Soviet people were impatient for more consumer goods and unwilling to accept sacrifices.

E. Gorbachev hoped to introduce the policy of perestroika, the fundamental restructuring of the economy and government.

F. Gorbachev did not remain in power long enough to see his plans realized, and the Soviet Union collapsed.

Discussion Question

What people would have been more interested in seeing Gorbachev’s reforms fail than in reforming the economy? (members of the Communist Party and managers at various levels who would have lost their power and secure positions)
Where once the Soviet empire was shut off from the free flow of information, now many of its former republics have their own sites on the World Wide Web. Most up-to-date almanacs include those countries’ Web sites.

**I. Problems of Transition**

A. Privatization in some transitional states has been accomplished using vouchers, and by selling state-owned companies to foreign corporations.

B. Where vouchers worked, the Communist Party leaders lost power; in other nations, the old ruling group retained their power.

C. Nations in transition have yet to develop the automatic stabilizers and social welfare nets that cushion the instabilities of capitalism.

D. Transitional countries will have to learn to live with a whole new set of incentives.

**Discussion Question**

What are the costs to individual workers of making the transition from a command economy to a capitalist one? (Their jobs will not be guaranteed. The enterprises they work for will have to compete in the marketplace and will not have the support of the government. If an enterprise is inefficient, it will fail, and workers will have to seek other work.)

**II. Countries and Regions in Transition**

A. Privatization in Russia is well underway.

B. Poland, Hungary, the Czech Republic, and the Baltic states are moving toward capitalism.

C. Mexico is rapidly moving towards capitalism and open markets.

D. In China, after such disastrous plans as the Great Leap Forward, the government has introduced privatization of industries and market reforms.

**Discussion Question**

What countries are former Soviet republics more likely to trade with during this transition period? (They are now free to trade with Western nations. They will probably continue to trade with former Soviet republics.)
Competition in an open marketplace has extended even to sports. Japan, where baseball is very popular, has developed many top players. Some have even been hired away by teams in the United States eager to improve their chances of winning.

I. Japan
A. The government is very involved in the day-to-day activities of the private sector.
B. Japan’s recent economic crisis has severely tested the historically close employee-employer relationship, which was one of the reasons for Japan’s early success.
C. Another reason for Japan’s success was its ability and willingness to develop new technology.
D. Government has worked closely with businesses to limit foreign competition in the domestic market.
E. Japan’s economy is partially closed to the products of foreign producers.
F. Protectionism in Japan does not help consumers, who pay high costs for many products.
G. The Ministry of International Trade and Industry identifies promising export markets and then subsidizes industries so that they can be competitive in this area.
H. In the 1990s a banking crisis resulting from bad loans was part of the reason for Japan’s poor economic performance.
I. Japan needs to institute reforms that redefine the government’s role in the economy and to restructure how firms produce and compete with each other.

Discussion Question
Who would benefit most if Japan opened up its market? (Initially it would be consumers, who would then have access to lower-priced goods. If domestic industries competed by becoming more efficient, all would benefit from the jobs and security of worldwide product leadership.)
II. The Asian Tigers

A. Entrepreneurs in Hong Kong developed an efficient manufacturing-based economy that used technology other countries had developed.

B. Singapore uses generous tax breaks, government subsidies, and government-sponsored training of employees to develop its own technology.

C. Taiwan’s economic development was based on government intervention in various markets in order to direct the flow of resources.

D. In South Korea new economic growth depends on the private economy’s adapting to competition and reducing the support from the political sector.

Discussion Question

New technology is usually based on an important step in manufacturing, research, and development. Is it important that a country develop its own technology? Why or why not? (Though a country’s industries can, for a price, import technology that has been developed elsewhere, thus saving time in production, it may in the long run be more profitable to develop and market one’s own technology.)

III. Sweden

A. The country is not a model of pure socialism because it has had a considerable amount of private enterprise.

B. Government owned some basic industries and used steep taxes to pay for welfare state benefits.

C. The heavy tax burden has cut into Sweden’s economic growth.

D. A free-market government elected in 1991 has reduced the role of the public sector.

Discussion Question

High taxes in Sweden provided such supports as generous maternity leave, education, disability, and old-age benefits. How might the country preserve these benefits without overburdening taxpayers? (Possibilities might include cutting but not eliminating benefits while simultaneously providing incentives for individual savings and employer contributions for social purposes.)
**DID YOU KNOW?**

When the Peace Corps was founded in 1961 by President John F. Kennedy, it drew most of its volunteers from recent college graduates. In the 1990s volunteers were, on average, older and had more experience in specialized fields.

**PAGES 521-522**

I. Interest in Economic Development

   A. The international community has humanitarian, economic, and political concern for the developing countries.

   B. Many people in developing countries starve to death or die from diseases related to inadequate diets and health conditions.

   C. Assistance to developing countries helps assure industrial nations of a stable supply of certain raw materials.

   D. Developing nations are markets for the products of industrial nations.

   E. The gap between industrialized and developing countries contributes to revolution, social upheaval, and even war.

   F. The majority of developing nations are in Africa and Asia.

**Discussion Question**

There are people in the United States who want less foreign aid to be given to developing countries rather than more. What arguments would you use to dissuade them? (Foreign aid would contribute to political stability, help the U.S. retain allies, keep available sources of raw materials, and open further markets for this country’s exports.)
II. Obstacles to Development

A. Population growth is one obstacle to development, as high crude birthrate combines with increasing life expectancy.

B. Limited natural resources, which includes unproductive land and harsh climates, is another obstacle.

C. The lack of education and technology is an economic development obstacle.

D. Religion might keep some people from being interested in economic growth.

E. External debt is money borrowed from foreign banks and governments that some nations may never be able to repay.

F. Capital flight is the legal or illegal export of a nation’s currency and foreign exchange.

G. Corruption at any level of government is an obstacle to economic development.

H. War’s aftermath can linger for decades.

Discussion Question
How does population growth affect per capita GNP? (Longer life expectancies, coupled with a high crude birthrate, make it difficult to increase per capita GNP.)

III. International Agencies

A. The International Monetary Fund (IMF) helps all nations on monetary and fiscal policies and supports developing nations with loans.

B. The World Bank is an important international lending and development agency that makes loans and provides financial assistance and advice to developing nations.

Discussion Question
While economic assistance from an international development agency is vital to a developing nation, advice can also be crucial. In what way might that advice go wrong? (It is important that the advisers be knowledgeable about the country they are advising and make sure that their suggestions are appropriate to that country and its people.)
DID YOU KNOW?

Protective tariffs may serve one part of a country and be a burden on another. When, during the term of John Quincy Adams, the Congress protected northern industries by passing a high-tariff bill, the South, which had to import manufactured goods, called it the “Tariff of Abominations.”

I. Stages of Economic Development

A. Primitive equilibrium is a stage in which there is no formal economic organization.
B. Breaking with primitive equilibrium is a transition period that comes after exposure to outside forces.
C. Takeoff means more rapid growth after overcoming the barriers of primitive equilibrium.
D. Semidevelopment means that the makeup of the country’s economy changes as industry, per capita income, transportation, communications, medicine, law, and other services grow.
E. Development means there is an emphasis on services and more public goods.

Discussion Question

What events or forces might cause one country, such as the United States, to be in more than one stage at the same time? Can you think of an example of this? (Varying national resources in different parts of the country and the effects of war are two factors that might set regions apart. An example might be the period around the Civil War. Before the war, the North was more industrialized than the South. Since much of the war was fought in the South, it had more of a struggle to catch up to the rest of the country.)

II. Priorities for Industrialized Nations

A. Reducing trade barriers could increase export earnings for developing nations by as much as $50 billion.
B. Reforming macroeconomic policy could reduce budget deficits, stabilize inflation, lower interest rates, and stabilize foreign currency fluctuations.
C. Industrialized countries need to increase financial support to developing countries.
D. By supporting policy reform in developing countries a more favorable business climate among all nations can be attained.
Discussion Question
The World Bank often requires that countries make market reforms as a condition for obtaining a loan. Do you think that is right? Why or why not? (As a lender, the World Bank needs to be sure that a borrowing country can pay back its loan. They should be able to ask for reforms that will make repayment more likely. Requested reforms should be realistic and based on conditions in that particular country.)

PAGES 530-531

III. Priorities for the Developing Countries
   A. They should invest in people: education, family planning, nutrition, and basic health care.
   B. They must improve the climate for free enterprise by removing regulations that restrict the free development of markets.
   C. They need to open economies to international trade because trade barriers hold down a country’s standard of living.
   D. They should revise macroeconomic policies: curbing inflation, reducing borrowing, decreasing deficits, and allowing market incentives.

Discussion Question
Developing countries sometimes feel that unrealistic standards are imposed upon them—such as pollution controls for industry and labor practices—standards which developed nations did not adhere to when they were at the same stage of development. Do you think this is fair? Why or why not? (Answers will vary. Some students may argue that it is not always a matter of fairness, but of survival, and morality. Some may suggest that developing nations should impose higher global standards but also support those standards by offering financial assistance.)
DID YOU KNOW?

Wampum, made from seashells strung as beads or woven into belts, was used not only as a medium of exchange but also to record diplomatic relationships among Indian tribes. The word wampum comes from the word Wampumpeag, a Massachusetts Indian language that used different color shells for recording important matters such as treaties. The purple or white wampum beads were carefully woven into patterns that would serve as a visual reminder of a treaty and the arrangements agreed upon.

PAGES 533-534

I. Development with Internal Funds
   A. Internal funds are an important source of capital.
   B. To generate internal funds, an economy must produce more than it consumes.
   C. In a market economy, these savings, in turn, produce financial capital.
   D. In a command economy, governments are able to force savings on the economy.

Discussion Question

What kinds of long-term incentives can governments use to encourage individuals to save? (They can give tax benefits such as deductions for retirement savings; reduce taxes on interest paid for savings; and defer taxation on long-term savings.)

PAGES 534-535

II. Development with External Funds
   A. Developing countries can try to attract private investment.
   B. They can ask for assistance from industrialized countries.
   C. They can borrow from international agencies, including those that offer interest-free loans to the neediest countries.

Discussion Question

Why is it especially important that a developing country be able to exchange its currency for other world currencies? (This makes it easier to conduct international trade, which in turn helps the developing country buy and sell on the world market, thus improving its economy and the welfare of its people.)
III. Regional Cooperation

A. Some countries have formed free-trade areas to reduce trade barriers and tariffs among themselves.

B. Others have formed customs unions, abolishing tariffs and trade restrictions among themselves.

C. Within the European Union, which started out as a customs union, there are no internal barriers to regulate the flow of workers, financial capital, or goods and services.

D. ASEAN is a ten-nation group working to promote regional peace and stability, accelerate economic growth, and liberalize trade policies.

E. OPEC is an international cartel of producers or sellers of petroleum whose higher prices have taken in trillions of dollars from industrialized nations.

Discussion Question

The effects of free-trade organizations are not necessarily felt immediately. Usually trade barriers are removed gradually. Why do you think this happens? (The time lag provides protected industries or agricultural interests time to adjust to the new reality. If they can institute changes that improve their efficiency, they are more likely to survive the lack of protection.)

IV. The South Korean Success Story

A. South Korea overcame the ravages of war and high population density to become a major economic power.

B. The government focused on labor-intensive industries and opened its markets to trade which gave people experience producing and exporting for world markets.

C. The country is now highly industrialized.

Discussion Question

How might the situation in South Korea have been different if it had relied only on foreign aid? (The money would have had the short-term effect of supplying humanitarian and strategic relief, but it would not have done much for the long-term needs of developing a strong industrial economy.)
DID YOU KNOW?

The three most densely populated states are in the Northeast. New Jersey has 1,094 residents per square mile, with runners-up being Rhode Island (946) and Massachusetts (784). Though the West’s population shows the most rapid growth, it has the three states with the lowest density: Alaska with 1, Wyoming with 5, and Montana with 6.

I. The Global Population Issue

A. The views of Thomas Malthus on population, published in 1798, are still relevant today because of Earth’s growing population and its demand for resources.

B. Malthus argued that population would grow faster than its ability to feed itself and eventually be reduced to a condition of subsistence.

C. Malthus did not foresee advances in productivity and family choice.

D. The annual worldwide population growth rate is approximately 1.4 percent a year.

Discussion Question

Which countries are feeling the greatest pressures from a population increase, the developing or the industrialized nations? (Developing nations especially feel the pressure because much of their populations lives at subsistence level. However, industrialized nations also feel the pressure as people from the developing nations move across borders, legally or otherwise, to look for work.)

II. Nonrenewable Energy Sources

A. Population pressure adds to the depletion of many important resources, including energy.

B. Nonrenewable resources cannot be replenished once they are used.

C. The once-low cost of petroleum affected living habits, making people more dependent on it.

D. The artificially low prices of natural gas contributed to its popularity today.

E. Nuclear energy is costly and the disposal of its hazardous byproducts poses a major problem.
Discussion Question

How would your living habits be different if petroleum reserves were almost depleted? (The world would have to find a relatively inexpensive substitute. More consideration would have to be given to such issues as public transportation, smaller and more fuel-efficient vehicles, rationing, carpooling, home-based telecommuters, and smaller houses.)

III. Renewable Energy Sources

A. Alternative energy sources account for only a small portion of the total energy consumed.
B. Hydroelectric power accounts for half of all renewable energy consumed in the United States today.
C. Biomass accounts for approximately 40 percent of all renewable energy in the United States today.
D. Solar energy, the third-largest source of renewable energy, has never been effectively harnessed.
E. Wind power is an important source of power in areas where it is difficult to obtain other forms of energy.

Discussion Question

Which of the renewable energy sources do you think might someday be used to power vehicles successfully? (Ethanol, a grain alcohol made from corn, is used to make gasohol, which can power vehicles. Though currently not cost-effective, it is possible that solar energy cells may someday be commonly used to power vehicles.)

IV. Other Resources

A. Water shortage is an issue in areas where the water table of aquifers has been falling because of heavy use.
B. Urban sprawl has claimed what was once some of the country’s finest farmland.

Discussion Question

Generally, growth in a modern city is vertical. Urban sprawl is the result of horizontal growth. Could vertical growth be the answer to urban sprawl? (Vertical growth is characteristic more of a city than a suburb. Therefore, it is not likely to be a practical solution to urban sprawl. It would be out of character with the suburban landscape and only exaggerate the urbanization of the suburb.)
Acid rain is in part due to efforts to reduce the effects of the Industrial Revolution. When smokestacks are short, the pollutants released hug the ground, causing local health problems. When smokestack heights were increased, the pollutants reached higher into the atmosphere, creating acid rain.

**Did You Know?**

**I. The Price System**

A. The price system contributes to whether scarce resources are conserved.

B. Interest in alternative energy sources surged when there was an oil embargo and waned when there was a glut.

C. The price system works to establish an equilibrium between the rising cost of obtaining water and the profitability of the crops grown with water.

D. The Law of Supply led gas producers to produce more of deregulated deep gas when its price went up.

**Discussion Question**

Why might a country choose to regulate the price of energy sources? *(Possibilities might include preventing monopolies from charging very high prices; equalizing the access of various industries to energy sources; and promoting the use of one source over another.)*

**II. Pollution and Economic Incentives**

A. Pollution will be less of a problem when the incentive to pollute is removed.

B. The setting of legislated standards is one way to control pollution; another is through economic incentives.

C. Legislated standards can be effective, but are generally inflexible.

D. Another way of controlling pollution is to have companies pay taxes on the amount of pollutants they release.

E. The Environmental Protection Agency issues sulfur dioxide pollution permits that will become scarcer and more expensive as time goes by.
Discussion Question

The pollutants that cause acid rain may not be generated in the area that suffers from the damage it causes. This is because prevailing winds carry the pollutants long distances. What can states and countries do to prevent their having to suffer from another state or country’s pollution problems? (Interstate and international treaties may be the only answer to this problem. This is not an easy problem to solve. It may be hard to prove where the pollutants originate and cleaning them up may have economic consequences.)

III. Using Resources Wisely

A. Economists are optimistic about the future, especially if the price system is allowed to fulfill its role in the economy.

B. As long as the price system is allowed to operate, we will never suddenly run out of an endangered resource.

C. Instead, the price of the resource will rise as it becomes scarce, encouraging more careful use and greater attempts to find workable alternatives.

D. The more endangered the resource, the higher the price, making the efforts to conserve and find workable alternatives more urgent.

Discussion Question

What might the economic consequences be of scientists finding a clean, renewable source of energy? (There would be conversion costs for energy users. Also, providers of other sources of energy would either have to change over themselves or lose income.)
DID YOU KNOW?

Though the Nobel Prizes were first distributed in 1901, the one for Economic Science was first awarded in 1969. While the money for the other prizes is drawn from the interest on the $9 million left by Alfred B. Nobel (1833–1896), inventor of dynamite, the economics prize is funded by the central bank of Sweden.

Did you know that

I. A Framework for Decision Making
   A. Economic decision making requires a careful, reasoned approach to problem solving.
      The steps are:
      1. State the problem.
      2. Determine the goal to be obtained.
      3. Consider the alternatives needed to reach the goal.
      4. Choose an economic concept and use it to evaluate the alternatives.
      5. Decide which alternative leads to the achievement of the goal.
   B. Cost-benefit analysis involves comparing the costs of an action to its benefits.
   C. These costs include both opportunity and monetary costs.

Discussion Question

Why is the mission of the National Council on Economic Education, to improve economic literacy in the United States, an important one for the future? (While the economy and the kinds of economic decisions to be made might change, it makes sense to understand how to apply logic to analyze the problems that do arise.)
II. Coping With the Future

A. Although no one knows what the future will bring, capitalism has demonstrated its ability to adapt.

B. Capitalism is no longer ruthlessly efficient as it was in the 1930s.

C. The United States is now a free-market economy based on capitalism yet modified to satisfy social needs.

Discussion Question

As many countries turn to capitalism and a global economy, do you feel that there will be a uniformity in the way free-market economies work? (There are likely to be many similarities, but there are also likely to be many differences because in each country political policies as well as market rules affect how the economy works.)