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**Standard & Poor’s** is a leading source of data, news, and analyses on regional, national, and global economic developments. Standard & Poor’s information is used by industrial firms, financial institutions, and government agencies for setting policy, managing financial positions, planning production, formulating marketing strategies, and a range of similar activities. Standard & Poor’s data services represent the single most sophisticated source of information for organizations that need to understand the impact of the path of economic growth and of government fiscal and monetary policies on their activities.
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Mario Tama/Getty Images


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Federal Spending

- Income security, Social Security, and Medicare: 48.3%
- National defense: 18.8%
- Net interest: 7.4%
- Health: 10.5%
- Other: 13.4%
- International affairs: 1.6%

Source: U.S. Office of Management and Budget.
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GET TO KNOW YOUR BOOK!

*Economics Today and Tomorrow* contains a wealth of information—the trick is to know where to find it. If you go through this scavenger hunt, either alone, with a fellow student, or with your teacher or parents, you will quickly learn how the textbook is organized and how to get the most out of your reading and study time. Let’s get started!

1. How many units and chapters are in the book?

2. What is the difference between the glossary and the index?

3. Unit 2 of the book contains a great deal of information on how to handle the economic aspects of your personal life. Where in the book can you find further information on how economics impacts you on a day-to-day basis?

4. Which feature provides information on current controversial topics in economics?

5. How can you find out how each Main Idea in the book relates to your life?

6. If you want to quickly find all the charts and graphs about supply and demand, where in the front of the book do you look?

7. What is the quickest way to find information on detailed, specific topics like gross domestic product and the national debt?

8. Where can you find the topic of Marketing and Distribution summarized in a visual way?

9. The Web site for the book is referred to at least four times in each chapter. Choose one chapter and find all of the references. How can the Web site help you?

10. Which of the special features provides information about economics in other countries?
As you read *Economics Today and Tomorrow*, you will be given help in sorting out all the information you encounter. This textbook organizes economic concepts around Big Ideas. These Big Ideas are the keys that will help you unlock all of the concepts you will study. By recognizing the Big Ideas and how they relate to the different concepts, you will better understand how economics affects you, your family, and your community today and in the future.

**Scarcity is the basic economic problem that requires people to make choices about how to use limited resources.**
As much as we would like to do and buy anything we want at any time, this is not always possible because there are not enough resources to produce all the things people would like to have. Scarcity forces us to make choices about what, how, and for whom we produce.

**Every society has an economic system to allocate goods and services.**
All societies develop economic systems in which to provide for the wants and needs of their citizens. In the market economy of the United States, buyers and sellers make economic decisions in their best interest.

**The profit motive acts as an incentive for people to produce and sell goods and services.**
In a market economy, people open businesses because they hope to be successful and make a profit. They are free to produce any good or service they wish.

**Buyers and sellers voluntarily interact in markets, and market prices are set by the interaction of demand and supply.**
Sellers can freely choose what to sell, and buyers are free to choose what to buy in a market economy. The price for a product is set by the forces of demand and supply.

**Governments strive for a balance between the costs and benefits of their economic policies to promote economic stability and growth.**
The federal government uses a number of economic policies to further economic growth. The government tries to limit the negative effects of its policies while expanding the benefits.

**Governments and institutions help participants in a market economy accomplish their financial goals.**
There are a number of organizations that help people accomplish their financial goals. Governments develop regulations, and institutions such as banks and nonprofits offer ways to save and grow money.
Economists look at a variety of factors to assess the growth and performance of a nation’s economy. Over time, economists have devised different ways to measure economic performance. These measures range from factors that affect individuals to those that assess the economies of countries, regions, and the world.

The labor market, like other markets, is determined by supply and demand. The forces of supply and demand influence labor as much as any other market. Factors such as skills required and competition for various jobs determine wages.

All levels of government use tax revenue to provide essential goods and services. We have to pay taxes at the local, state, and federal levels. The governments, in turn, use these revenues to provide goods and services that the market economy does not offer. Generally, local governments provide goods and services at the local level, states work statewide, and the federal government focuses on national needs.

Trade and specialization lead to economic growth for individuals, regions, and nations. The more we practice a particular skill, the better we tend to get at it. The same is true in economics. When companies, regions, or nations specialize in the production of goods and services, they become better at it and both the seller and the buyer profit.

The study of economics helps us deal with global economic issues and global demand on resources. Scarcity is an issue not just on a local or national level—it provides challenges on a global scale. Understanding how economics works helps us learn how we can address global problems such as population growth, pollution, and limited resources.

Using the Big Ideas

You will find Big Ideas at the beginning of each chapter of your text. You are asked questions that help you put it all together to better understand you economic concepts are connected—and to see why economics is important to you.
Voluntary National Content Standards in Economics

Economics: Principles and Practices incorporates the 20 Voluntary National Content Standards developed by the National Council on Economic Education.

**Standard 1 Scarcity**

Productive resources are limited. Therefore, people can not have all the goods and services they want; as a result, they must choose some things and give up others.


**Standard 2 Marginal Cost/Benefit**

Effective decision making requires comparing the additional costs of alternatives with the additional benefits. Most choices involve doing a little more or a little less of something: few choices are “all or nothing” decisions.

*Related concepts:* Decision Making, Profit Motive, Benefit, Costs, Marginal Analysis, Profit, Profit Maximization, Cost/Benefit Analysis

**Standard 3 Allocation of Goods and Services**

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

*Related concepts:* Economic Systems, Market Structure, Supply, Command Economy, Market Economy, Traditional Economy

**Standard 4 Role of Incentives**

People respond predictably to positive and negative incentives.

*Related concepts:* Choice, Incentive

**Standard 5 Gain from Trade**

Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation, and usually among individuals or organizations in different nations.

*Related concepts:* Barriers to Trade, Barter, Exports, Imports, Voluntary Exchange, Exchange, Exchange Rate
Standard 6  Specialization and Trade

When individuals, regions, and nations specialize in what they can produce at the lowest cost and then trade with others, both production and consumption increase.

Related concepts: Division of Labor, Production, Productive Resources, Specialization, Factor Endowments, Gains from Trade, Relative Price, Transaction Costs, Factors of Production, Full Employment

Standard 7  Markets—Price and Quantity Determination

Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.

Related concepts: Market Structure, Markets, Price Floor, Price Stability, Quantity Demanded, Quantity Supplied, Relative Price, Exchange Rate

Standard 8  Role of Price in Market System

Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives.


Standard 9  Role of Competition

Competition among sellers lowers costs and prices, and encourages producers to produce more of what consumers are willing and able to buy. Competition among buyers increases prices and allocates goods and services to those people who are willing and able to pay the most for them.

Related concepts: Market Structure, Non-price Competition, Levels of Competition

Standard 10  Role of Economic Institutions

Institutions evolve in market economies to help individuals and groups accomplish their goals. Banks, labor unions, corporations, legal systems, and not-for-profit organizations are examples of important institutions. A different kind of institution, clearly defined and enforced property rights, is essential to a market economy.

Related concepts: Legal and Social Framework, Mortgage, Borrower, Interest, Labor Union, Legal Forms of Business, Legal Foundations of a Market Economy, Nonprofit Organization, Property Rights, Banking, Economic Institutions
Standard 11  Role of Money

Money makes it easier to trade, borrow, save, invest, and compare the value of goods and services.

Related concepts: Exchange, Money Management, Money Supply, Currency, Definition of Money, Money, Characteristics of Money, Functions of Money

Standard 12  Role of Interest Rates

Interest rates, adjusted for inflation, rise and fall to balance the amount saved with the amount borrowed, which affects the allocation of scarce resources between present and future uses.

Related concepts: Interest Rate, Monetary Policy, Real vs. Nominal, Risk, Investing, Savers, Savings

Standard 13  Role of Resources in Determining Income

Income for most people is determined by the market value of the productive resources they sell. What workers earn depends, primarily, on the market value of what they produce and how productive they are.

Related concepts: Human Resources, Derived Demand, Functional Distribution of Income, Labor, Labor Market, Marginal Resource Product, Personal Distribution of Income, Wage, Aggregate Demand (AD), Aggregate Supply (AS), Demand, Prices of Inputs, Functional Distribution

Standard 14  Profit and the Entrepreneur

Entrepreneurs are people who take the risks of organizing productive resources to make goods and services. Profit is an important incentive that leads entrepreneurs to accept the risks of business failure.

Related concepts: Taxation, Costs, Costs of Production, Entrepreneur, Risk, Taxes, Cost/Benefit Analysis, Innovation, Entrepreneurship, Inventors

Standard 15  Growth

Investment in factories, machinery, new technology, and in the health, education, and training of people can raise future standards of living.

**Standard 16  Role of Government**

There is an economic role for government in a market economy whenever the benefits of a government policy outweigh its costs. Governments often provide for national defense, address environmental concerns, define and protect property rights, and attempt to make markets more competitive. Most government policies also redistribute income.


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**Standard 17  Using Cost/Benefit Analysis to Evaluate Government Programs**

Costs of government policies sometimes exceed benefits. This may occur because of incentives facing voters, government officials, and government employees, because of actions by special interest groups that can impose costs on the general public, or because social goals other than economic efficiency are being pursued.

**Related concepts:** Cost/Benefit Analysis, Benefit, Costs, Special Interest Group, Barriers to Trade

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**Standard 18  Macroeconomy-Income/Employment, Prices**

A nation’s overall levels of income, employment, and prices are determined by the interaction of spending and production decisions made by all households, firms, government agencies, and others in the economy.

**Related concepts:** Gross Domestic Product (GDP), Macroeconomic Indicators, Nominal Gross Domestic Product (GDP), Per Capita Gross Domestic Product (GDP), Potential Gross Domestic Product (GDP), Real Gross Domestic Product (GDP), Circular Flow

---

**Standard 19  Unemployment and Inflation**

Unemployment imposes costs on individuals and nations. Unexpected inflation imposes costs on many people and benefits some others because it arbitrarily redistributes purchasing power. Inflation can reduce the rate of growth of national living standards because individuals and organizations use resources to protect themselves against the uncertainty of future prices.

**Related concepts:** Types of Unemployment, Causes of inflation, Consumer Price Index (CPI), Deflation, Labor Force, Unemployment, Unemployment Rate, Inflation

---

**Standard 20  Monetary and Fiscal Policy**

Federal government budgetary policy and the Federal Reserve System’s monetary policy influence the overall levels of employment, output, and prices.

**Related concepts:** Inflation, National Debt, Tools of the Federal Reserve, Discount Rate, Federal Budget, Fiscal Policy, Monetary Policy, Open Market Operations, Reserve Requirements, Budget, Budget Deficit, Central Banking System, Budget Surplus, Causes of inflation
In this unit, read to find out...

- what role economics plays in your life.
- what role you play in the economic system of the United States.
- what kinds of different economic systems operate around the world.
The BIG Idea
Scarcity is the basic economic problem that requires people to make choices about how to use limited resources.

Why It Matters
Have you ever wanted to buy something or to participate in an activity, but you couldn't because you didn't have enough income or time? How do scarce resources like time and income affect you and everyone around you? In this chapter, read to learn about what economics is and how it is part of your daily life.

Economics ONLINE
Chapter Overview  Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 1—Chapter Overviews to preview chapter information.
The Basic Problem in Economics

GUIDE TO READING

Section Preview
In this section, you will learn that the driving forces behind economics are scarcity and choices.

Content Vocabulary
- economics (p. 6)
- microeconomics (p. 6)
- macroeconomics (p. 6)
- scarcity (p. 7)
- factors of production (p. 8)
- land (p. 8)
- labor (p. 8)
- goods (p. 8)
- services (p. 8)
- capital (p. 9)
- productivity (p. 9)
- entrepreneurship (p. 9)
- technology (p. 10)

Academic Vocabulary
- utilize (p. 6)
- focus (p. 6)

Reading Strategy
Organizing As you read the section, complete a table like the one below by providing two examples for each of the terms listed in the chart.

<table>
<thead>
<tr>
<th>Term</th>
<th>Example 1</th>
<th>Example 2</th>
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<tbody>
<tr>
<td>Needs</td>
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<td>Wants</td>
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<td>Goods</td>
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<td>Services</td>
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</tbody>
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ISSues In ThE NeWS
—from The Guardian

ECONOMICS IS EVERYWHERE Harry Potter may seem like he lives in a world where wizards have a wand and receive instant gratification, but that’s a view that needs to be demolished by the Womping Willow.

Scarcity exists in the magic world just as much as in the Muggle world. There are a limited number of tickets to the Quidditch World Cup, magical creatures only shed so many feathers or hairs to go into wands, and not everyone has an invisibility cloak.

J.K. Rowling’s fictional world . . . has its own central government (the Ministry of Magic), owl postal system, jail, hospital, news media, and public transport, not to mention Gringotts Bank and a special wizard currency.

There are enough institutions to make Adam Smith salivate.

With scarcity and a monetary system, the Harry Potter series should be a case study for any economics course.

Starting at a very young age, many Americans use the words want and need interchangeably. How often do you think about what you “want”? How many times have you said that you “need” something? When you say, “I need some new clothes,” do you really need them, or do you just want them? As you read this section, you’ll find that economics deals with questions such as these.
Wants, Needs, and Choices

Main Idea The basic problem in economics is how to satisfy unlimited wants with limited resources.

Economics & You Think of the last time you said that you needed something. Was the object really necessary for your survival? Read on to learn that people must make choices about how to spend their limited resources.

What, exactly, is economics? Economics is the study of how individuals, families, businesses, and societies use limited resources to fulfill their unlimited wants. Economics is divided into two parts. Microeconomics deals with behavior and decision making by small units such as individuals and firms. Macroeconomics deals with the economy as a whole and decision making by large units such as governments.

People often confuse wants with needs. When they use the word need, they really mean that they want something they do not have. Obviously, everyone needs certain things, such as food, clothing, and shelter, to survive. To economists, however, anything other than what people need for basic survival is a want. People want such items as new cars and electronics, but they often convince themselves they need these things. In a world of limited resources, individuals satisfy their unlimited wants by making choices.

Like individuals, businesses must also make choices. Businesspeople make decisions daily about what to produce now, what to produce later, and what to stop producing. Societies, too, face choices about how to utilize their resources. How these choices are made is the focus of economics.

Reading Check Explaining What do people have to do when faced with unlimited wants and limited resources?

Consumers often feel that wants, such as concert tickets, are actually needs.

ZITS
The Problem of Scarcity

Main Idea  Scarcity exists because people's incomes and time are limited.

Economics & You  If you were very wealthy, would your resources be unlimited? Read on to learn why scarcity exists for everyone.

The need to make choices arises because everything that exists is limited, although some items (such as trees in a large forest) may appear to be in abundant supply. At any single moment, a fixed amount of resources is available. At the same time, people have competing uses for these resources. This situation results in scarcity—the basic problem of economics. Scarcity means that people do not and cannot have enough income and time to satisfy their every want. What you buy as a student is limited by the amount of income you have. Even if everyone in the world were rich, however, scarcity would continue to exist, because even the richest person in the world does not have unlimited time. (See Figure 1.1 above.)

Do not confuse scarcity with shortages. Scarcity always exists because of competing alternative uses for resources, whereas shortages are temporary. Shortages often occur, for example, after hurricanes or floods destroy goods and property.

Identifying  What two specific resources create scarcity?

scarcity: basic economic problem that results from a combination of limited resources and unlimited wants
The Factors of Production

Main Idea Scarce resources require choices about uses of the factors of production: land, labor, capital, and entrepreneurship.

Economics & You If you have a job, how does the work you do fit in with the bigger economic picture? Read on to learn that labor is one of the factors of production.

When economists talk about scarce resources, they are referring to the factors of production, or resources needed to produce goods and services. Traditionally, economists have classified these productive resources as land, labor, capital, and entrepreneurship. (See Figure 1.2 below.)

Land As an economic term, land refers to natural resources that exist without human intervention. “Land” includes actual surface land and water, as well as fish, animals, trees, mineral deposits, and other “gifts of nature.”

Labor The work people do is labor—which is often called a human resource. Labor includes any work people do to produce goods and services. Goods are tangible items that people can buy, such as medicine, clothing, or computers. Services are activities done for others for a fee. Doctors, hair stylists, and Web-page designers all sell their services.

Figure 1.2 Factors of Production

- The four general categories of resources needed in the production of all goods and services include land, labor, capital, and entrepreneurship.

A. Land Land includes all “gifts of nature,” or any natural resource not created by people.

B. Labor Labor includes any work done by people, whether they are doing manual labor or performing services.
**Capital**  Another factor of production is capital—the manufactured goods used to make other goods and produce other services. The machines, buildings, and tools used in making automobiles, for example, are capital goods. The newly assembled goods are not considered capital unless they, in turn, produce other goods and services, such as when an automobile is used as a taxicab.

When capital is combined with land and labor, the value of all three factors of production increases. Think about the following situation. If you combine an uncut diamond (land), a diamond cutter (labor), and a diamond-cutting machine (capital), you end up with a highly valued gem.

Capital also increases productivity—that is, greater quantities of goods and services are produced in better and faster ways. Consider how much faster an optical check-reading scanner—a capital good—can sort checks as compared to an individual worker reading each one.

**Entrepreneurship**  The fourth factor of production is entrepreneurship. This refers to the ability of individuals to start new businesses, introduce new products and processes, and improve management techniques. Entrepreneurship involves initiative and willingness to take risks in order to reap profits. Entrepreneurs must also incur the costs of failed efforts. About 30 percent of new business enterprises fail. Of the 70 percent that do survive, only a few become wildly successful.
**Technology** Some economists add technology to the list of factors of production. **Technology** includes any use of land, labor, and capital that produces goods and services more efficiently. For example, computerized word processing was a technological advance over the typewriter. Today, the word technology is commonly used to describe new products and new methods of producing goods and services.

**Effect on Income and Wealth** How much of each of the factors of production an individual has determines his or her wealth. The more land and capital you have, the richer you will probably be. The greater your entrepreneurial skills, the more income you might earn. In other words, the distribution of factors of production affects a nation’s income distribution—what percentage of Americans are rich and what percentage are poor. The same holds true across nations as well. Nations with many natural resources at their disposal, for example, tend to be wealthier than nations with few natural resources.

**Identifying** What are the four factors of production?

---

**Vocabulary**
1. **Explain** the significance of: economics, microeconomics, macroeconomics, scarcity, factors of production, land, labor, goods, services, capital, productivity, entrepreneurship, technology.

**Main Ideas**
2. **Making Distinctions** Wants and needs are not always easy to separate. Identify each of the following as a want or a need, and tell why you made that choice.

<table>
<thead>
<tr>
<th>Choices</th>
<th>Want or Need</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Car</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yearly physical exam</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cell phone</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**
3. **The BIG Idea** Explain why scarcity and choice are basic problems in economics.
4. **Identifying** Scarcity leads to economic choices. Give an example of an economic decision you made and what you gave up when you made your choice. Then think of a choice our country has made and what we may have given up in making that choice.

**Applying Economics**
5. **Microeconomics** For every purchase you make, you affect the economy. List three items you bought recently. For each item, list three businesses that benefited from your purchase.
Adam Smith was born in Kirkcaldy, Scotland, in 1723. In school he proved himself a good scholar as he studied the usual subjects of the period—English, Latin, Greek, history, and arithmetic. At 14, along with other boys the same age, he entered Glasgow University, and in 1740 went on to Oxford.

Throughout his student years he encountered many ideas and individuals that would prepare him for the eventual writing of his important work, *An Inquiry into the Nature and Causes of the Wealth of Nations*. In it he brought together the economic concepts and theories that established the basis of modern economics.

Smith’s main argument was that the general welfare of society is best promoted by allowing individuals to pursue their own self-interest within the law, because this alone is “capable of carrying on the society to wealth and prosperity.” People should be able to do so through voluntary and mutually beneficial exchanges in free markets, with limited regulation by government officials:

> “Every individual . . . intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.”

Smith also believed that any attempt by government to force the economy beyond this “system of natural liberty” is counterproductive:

> “It retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labor.”

Because of the original ideas Smith put forth in his works, he is considered the founder of classical economics.

### Checking for Understanding

1. **Explaining** What did Smith mean when he referred to an “invisible hand” that guides people’s economic choices?

2. **Extending** List three examples in which a person’s pursuit of his or her own self-interest might benefit society as a whole.
Pencils—An International Product

As you’ve learned, the “land” factor of production includes natural resources. The natural resources that make up a pencil come from all over the world. So a pencil—yes, the simple writing tool you hold in your hand—is an international product.

Manufacturers
The Eberhard Faber Division makes its pencils in Lewisburg, Tennessee. The company produces almost a billion pencils every year. The J.R. Moon Pencil Company is also located in Lewisburg.

The Casing
The casing (material around the lead) of most wooden pencils is made from incense cedar. Most of this cedar comes from the High Sierras in California, but some of it comes from Oregon and Washington.

Wax
Wax from Brazil coats the lead and soaks into the wood. The wax on the lead helps the pencil write more smoothly. Wax in the wood makes the wood easier to run through the machines at the factory and also makes the finished pencil easier for you to sharpen.
What Is Economics?

1. Identifying Producing pencils requires several different raw materials. Which ones come from within the United States? Which ones are obtained from other countries?

2. Analyzing What do you think might happen to the price of pencils if Brazil decided to double the price of wax?

3. Critical Thinking When we buy raw materials from a foreign country to make pencils, how does the exchange benefit the foreign country? What might be a drawback of this exchange?

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The Lead

The lead in a pencil is not really lead at all. It’s a mixture of graphite and clay. The best graphite comes from Sri Lanka, Madagascar, and Mexico. Many pencil makers prefer the graphite from Mexico because it makes the blackest marks. Clay comes from Germany and Georgia.

The Eraser

Rubber and pumice are the traditional ingredients of erasers. Pumice is the part that actually erases—the rubber just holds it together. The pumice comes from Italy, and the rubber comes from Malaysia. Modern erasers mix pumice with either vinyl or synthetic rubber.

Yellow Pencils

Pencils were first painted yellow to honor China, where the best graphite came from. In China, yellow is a color of royalty and respect.

Thinking Globally

1. **Identifying** Producing pencils requires several different raw materials. Which ones come from within the United States? Which ones are obtained from other countries?

2. **Analyzing** What do you think might happen to the price of pencils if Brazil decided to double the price of wax?

3. **Critical Thinking** When we buy raw materials from a foreign country to make pencils, how does the exchange benefit the foreign country? What might be a drawback of this exchange?
GUIDE TO READING

Section Preview
In this section, you will learn about the relationship between trade-offs and opportunity costs, and how a production possibilities curve can help people make informed economic choices.

Content Vocabulary
- trade-off (p. 15)
- opportunity cost (p. 16)
- production possibilities curve (p. 17)

Academic Vocabulary
- alternative (p. 16)
- reveal (p. 17)

Reading Strategy
Organizing Imagine that you have just received your first paycheck from a new job. Using the information from this section, complete a table like the one below by listing the trade-off and opportunity cost of each economic decision you might make.

<table>
<thead>
<tr>
<th>Decision</th>
<th>Trade-Off</th>
<th>Opportunity Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buying something you want</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saving your money</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

 ISSues In ThE NeWS
— from the New York Times

Health and Safety Trade-Offs
Public health measures always involve trade-offs. . . . Health economists are typically concerned with finding policies that maximize the total number of life years, or . . . the average life expectancy of the population, leaving aside quality-of-life issues. A focus on life years recognizes that there are inevitable trade-offs involved in health and safety policies. . . . If government policy always erred on the side of life, the speed limit would be reduced to 5 miles per hour to eliminate all fatal accidents. Of course, voters would not stand for a 5 mph speed limit, so . . . policy makers recognize that there is a trade-off between risk and the time required to transport goods and people on the highways.

As you learned in Section 1, scarcity forces people to make choices about how they will use their resources. In this section, you’ll learn that the effects of these choices may be far-reaching and long-lasting. For example, one day you may choose to either go to work for a company or open your own business. Such a decision would affect many aspects of your life, including how much you earn and how you manage your time.
**Trade-Offs**

**Main Idea** Economic decisions always involve trade-offs that have costs.

**Economics & You** Think about the last time you spent an hour watching television. Were there other ways you could have spent your time? Read on to learn about how using resources one way means giving up other alternatives.

The economic choices people make involve exchanging one good or service for another. If you choose to buy an iPod, you are exchanging your income for the right to own the iPod. Exchanging one thing for another is called a **trade-off**.

Individuals, families, businesses, and societies are forced to make trade-offs every time they use their resources in one way and not another.

**The Cost of Trade-Offs** The cost of a trade-off is what you give up in order to get or do something else. Time, for example, is a scarce resource—there are only so many hours in a day—so you must choose how to use it. When you decide to study economics for an hour, you are giving up any other activities you could have chosen to do during that time.

*trade-off:* sacrificing one good or service to purchase or produce another

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If you decide to go to college rather than work full-time right after high school, you are giving up the opportunity to start making money right away. You also may have to take on the burden of student loans. These are the trade-offs you make to gain a college education and increase your potential earning power later.
In other words, there is a cost involved in time spent studying this book. Economists call this an **opportunity cost**—the value of the next best alternative that had to be given up to do the action that was chosen. You may have many trade-offs when you study—exchanging instant messages with your friends, going to the mall, watching television, or practicing the guitar, for example. But whatever you consider the single next best alternative is the opportunity cost of your studying economics for one hour.

A good way to think about opportunity cost is to realize that when you make a trade-off (and you always make trade-offs), you lose something. What do you lose? You lose the ability to engage in your next highest valued alternative. In economics, therefore, opportunity cost is always an opportunity that is given up.

**Considering Opportunity Costs** Being aware of trade-offs and their resulting opportunity costs is vital in making economic decisions at all levels. Whether they are aware of it or not, individuals and families make trade-offs every day. Businesses must consider trade-offs and opportunity costs when they choose to invest funds or hire workers to produce one good rather than another.

Consider an example at the national level. Suppose Congress approves $220 billion to finance new highways. Congress could have voted instead for increased spending on medical research. The opportunity cost of building new highways, then, is less medical research.
Production Possibilities Curve

Main Idea A production possibilities curve shows the maximum combinations of goods and services that can be produced with a given amount of resources.

Economics & You Imagine that you are taking two classes—economics and math. You can spend 10 hours per week studying. How will you decide how many hours to study for each subject? Read on to learn how a production possibilities curve helps people make such decisions.

Obviously, many businesses produce more than one type of product. An automobile company, for example, may manufacture several makes of cars per plant in a given year. What this means is that the company produces combinations of goods, which results in an opportunity cost.

Economists use a model called the production possibilities curve to show the maximum combinations of goods and services that can be produced from a fixed amount of resources in a given period of time. This curve can help determine how much of each item to produce, thus revealing the trade-offs and opportunity costs involved in each decision.

Imagine that you run a jewelry-making business. Working 20 hours a week, you have enough resources to make either 10 bracelets or 5 pairs of earrings. If you want to make some of both, Figure 1.3 below shows your production possibilities.

Figure 1.3 A Production Possibilities Curve

- The curve here represents the production possibilities between bracelets and pairs of earrings during a 20-hour workweek. Note that if you make 10 bracelets (point A on the curve), you have no resources or time to make earrings. If you make only 6 bracelets (point B on the curve), you have enough resources and time to also make 2 pairs of earrings. Therefore, the opportunity cost of making 2 pairs of earrings is the 4 bracelets not made. Although you are making both bracelets and earrings, you—and businesses and nations—cannot produce more of one thing without giving up producing something else.

Economic Analysis

Using Graphs What is the opportunity cost of making 3 pairs of earrings in a 20-hour workweek?
The classic example for explaining production possibilities in economics is the trade-off between spending on military defense and civilian goods, sometimes referred to as "guns" versus "butter." The extreme situation for any nation would be to use all of its resources to produce only military goods or only civilian goods. Of course, in reality, nations always produce some of both. Governments, like businesses, face production possibilities curves all of the time, so they know they have to give up production of one type of good or service in order to get more production of another.

Look at Figure 1.4 above. Point A on the graph represents a situation where all of a nation’s resources are being used to produce only military goods (guns). Point E represents the other extreme—a situation where all the nation’s resources are being used to produce only civilian goods (butter). The amount of military goods given up in a year is the opportunity cost for increasing the production of civilian goods, and vice versa.

In the United States, Congress and the president decide where on this curve the nation will be in terms of production of each type of good. The government collects revenue from citizens through taxes, and then it must decide how to use the revenue to best serve the nation. A production possibilities curve is useful in determining what the opportunity cost will be if a particular course of action is taken.
Of course, the real world doesn’t work exactly as our graphs predict. In the real world, it takes time to move from point A to point B on the curve. Also, in terms of nations, leaders must take factors other than economics into consideration when allocating resources; they also look at the political and social concerns of citizens. The important point to remember is that a production possibilities curve can help nations, businesses, and individuals decide how best to use their resources.

Examining What is the classic example economists often use to explain production possibilities in economics?

Review

Vocabulary
1. Explain the significance of: trade-off, opportunity cost, production possibilities curve.

Main Ideas
2. Explaining What is the opportunity cost of any trade-off?
3. Determining Cause and Effect Individuals, families, and businesses make trade-offs. Create a chart like the one below, and for each example given, add a likely opportunity cost.

<table>
<thead>
<tr>
<th>Economic Decision</th>
<th>Likely Opportunity Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>Gets second job</td>
</tr>
<tr>
<td>Family</td>
<td>Purchases car</td>
</tr>
<tr>
<td>Business</td>
<td>Paves parking lot</td>
</tr>
</tbody>
</table>

Critical Thinking
4. The BIG Idea A politician promises to increase funding for both the space program and education. Knowing about opportunity costs, what question should you ask as a citizen?

Applying Economics
5. Analyzing Imagine that an independent supermarket owner decides to expand and builds another store in a neighboring town. However, it is now difficult to supervise employees in both stores. Explain how each of the following concepts might be applied to this situation:

- trade-off
- opportunity cost
- production possibilities curve
- scarcity
GUIDE TO READING

Section Preview
In this section, you’ll learn about how economists use models to explain and predict economic behavior, and that economists may not always agree on which model or theory is the best one.

Content Vocabulary
- economy (p. 21)
- economic model (p. 21)
- hypothesis (p. 22)

Academic Vocabulary
- analyze (p. 20)
- complex (p. 22)
- theory (p. 22)

Reading Strategy
Contrasting As you read, complete a table like the one below by listing the benefits and drawbacks of using models to predict economic behavior.

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
<td>3.</td>
</tr>
</tbody>
</table>

ISSUES IN THE NEWS
—from TIME

A NATION OF CONSUMERS If you made a graph of American life since the end of World War II, every line concerning money and the things money can buy would soar upward.

The size of the typical new house has more than doubled. A two-car garage was once a goal; now we’re nearly a three-car nation. Designer everything, personal electronics and other items that didn’t even exist a half-century ago are now affordable.

. . . That money never satisfies, [though,] is suggested by this telling fact: polls show that Americans believe that, whatever their income level, they need more to live well. Even those making large sums said still larger sums were required. We seem conditioned to think we do not have enough, even if . . . our lives are comfortable.

As you’ve learned, economics is concerned with the ways individuals and nations choose to use their scarce resources. Economists might analyze how the super-rich spend their income, for example, and the effect this spending has on the economy. As you read this section, however, you’ll find that something economists don’t do is judge whether there should be a social class of super-rich people.
Economic Models

**Main Idea** Economists construct models to investigate the way that economic systems work.

**Economics & You** Have you ever tried to predict the outcome of a sports match? On what information did you base your prediction? Read on to learn how economists use models to help them explain and predict economic behavior.

Remember that economics is concerned with the ways individuals, businesses, and nations choose to use their limited resources. To economists, the word *economy* means all the activity in a nation that together affects the production, distribution, and use of goods and services. When economists study specific parts of the economy—teenage employment rates or spending habits, for example—they often formulate theories and gather data from the real world. The theories that economists use in their work are called *economic models*. The study of these models can help explain and predict economic behavior.

You may be familiar with other types of models, such as model trains or airplanes, or models of buildings that architects have designed. Like these other types of models, economic models are simplified representations of the real world. Economists test these economic models, and the solutions that result from these tests often become the basis for actual decisions by private businesses or government agencies. Keep in mind, though, that no economic model records every detail and relationship that exists about a problem to be studied. A model will show only the basic factors needed to analyze the problem.

**Models**

Model airplanes, like economic models, are simplified representations of objects or concepts in the real world.
What Models Show  Physicists, chemists, biologists, and other scientists use models to understand in simple terms the complex workings of the world. One purpose of economic models is to show visual representations of consumer, business, or other economic behavior. Economic models all relate to the way individuals (as consumers) and businesspeople react to changes in the world around them. The most common economic model is a line graph explaining how consumers react to changes in the prices of goods and services. You’ll learn about this model in Chapter 7.

Economic models assume that some factors remain constant. In studying the production possibilities curve for making jewelry in Section 2, for example, we assumed that the price of inputs (beads, wire, and so on) would not increase. We also assumed that inclement weather would not close schools for a day, which would have enabled you to work more than 20 hours a week on jewelry.

Why are these constant-factor assumptions important? Economists realize that, in the real world, several things may be changing at once. Using a model holds everything steady except the variables assumed to be related. In the same way that a map does not show every alley and building in a given location, economic models do not record every detail and relationship that exists about a problem to be studied. A model will show only the basic factors needed to analyze the problem at hand.

Creating a Model  Models are useful if they help us analyze the way the real world works. An economist begins with some idea about the way things work, then collects facts and discards those that are not relevant. Let’s assume that an economist wants to find out why teenage unemployment rises periodically. Perhaps this unemployment occurs when the federal minimum wage goes up, thereby forcing employers to pay their teenage workers more or to lay some workers off. The economist can test this theory, or model, in the same way that other scientists test a hypothesis—an educated guess or prediction.

Testing a Model  Testing a model, or hypothesis, allows economists to see if the model does a good job of representing reality. Suppose an economist has developed the model shown in Graph A of Figure 1.5 on the next page. The economist would collect data on the amount of teenage unemployment every year for the last 30 years. He or she would also gather 30 years of information on federal legislation that increased the legal minimum wage paid to teenagers.
The economist can be fairly satisfied with the model if teenage unemployment rose every time the minimum wage rate increased. But suppose that the data instead resulted in Graph B of Figure 1.5. In that case, the economist would have to develop another model to explain changes in teenage unemployment.

**Applying Models to Real Life** Much of the work of economists involves attempts at predicting how people will react in a particular situation. Consider, for example, that some economists believe that to stimulate the economy, taxes should be cut and government spending increased. Cutting taxes, these economists believe, will put more income into consumers’ pockets, which will increase both spending and production. People’s fears concerning higher taxes in the future, though, might cause them to save the extra income rather than spend it. As this example illustrates, some models take into account several factors that may influence people’s behavior.

**Describing** What is an economic model?
Schools of Economic Thought

Main Idea Competing economic theories are supported by economists from different schools of thought.

Economics & You Have you and a friend ever read the same book or seen the same movie and then disagreed about what it was trying to say? Read on to learn about how economists disagree about economic theories.

Economists deal with facts. Their personal opinions and beliefs may nonetheless influence how they view those facts and fit them to theories. The government under which an economist lives also shapes how he or she views the world. As a result, not all economists will agree that a particular theory offers the best prediction. Often, economists from competing schools of thought claim that their theories are better than others’ theories in making predictions.

During a given period of time, a nation’s political leaders may agree with one school of economic thought and develop policies based on it. Later, other leaders may agree with another group of economists. Throughout American history, for example, many economists have stressed the importance of the government maintaining a “hands off” (or laissez-faire) policy in business and consumer affairs to prevent increased Stabilizing the National Economy. Other influential economists have proposed that the federal government should intervene in the economy to reduce unemployment and prevent inflation. (See Figure 1.6 below.)

Figure 1.6 Politicians and Schools of Economic Thought

A. Democrats
Democrats, like former president Bill Clinton, tend to believe that free markets are unstable and that the federal government sometimes needs to intervene in the economy to help the nation’s citizens.

B. Republicans
Republicans, like George W. Bush, tend to think that free markets will take care of themselves and that government intervention in the workings of the market should be minimal.

Economic Analysis Evaluating Which major political party tends to support laissez-faire economic policy?
Learning about economics will help you predict what may happen if certain events occur or certain policies are followed. Economics will not tell you, however, whether the results will be good or bad. Judgments about results depend on a person’s values. Values are the beliefs or characteristics that a person or group considers important, such as religious freedom, equal opportunity, individual initiative, freedom from government meddling, and so on. Even having the same values, however, does not mean that people will agree about strategies, interpretation of data, or solutions to problems.

For example, those in favor of decreasing teenage unemployment in order to bring about economic opportunity may disagree about the best way to solve this problem. If you were a legislator, you might show your commitment to this value by introducing a bill to decrease teenage unemployment. The economists who help you research the causes of teenage unemployment will tell you, based on their expertise, whether they think the proposed solution will actually reduce teenage unemployment.

Remember always that the science of economics is not used to judge whether a certain policy is good or bad. Economists only inform us as to likely outcomes of these policies.

Review

Vocabulary
1. Explain the significance of: economy, economic model, hypothesis.

Main Ideas
2. Sequencing Create a diagram like the one below to show how economists use models to study the real world.

![Diagram: Idea -> Model -> Test -> Hypothesis]

Critical Thinking
3. The BIG Idea No one can change the fact that scarcity exists. Assume, however, that scarcity did not exist. How would your life be different?

4. Explaining Give an explanation about why models can never be completely realistic.

Applying Economics
5. Examining Which of the statements below would be a valid hypothesis to research, according to what you learned in this section? Explain why.
   a. Given an income of $150 per month, a teenager will spend more on food than he or she will save.
   b. Given an income of $150 per month, a teenager should save at least 50% of this money.
   c. Given an income of $150 per month, a teenager will spend too much on music.
Taking the trade-off between work or a college education to the racetrack.

Check It Out! In this chapter you learned about trade-offs. A huge trade-off you will make after high school is whether to begin working or to attend college. This article discusses a new college degree that may interest you.

Students at Belmont Abbey College may have a head start in the race for post-graduation jobs—at least jobs that go vroom! Starting this fall, the 1,000-student school outside Charlotte, N.C., will offer the nation’s first four-year bachelor’s degree in Motorsports Management. . . . “The program will be NASCAR-focused but will have a broad application to all portions of the motor sports industry,” says Philip Bayster, chair of the school’s business department.

The idea originated with H. A. “Humpy” Wheeler, president of racetrack owner Speedway Motorsports. He saw a need to boost management talent in the booming race-car business. . . .

Pay is anything but the pits: A 2005 study by two University of North Carolina-Charlotte professors found that annual salaries for the region’s 14,000 motor sports jobs, not including drivers, averaged $72,000. Ladies and gentlemen, turn your tassels.

—Reprinted from BusinessWeek

Think About It

1. Identifying What is the opportunity cost of earning a Motorsports Management degree?

2. Evaluating How does the annual salary in a motorsports job compare to the average salary of a person with a bachelor’s degree?
Scarcity exists because people’s income and time are limited. Consumers seek a balance between satisfying their needs and wants and allocating their time and income.

Economic decisions always involve trade-offs that have costs. Whenever you make an economic choice, you are sacrificing other goods or services that you may have purchased with your limited resources.

Economists use economic models to investigate the ways in which economic systems work.
Review Content Vocabulary

1. Think about any business in the United States, such as a company that produces computers or one that paints people's houses. Write a paragraph explaining how this business would use the factors of production. Use all of the following terms.

- factors of production
- entrepreneurship
- land
- labor
- capital
- productivity
- technology

2. Thinking of the same business, now write a short paragraph about how an economist might use economic models to help the business owner make decisions about trade-offs and opportunity costs. Use all of the following terms.

- economy
- economic model
- hypothesis
- production possibilities curve
- opportunity cost
- trade-off

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

- a. utilize
- b. focus
- c. alternative
- d. reveal
- e. analyze
- f. theory
- g. complex

3. An economist might use an economic model to _______ how new technology might affect productivity in a particular industry.

4. The opportunity cost of a trade-off is the value of the next best _______ that had to be given up.

5. Some economic choices are simple or easy, while others are _______.

6. By making choices about what to buy, consumers _______ what they value most.

7. Studying how people use limited resources to fulfill their unlimited wants is the _______ of economics.

8. An economist might use an economic model to formulate a _______, or hypothesis, about some aspect of the economy.

9. Different societies might _______ the same resource in different ways.

Review the Main Ideas

Section 1 (pp. 5–10)

10. What is the difference between microeconomics and macroeconomics?

11. How does scarcity differ from a shortage?

12. Your friend says, “I need some new clothes.” Under what conditions would this be expressing a need? A want?

13. Complete the chart below by listing the four factors of production and an example of each.

<table>
<thead>
<tr>
<th>Factors of Production</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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</tbody>
</table>

Section 2 (pp. 14–19)

14. What does making a trade-off require you to do?

15. If a person chooses to buy a pair of shoes instead of a new jacket, what does the jacket represent in economic terms?

16. What does a production possibilities curve show?

Section 3 (pp. 20–25)

17. For what purposes do economists use real-world data in building models?

18. What do economists and other scientists call the educated guesses that they make and test?

19. When does an economist consider an economic model useful?
Math Practice

The production possibilities curve below shows the production possibilities for a carpenter's typical workweek and supply of wood. Refer to this production possibilities curve to answer the following questions.

20. What is the opportunity cost of making 7 bookshelves with the time and wood available?

21. What must happen in order to move from point B to point C?

22. What would happen to the curve if the carpenter got sick for a couple of days or his wood supply was delivered a bit late? Why?

23. Point E represents an impossible situation—the carpenter would not be able to produce 6 bookshelves and 4 tables. Why?

Critical Thinking

24. The BIG Idea Imagine that the Guevara family buys a large piece of land suitable for growing grapes or oranges. They decide to ask an economist for advice about their options for turning the land into a money-making resource for the family. What are some examples of the kinds of hypotheses the economist might offer the family? Based on the economist's hypotheses, how will the Guevaras know whether the economic decisions they make are right or wrong?

Analyzing Visuals

25. Study the cartoon on the right, and then answer the following questions.

a. Who are the two men in the cartoon, and what transaction are they discussing?

b. Why would the car pictured be exceptionally fuel efficient?

c. What is the trade-off to which the man on the left is referring?
Why do males under 25 pay more for car insurance?

THE ISSUE
Although some insurance companies have started to base their rates on the number of years of driving experience rather than age, on average, it still costs young men more to insure their cars than young women or other age groups. A family that adds a teenage daughter to its insurance policy will pay about twice as much as before. If the same family adds a teenage son to the policy, the premiums may triple. Why do young men have to pay more for car insurance?

THE FACTS
To insurers, you’re not a person—you’re a set of risks. Before quoting a price for insuring your car, they consider the type of car, number of miles you drive per year, where you live, and who you are: age, gender, marital status, and driving record. Why? By comparing your profile to profiles of typical people who have been involved in crashes, they can estimate the likelihood of you having an accident that will cost them money.

While less than 7 percent of drivers are under 25, they are involved in 25 percent of traffic accidents. For drivers age 16 to 19, the crash risk is four times higher than for older drivers. Men of all ages are involved in twice as many crashes as women, and fatal crashes are twice as common among teenage males as teenage females. Check the chart below for more facts about young drivers.

Some companies also consider educational level and occupation. People with advanced degrees have fewer accidents than those with high-school diplomas. Who are the best drivers? They include editors, judges, firefighters, health technicians, homemakers, teachers, secretaries, and artists. The riskiest? Students, doctors, attorneys, architects, and real-estate agents.
THE ECONOMIC CONNECTION: PROFIT INCENTIVE

Like all businesses, insurance companies have a profit motive: they must make a profit to stay in business. When a clothing company sells you a pair of jeans, it’s not taking a financial risk. But when an insurance company sells its service, it’s taking a big risk. If you have an accident, the medical care, court costs, car repairs, and other expenses you might have will more than wipe out any profit the company might have made from the premiums you pay.

Successful companies do research to find out which types of customers generate the most—and the least—profit. Based on their research, auto insurers know it’s less risky—and more profitable—to insure a 40-year-old woman teacher who owns a station wagon and has been driving and paying premiums for 20 years without having an accident. On the other hand, a 16-year-old male student with six months’ experience driving a sports car carries a much larger risk.

Traffic accidents involving teens cost society about $40 billion a year. Insurance companies must offset the losses they sustain on accident claims in order to make a profit. Since a few young men cause most of these accidents, all young men pay higher insurance premiums. But they are not the only ones. Companies usually also distribute some of the higher costs among all of their customers.

CONCLUSION

The profit incentive that drives all businesses in a market economy determines the prices consumers pay for goods and services. To ensure that profits (premiums) are greater than losses (accident claims), insurance companies charge all customers more, so all buyers of car, mortgage, or health insurance pay for the mistakes of others. When some young men drive recklessly, some homeowners cause fires by leaving lit candles unattended, or medical patients continue to live unhealthy lifestyles—everyone pays more for insurance.

Analyzing the Impact

1. Synthesizing Why would insurance rates be affected by where a driver lives?

2. Critical Thinking Which of the activities in the chart on the previous page do you think are the most dangerous? Why do you think more young people than older people engage in these activities while driving?
The BIG Idea
Every society has an economic system to allocate goods and services.

Why It Matters
As an American, you have many economic choices available to you. Not all nations offer their citizens the same economic choices that most Americans enjoy. In this chapter, read to learn how the American economy is different from the economies of some other countries.

Economics ONLINE
Chapter Overview  Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 2—Chapter Overviews to preview chapter information.
The economy of India is expanding, thanks in large part to growth in industries like call centers and software development. The economies of many other nations are changing as well, while others, like that of the United States, have remained relatively stable for many years. In this section, you’ll learn that each nation’s economy depends on how that nation chooses to use its resources to satisfy people’s wants and needs.
Three Basic Questions

Main Idea All economic systems face the same basic questions: What should be produced? How should it be produced? For whom should it be produced?

Economics & You Do you think it’s fair that some people have more than others, or should everyone share equally in what a society produces? Read on to learn about this and other questions that all economic systems must answer.

The way a nation determines how to use its resources to satisfy its people’s needs and wants is called an economic system. Although nations have different economic systems, each one is faced with answering the same three basic questions: What goods and services should be produced? How should they be produced? Who should share in what is produced? (See Figure 2.1 below.)

What Should Be Produced? As you’ve learned, we live in a world of scarcity and trade-offs. If more of one particular item is produced, then less of something else will be produced. If the government decides to use resources to build new roads, then fewer resources are available to maintain national parks. If a city decides to hire more police officers, fewer funds are available to add teachers to classrooms. Similarly, an automobile manufacturer must decide whether to produce pickup trucks, minivans, sport utility vehicles, or luxury cars—and how much of each.

Skills Handbook
See page R35 to learn about Identifying Main Ideas.

economic system: way in which a nation uses its resources to satisfy its people’s needs and wants

Figure 2.1 The Three Basic Economic Questions

In any economic system, the same three basic economic questions need to be addressed.

A. What to Produce?
Because of scarcity, no nation can produce every good it needs or wants. Often, what a nation produces depends upon its natural resources. For example, because its soil and climate are good for growing coffee, Colombia produces a great deal of that product.

B. How to Produce?
Trade-offs exist among the available factors of production. In factory settings, producers often need to decide whether piecemeal work or assembly line production would be more efficient.
How Should It Be Produced? After deciding what to produce, an economic system must then decide how those goods and services will be produced. How many laborers will be hired? Will skilled laborers or unskilled laborers do the work? Will capital goods be used to manufacture the products, thereby reducing the number of laborers needed? What kinds of technology will be used in the production process? For each good and service produced, there are always trade-offs possible among the available factors of production. Decisions must be made as to what the best combination of available inputs will be to get the job done for the lowest possible cost.

For Whom Should It Be Produced? After goods or services are produced, the type of economic system under which people live determines how the goods and services will be distributed among its members. Who receives the new cars? Who benefits from a new city school? Who lives in new apartment buildings? As you will read, the answers to these economic questions vary greatly depending on where you live. In the United States and in many other countries, most goods and services are distributed to individuals and businesses through a price system. Other economies may distribute products through majority rule, through a lottery, on a first-come-first-served basis, by sharing equally, by military force, and in a variety of other ways.

Identifying What is an economic system, and what basic questions does it address?

C. For Whom to Produce? Economic systems determine how people will receive goods and services. In the United States, anyone who is willing and able to pay the price of a good or service is usually able to do so.

Economic Analysis Explaining Why can’t businesses or nations produce as much as they want?
Types of Economic Systems

Main Idea There are four basic types of economic systems: traditional, command, market, and mixed.

Economics & You How would you feel if the government told you where you could work and how much income you would make? Read on to learn about the four types of economic systems and the differences among them.

Economists have identified four types of economic systems. They differ from one another based on how they answer the three basic questions of what, how, and for whom to produce. The four general types of economic systems are traditional, command (or controlled), market (or capitalist), and mixed. Keep in mind that the four systems described here are theoretical representations of economies found throughout the world. No “pure” systems really exist—they are all mixed economies to some degree.

Traditional System A pure traditional economy answers the three basic questions according to tradition. In such a system, things are done “the way they have always been done.” Economic decisions are based on customs and beliefs—often religious—handed down from generation to generation.

If you lived in a traditional economic system, your parents would teach you to perform the same tasks that they learned from their parents. As a male, if your father was a fisherman, you would become a fisherman. You would learn to make fishing nets the same way that he was taught, and you would distribute your catch in the manner that it had always been done.
An advantage of living in a traditional economy is that you know what is expected of you. In addition, family and community ties are usually very strong. Disadvantages include an economy in which change is discouraged and perhaps even punished, and in which the methods of production are often inefficient. Consequently, choices among consumer goods are rare. Also, people living and working in traditional economies rarely experience an increasing level of material well-being. Things tend to stay the same.

Traditional economies exist to some extent in very limited parts of the world today. The Inuit of North America, the Mbuti of the Democratic Republic of the Congo, and the Aborigines of Australia are organized into traditional economic systems.

**Command System** The pure command economy is somewhat similar to the traditional economy in that the individual has little, if any, influence over how the basic economic questions are answered. However, in a command or controlled system, government leaders—not tradition—control the factors of production and, therefore, make all decisions about their use.

Decisions in government may be made by one person, a small group of leaders, or a group of central planners in an agency. These people choose what is to be produced and how resources are to be used at each stage in production. They also decide how goods and services will be distributed. If you lived in a command economy, you would be paid according to what the central planners decide, and you might not be allowed to choose your own career. Through a series of regulations about education, the government guides people into certain jobs.

Disadvantages of such a controlled economy include a lack of incentives to work hard or to show inventiveness, as well as a lack of consumer choices. Because the government sets workers’ salaries, there is no reason to work efficiently.

Only a few countries in the world today still have much of a command economy. North Korea and parts of the People’s Republic of China are the two main examples because so much economic activity there is government-planned.
Market System  The opposite of a pure command economy is a pure **market economy**—also called capitalism. In a market system, economic decisions are made not by government, but by individuals looking out for their own and their families’ best interests. A limited government makes it possible for individuals to decide for themselves the answers to the three basic questions. Individuals own the factors of production, and therefore choose what to produce and how to produce it. Individuals also choose what to buy with the income received from selling their labor and other resources. All of these choices are guided not by tradition or a central planning agency, but by information in the form of market prices.

A **market** is not necessarily a place. Rather, it is the *voluntary exchange* of goods and services between buyers and sellers. This exchange may take place in a worldwide market for a good such as crude oil. It may also take place in a neighborhood market for services such as paper delivery, snow shoveling, and baby-sitting.

Prices in a market coordinate the interaction between buyers and sellers. As prices change, they act as signals to everyone within the system as to what should be bought and what should be produced. A high price for a good generally means that it is relatively scarce. A low price suggests that it is relatively abundant. The freedom of prices to rise and fall results in a neutral, self-organizing, incentive-driven system.

**Market Economy**

In a market economy, individuals make the economic decisions, and prices act as signals to buyers and sellers about what should be bought and what should be produced.
The flow of resources, goods and services, and income in a market system is actually circular, as shown in Figure 2.2 above. Economists use this model, called a **circular flow of income and output**, to illustrate how the market system works. Note how dollars flow from businesses to individuals and back to businesses again. The factors of production flow from individuals to businesses, which use them to produce goods and services that flow back to individuals.

The advantages of a pure market system are many. People have freedoms—to choose a career, to spend their income how they wish, to own property, and to take risks and earn profits. Also, the existence of competition provides consumers with a wide array of goods and services from which to choose, as well as an efficient system of determining costs. One disadvantage of a pure market system involves concern about those too young, too old, or too sick to work. Many fear that survival for these people would be difficult unless the government, churches, family members, or other organizations stepped in to provide goods and services for them.
A **mixed economy** combines basic elements of a pure market economy and a command economy. Most countries of the world have a mixed economy in which private ownership of property and individual decision making are combined with government intervention and regulations. In the United States, most decisions are made by individuals reacting as participants within the market. Federal, state, and local governments, however, make laws protecting private property and regulating certain areas of business. Such regulations include certain environmental protections, safety guidelines for workers, and laws to protect consumers. In Section 2, you’ll learn more about the United States’s mixed economy, and the role of government in it.

To summarize, consider why a society has one type of economic system and not another. The goals that individuals set for their society help determine their economic system. The amount of government involvement in allocating scarce resources also determines a society’s economic system.

**Vocabulary**

1. Explain the significance of: economic system, traditional economy, command economy, market economy, market, circular flow of income and output, mixed economy.

**Main Ideas**

2. Explaining An economic system answers what three basic questions?

3. Summarizing In a chart like the one below, fill in the answers to the questions about each major type of economic system.

<table>
<thead>
<tr>
<th>Type of System</th>
<th>Who Answers 3 Basic ?'s</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Command</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mixed</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

4. The BIG Idea Go back to the web diagram you made at the beginning of the section. For each economic system you listed, write down the name of a country that uses that system. Use examples from the text or your own knowledge.

5. Contrasting In the circular flow of income and output model in this section, consumers and businesses pass income back and forth freely. Which of the four economic systems would not be represented by this model, and why?

**Applying Economics**

6. Political Systems Some economic systems work better with democracies and some work better with authoritarian rule. Which political system best matches each economic system? Why?
John Stuart Mill was very much a product of home schooling. His father, James Mill, spent a great deal of time educating his nine children, but it was to John, the first born, that he devoted the most attention. By the time John was six, he had been reading Greek for three years and was an accomplished reader of Latin. As the eldest, John was forced to take a large part in the education of his younger siblings.

Mill went on to make important contributions to both political philosophy and economics. His essay *On Liberty* is considered a classic defense of personal freedom and individuality. In it he states, “[T]he only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others. His own good, either physical or moral, is not a sufficient warrant. . . . The only freedom which deserves the name, is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs. . . .”

Although Mill favored individual freedom in general, he was prepared to make numerous exceptions based on the philosophy of utilitarianism, the idea that society should adopt policies promoting “the greatest happiness of the greatest number.” His *Principles of Political Economy*, for example, emphasized production and distribution as separate processes, with distribution to be regulated by the government in order to achieve the utilitarian goal:

“The distribution of wealth . . . depends on the laws and customs of society. . . . Society can subject the distribution of wealth to whatever rules it thinks best.”

**Checking for Understanding**

1. **Clarifying** What is the goal of utilitarianism?

2. **Extending the Content** How did Mill think society should go about achieving “the greatest happiness of the greatest number”?
In a market economy, producers often spend large amounts to make sure that consumers—even very young children—know the names and logos of their products. This is because free-market consumers have freedom of choice, and they will often choose brand names they recognize. In this section, you’ll learn more about freedom of choice and the other major characteristics of a market economic system.
Limited Role of Government

Main Idea | Under capitalism, government plays a relatively limited role in the allocation of resources.

Economics & You | Do you think the government has a right to control a nation's resources, or should decisions about economic activity be left up to individuals? Read on to learn about the relatively limited role of government in a capitalist system.

In his book *An Inquiry into the Nature and Causes of the Wealth of Nations*, economist Adam Smith in 1776 described a system in which government has little to do with a nation's economic activity. He said that individuals left on their own would work for their own self-interest. In doing so, they would be guided as if by an "invisible hand" to use resources efficiently and thus achieve the maximum good for society.

Smith's version of the ideal economic system is called capitalism, another name for the market system. Pure capitalism has also been called a *laissez-faire* system. This French term means "let [people] do [as they choose]." A pure capitalist system is one in which the government lets people and businesses make their own economic decisions without government interference. Capitalism as practiced in the United States today would be best defined as an economic system in which private individuals own the factors of production but use them within certain legislated limits.

Smith's ideas influenced the Founders of the United States, who limited the role of government mainly to national defense and keeping the peace. Since the 1880s, however, the role of government—federal, state, and local—has increased significantly. Among other things, federal agencies regulate the quality of various foods and drugs, watch over the nation's money and banking system, inspect workplaces for hazardous conditions, and guard against damage to the environment. The federal government also uses tax revenues to provide social programs such as Social Security and Medicare. State and local governments have expanded their roles in such areas as education, job training, recreation, and care for the elderly.

Describing | What is meant by a *laissez-faire* economic system?

*capitalism*: economic system in which private individuals own the factors of production

*laissez-faire*: economic system in which the government minimizes its interference with the economy
Other Characteristics

**Main Idea** In a free market, economic activity is coordinated by private businesses and individuals responding to market signals.

**Economics & You** Have you ever bought something you were unhappy with? Would you ever buy that product again? Read on to learn how buyers influence the market.

The government’s relatively limited role in capitalist economies is only one characteristic of these economic systems. Now we will look at some of these systems’ other features.

**Freedom of Enterprise** The American economy, besides being termed capitalist, is also known as a free-enterprise system. This term emphasizes that individuals are free to own and control the factors of production. If you go into business for yourself, you may become rich selling your product. You may instead end up losing money, however, because you—or any entrepreneur—have no guarantee of success.

The government places certain legal restrictions on freedom of enterprise. For instance, just because you know how to fix cars does not mean that you can set up an automobile-repair business in your backyard. Zoning regulations, child-labor laws, hazardous waste disposal rules, and other regulations limit free enterprise to protect you and your neighbors.

**Freedom of Choice** Freedom of choice is the other side of freedom of enterprise. It means that buyers, not sellers, make the decisions about what should be produced. The success or failure of a good or service in the marketplace depends on individuals freely choosing what they want to buy. If a computer game company releases a new game, but few people buy it, the company most likely will not use that particular game designer again. Buyers have signaled that they do not like that game designer’s work.

**Freedom of Choice** If consumers buy a certain product at its current price, producers can maintain the current production level and price, or they can try raising the price to see if consumers will still buy the product. If the product still sells, the producers’ profits will go up. If the product doesn’t sell, producers will have to lower the price.
Although buyers are free to make choices in a free-market economy, the marketplace has become increasingly complex. At times, the government has intervened in various areas of the economy to protect buyers. Laws set safety standards for such things as toys, electrical appliances, and automobiles. In industries dominated by just a few companies—such as public utilities selling natural gas or electricity—the government sometimes regulates prices.

**Profit Incentive** When a person invests time, know-how, money, and other capital resources in a business, the goal is to make a profit. Profit is the amount left after all the costs of production have been paid, including wages, rents, interest, and taxes. The desire to make a profit is called the profit incentive, or profit motive. The profit incentive motivates entrepreneurs to produce new goods and services.

The risk of failing is also part of the free-enterprise system. What happens when profits are not realized—when businesses fail? Losses signal entrepreneurs that they should move resources elsewhere. Thus, the interaction of both profits and losses leads to an economy that is more efficient, adaptable to change, and continually growing.

**Competition** In a free-enterprise system, the lure of profits encourages competition—the rivalry among producers of similar products to win more business by offering lower prices or better quality. Effective competition often requires a large number of independent sellers, which means that no single company can noticeably affect the price of a particular product or service. If one company raises its prices, potential customers can simply go to other sellers.

Competition leads to an efficient use of resources. How so? Businesses have to keep prices low enough to attract buyers, yet high enough to make a profit. This forces businesses to keep their costs of production as low as possible.

For competition to exist, barriers to entry into, and exit from, industries must be weak. For the most part, the United States has weak barriers to entry and exit, but there are exceptions. For example, a person cannot become a physician until he or she has received a license from a state government.
Private Property  One of the most important characteristics of capitalism is the existence of private property, or property that is owned by individuals or groups rather than by the federal, state, or local governments. You as an individual are free to buy whatever you have the funds to do so, whether it is land, a business, an automobile, or baseball cards. You can also control how, when, and by whom your property is used. What are called the rights of property, however, are actually the rights of humans to risk investment, own productive assets, learn new ways of producing, and then to enjoy the benefits if these choices result in profits.

The Founders of the United States recognized that such rights must not be violated, because these rights are the invisible engine for creating wealth and prosperity for all. The Constitution guarantees an owner’s right to private property and its use. Thus, in principle, no level of government in the United States can seize or use private property, at least not without paying the owners.

Explaining  Who makes the decisions about what should be produced in a free-market system?

Vocabulary
1. Explain the significance of: capitalism, laissez-faire, free-enterprise system, profit, profit incentive, competition, private property.

Main Ideas
2. Identifying  Study the list of goods and services below. Then identify who you believe controls most decisions involved with each example, and explain your choice.

<table>
<thead>
<tr>
<th>Goods and Services</th>
<th>Who Controls?</th>
<th>Why?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electricity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lawn mowing service</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ice cream store</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea  Look back at the chart you made at the beginning of the section. Then think of a grocery store near your neighborhood, and give examples of how the store represents three of the characteristics of a pure market system.

4. Summarizing  In a capitalist system, why might business owners resist government intervention in their business?

Applying Economics
5. Extending the Content  Describe a situation in which a lack of competition caused you to pay more for a good or service than you would have otherwise.
GUIDE TO READING

Section Preview
In this section, you will learn about the goals of the American free-enterprise system and the rights and responsibilities that individual Americans face as members of this system.

Content Vocabulary
- economic efficiency (p. 48)
- economic equity (p. 49)
- standard of living (p. 49)
- economic growth (p. 49)

Academic Vocabulary
- element (p. 48)
- expand (p. 49)

Reading Strategy
Identifying Complete a table like the one below by listing the individual's rights and responsibilities in the American free-enterprise system.

<table>
<thead>
<tr>
<th>Rights</th>
<th>Responsibilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
<td>3.</td>
</tr>
</tbody>
</table>

ISSUES IN THE NEWS
— from BusinessWeek

THE INCOME GAP We can debate a lot of economic data but not income inequality. Every serious study shows that the U.S. income gap has become a chasm. Over the past 30 years, the share of income going to the highest-earning Americans has risen steadily to levels not seen since before the Great Depression.

Growing inequality helps explain why so many Americans feel so vulnerable even as the overall economy begins to expand. Moods understandably darken when many have to take second jobs and go into debt to improve their living standards.

If we don’t pursue policies to fix inequality, social pressures may force unwise, even extremist moves, like protectionism.

Nations have values, and they set goals for themselves based on those values. The United States is no exception. Its goals are evident in the supreme law of the land—the Constitution—as well as in its government policies and in the actions of people like you. In this section, you’ll learn how the nation strives both to reach its economic goals and treat its citizens fairly.
The economic goals of free enterprise are freedom, efficiency, equity, security, stability, and growth.

Economics & You Take a moment to think about the values of the United States that are most important to you. Then read on to learn about the economic values of the American free-enterprise system.

The United States has a free-enterprise, or capitalist, system. Therefore, the major characteristics of a market economy should be evident in its goals. Among the national goals of Americans are freedom, efficiency, equity, security, stability, and growth. Although these goals have ethical, social, and religious elements, let’s focus on their economic implications instead.

The goal of economic freedom is to allow each member of society to make choices. Americans have one of the highest degrees of freedom in the world to start their own businesses, to own private property, to make decisions in the marketplace, and to pursue other economic choices. Residents of the United States may choose to work nights or part-time, to have several jobs, and to move from place to place in search of work.

Along with this freedom come certain costs, as shown in Figure 2.3. In particular, individuals must normally accept the consequences of their decisions in our free-enterprise system. If an entrepreneur starts a business that fails, for example, the government usually won’t help out.

Using our limited resources wisely is the goal of economic efficiency. Because of scarcity, if the factors of production are wasted, fewer goods and services overall will be produced. We must always be watchful to use the lowest-cost way to produce any given amount of output.
The issue of fairness underscores the goal of economic equity. Americans want their economic system to be fair and just. That’s why we encourage our policy makers to pass laws such as those dealing with equal pay for equal work, fairness in hiring practices, and help for disabled workers. Another goal is economic security. Americans want protection against risks beyond our control—accidents on the job, natural disasters, business and bank failures, poverty in old age. Our economic system provides such security through a number of government social programs. The goal of economic stability seeks to reduce extreme ups and downs in the standard of living—the material well-being of an individual, group, or nation. The standard of living is measured by the average value of goods and services used by the average citizen during a given period of time. The United States has more individuals enjoying a high standard of living than almost anywhere else in the world. Finally, economic growth means producing increasing amounts of goods and services over the long term. As the population increases, the economy must also expand in order to provide for additional needs and wants. All nations have economic growth as a goal because it helps meet other goals.

**Reading Check** Evaluating Why is economic growth an important goal of the free-enterprise system?

**Figure 2.3** Trade-Offs Among Goals

In a world of scarcity, achieving national goals requires trade-offs. Understanding this will help you realize that not all political desires can be turned into economic reality.

**A. Economic Freedom** The trade-off for the freedom to start a business and try to make a profit is the possibility that the business will fail.

**B. Economic Security** The trade-off for programs that provide economic security, such as unemployment compensation, is the cost of resources that could have been used elsewhere.

**Economic Analysis**

**Synthesizing** What might some trade-offs be for economic equity?
Rights and Responsibilities

Individuals have both rights and responsibilities within a free-enterprise system.

Economics & You Think about a time in your life when you received greater rights, such as the right to stay out later at night. Did you also experience greater responsibilities as a result? Read on to learn about the rights and responsibilities of Americans in the free-enterprise system.

The American free-enterprise system bestows numerous economic rights and protections on individuals like you. You have the right to enter into just about any profession or business you want. You have the right to work very little or to become a “workaholic.” You have the right to buy those products and brands that you like and to reject all others.

A free-enterprise system will not work, however, if individuals do not take on certain responsibilities. The first is to be able to support yourself and your family. You have a responsibility to use your education in a way that helps you become a productive member of the free-enterprise system.

Also, because government has become such an important part of our economy, individuals in our system have the responsibility of electing responsible government officials. This requires both the knowledge of government policies and the ability to analyze the consequences of those policies.

Summarizing What are the economic responsibilities of Americans?

Vocabulary
1. Explain the significance of economic efficiency, economic equity, standard of living, economic growth.

Main Ideas
2. Identifying Create a diagram like the one below and list the major goals of a market economy.

Goals of U.S. Economy

Critical Thinking
3. The BIG Idea How might economic freedom and a rising standard of living be related to each other?

4. Contrasting List three examples of ways that economic freedom and economic equity might conflict.

Applying Economics
5. Synthesizing Research three articles that reflect three different economic goals that you’ve read about. For each article, write a short paragraph explaining how the article fits the goal you selected.
Some government intervention occurs in the American economy, but generally the marketplace answers the three basic economic questions of what, how, and for whom goods and services should be produced. In command (controlled) economies, however, the government (and not the market) answers these three basic questions. Read on to learn about the major alternative to market capitalism.
Pure Socialism

Main Idea  Pure socialism is characterized by centralized economic planning and state ownership of the factors of production.

Economics & You  Have you or a family member ever been treated unfairly in a job? Do you think that workers in general receive fair treatment under the American capitalist system? Read on to learn about socialism, the major alternative to free-enterprise systems.

Pure command socialism is an economic system in which there is little private property and the state owns virtually all the factors of production, such as big factories. In a socialist economic system, the government attempts to manage production and especially the distribution of goods. Few examples of pure command socialism exist. Perhaps the most extensively controlled economies today are in North Korea and Cuba. See Figure 2.4 below for a list of the characteristics of pure socialism.

The Marxian View of Socialism  Socialism as a modern economic system grew out of protests against the problems caused by the Industrial Revolution of the 1800s. Karl Marx viewed history as a continual struggle between various groups, or classes, in society. In his own day, he saw this struggle as going on between capitalists—owners of the land, machines, and factories—and the proletariat, or workers.

Figure 2.4  Pure Socialism

Socialism can be defined as an economic system that stresses government ownership of the major factors of production and control of the distribution of goods.

Characteristics of Pure Socialism

1. Most prices are set by the state, rather than by forces of supply and demand.
2. The movement of resources, particularly labor, is strictly controlled. The central planning authority makes all decisions.
3. Most of the major factors of production are owned by the state. Private property rights are strictly limited to small tools that an individual needs for an occupation.
4. Individual risk taking is not allowed. The state takes all of the risk when it decides which new companies shall be formed. All citizens pay for unsuccessful risk taking.
5. Economic decisions about what, how, and for whom to produce are all made by state officials through central planning agencies and other administrative units.
6. Taxation is often used to redistribute income.

Economic Analysis

Contrasting  How is life different for individual workers under pure socialism compared to under capitalism?
Marx believed that capitalists exploited the proletariat, or used them unfairly. According to Marx, the value of goods depends only on how much labor is used in producing them. He believed that when capitalists sold a good and kept the profit, they were taking income that rightly belonged to the proletariat, the people who were actually doing the work.

Despite capitalism’s dominance in the nineteenth century, Marx believed that it was ultimately doomed to fail. He outlined the eventual collapse of capitalism and predicted the evolution of socialism into communism—an idealized system with no need for a government. Today communism has come to mean any authoritarian socialist system that supports revolution as a means to overthrow capitalism and bring about socialist goals. Ironically, instead of “no government,” communist systems have historically demonstrated that a central government ends up controlling the entire economy. The proletariat, whom Marx envisioned owning and controlling the means of production, actually end up with little to no power at all.

**Socialism Since Marx** In the twentieth century, socialism split into two major trends: democratic socialism and authoritarian socialism. Democratic socialism is a type of socialist system that works within the constitutional framework of a nation to elect socialists to office. In democratic socialist nations, government usually controls only some areas of the economy.

Authoritarian socialism, in contrast, more closely follows Marx’s beliefs. Its supporters advocate revolution as the means to overthrow capitalism and bring about socialist goals. In authoritarian socialist nations, a central government controls the entire economy. Communism, the term Marx applied to his ideal society, came to mean any authoritarian socialist system. Few countries today have such a system.

**Reading Check** Comparing and Contrasting  How does democratic socialism differ from authoritarian socialism? How are they similar?
The Benefits of Capitalism

Main Idea  The main benefits of capitalism are economic efficiency and individual freedom.

Economics & You  Which do you value more: personal freedom and individuality, or fairness and equality for all? Why? Read on to learn the values of a capitalist system.

Many economists like to compare the advantages and disadvantages of capitalism and socialism. Often such comparisons are based on individual values.

Supporters of Capitalism  Those who place a high value on personal freedom, initiative, and individuality prefer capitalism. They point out that socialism often brings extensive government intervention in all parts of the economy and, by necessity, in people’s personal lives.

Supporters of capitalism point out that capitalism allows for more efficiency in the marketplace and for greater rates of economic growth. Indeed, considerable evidence shows that unregulated economic systems—those that are closer to pure capitalism—have much higher rates of economic growth.

Figure 2.5  Planning in Market and Command Economies

Planning is unavoidable, no matter what the economic system. The United States has a highly planned economy. The difference between economic planning in the United States and in command economies is who does the planning.

Economic Analysis  Under which system is risk-taking by individuals encouraged?
All Economies Are Planned It is often said that pure socialism requires centralized planning, and pure capitalism does not. In reality, all economies are planned in one way or another. (See Figure 2.5.) The United States has a highly planned economy. The difference between economic planning here versus that in socialist countries is who does the planning. Private firms, individuals, and elected government officials do the planning in the American economy. In pure socialist systems, central planners make decisions on behalf of everyone.

Real-world capitalism has some problems. Critics note that income is unequally distributed throughout the economy. They also say that although capitalist nations generally have enough government-provided goods such as highways, they do not have enough schools and museums for the general public. Such critics value some of the political goals of socialism.

Identifying What are some criticisms of socialism?

No System Is Perfect Some critics of capitalism claim that capitalist nations do not provide enough funds for schools and other institutions that benefit the public.

Vocabulary 1. Explain the significance of: socialism, proletariat, communism, democratic socialism, authoritarian socialism.

Main Ideas 2. Sequencing Create a diagram like the one below to show the major steps in the development of socialism.

3. Contrasting Write a short paragraph contrasting Marxian and democratic socialism.

Critical Thinking 4. The BIG Idea Look back at the chart you filled in listing the pros and cons of socialism and capitalism. Then list four reasons why authoritarian socialism seems to be ending while capitalism thrives.

Applying Economics 5. Economics & You Think of how you spend your time each day. Some goods and services you encounter are a result of our capitalist economy; someone made these items for a profit. Government provides other goods and services. Of the goods and services you used over the past 24 hours, which were made for a profit, and which were provided by the government?
RUSSIA: SHOPPERS GONE WILD

Russian consumers are on a buying spree.

Check It Out! In this chapter you learned about economic systems. This article discusses the changes in consumer buying habits after Russia’s transition from a command to a market economy.

It’s midday on Saturday, and the Mega-1 mall in southern Moscow is packed. Shoppers have come to stock up on groceries at the mall’s French-owned Auchan hypermarket, buy furniture at Swedish retailer IKEA, and browse dozens of boutiques selling everything from Yves Rocher cosmetics to Calvin Klein underwear. Although crammed with expensive Western merchandise, Mega has been a hit since it opened its doors in December 2002. Last year it was the world’s most frequented shopping center, with 52 million visitors.

What makes the buying surge all the more remarkable is that the average income per person, while growing fast, is still just $300 a month. Yet a surprising number of Russians live as well or better than their Western counterparts.

That’s because some 70% of Russians’ income is disposable, versus around 40% for a typical Western consumer. “We have 13% flat income tax, subsidized housing and utilities, and 10% savings. The rest of it is pretty much out there being spent,” says Natalia Zagvozdina, a consumer-goods analyst at Moscow investment bank Renaissance Capital.

—Reprinted from BusinessWeek

### Growing Consumerism in Russia

<table>
<thead>
<tr>
<th>Ownership by share of households</th>
<th>2001</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile phone</td>
<td>6%</td>
<td>50%</td>
</tr>
<tr>
<td>Computer</td>
<td>5%</td>
<td>20%</td>
</tr>
<tr>
<td>Washing machine</td>
<td>16%</td>
<td>35%</td>
</tr>
<tr>
<td>Stereo</td>
<td>15%</td>
<td>31%</td>
</tr>
<tr>
<td>Video recorder</td>
<td>39%</td>
<td>50%</td>
</tr>
<tr>
<td>Car</td>
<td>25%</td>
<td>31%</td>
</tr>
<tr>
<td>Imported TV</td>
<td>58%</td>
<td>71%</td>
</tr>
<tr>
<td>Apartment or house</td>
<td>71%</td>
<td>82%</td>
</tr>
</tbody>
</table>

Source: GfK Rus Market Research, Moscow.

Think About It

1. **Identifying** What percentage of Russian households now own a computer? A car?
2. **Explaining** What has enabled Russians to buy more consumer products?
All economic systems answer **three basic questions:** what to produce, how to produce, and for whom to produce.

There are four basic types of **economic systems:** traditional, command, market, and mixed.

The **American economy** is defined by six basic characteristics.
**Review Content Vocabulary**

1. Imagine that a new country is being formed and wants to set up an economic system similar to that of the United States. Write a paragraph or two explaining how this new country's system might work. Use all of the following terms.

   - economic system
   - mixed economy
   - market
   - circular flow of income and output
   - capitalism
   - laissez-faire
   - free-enterprise system
   - profit incentive
   - competition
   - economic equity
   - standard of living
   - economic growth

**Review Academic Vocabulary**

Choose the letter of the term that best completes each sentence.

a. available  

b. distribute  

c. incentive  

d. regulate  

e. expand  

f. element  

g. continual  

h. initiative

2. In a mixed economy, the government might _____ some areas of business by making laws to control or influence that part of the economy.

3. All societies make decisions about how to use _____ resources.

4. A market economy experiences _____ changes as market forces influence the factors of production.

5. An entrepreneur is someone who sees a need and takes the _____ by starting a new business.

6. Competition is usually the _____, or motivation, for businesses to lower prices.

7. If a business is doing well, it might _____, or grow larger.

8. Competition is an important _____ of capitalism.

9. Every business must decide how best to _____ its goods or services to consumers.

**Review the Main Ideas**

**Section 1** (pp. 33–40)

10. What basic economic question depends on a nation's available natural resources?

11. What economic question is being answered if an industry replaces some workers with machines?

12. How does a traditional economy answer the basic question, “How should it be produced?”

**Section 2** (pp. 42–46)

13. What are six important characteristics of free enterprise?

14. What is government's role in the modern American version of capitalism?

15. Why is private property important in the American economic system?

**Section 3** (pp. 47–50)

16. What are the six goals of free enterprise?

17. What are two examples of individuals' economic responsibilities in a free-enterprise system?

**Section 4** (pp. 51–55)

18. Complete the graphic organizer by filling in characteristics of each economic system.

<table>
<thead>
<tr>
<th>Economic System</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalism</td>
<td></td>
</tr>
<tr>
<td>Democratic socialism</td>
<td></td>
</tr>
<tr>
<td>Authoritarian socialism</td>
<td></td>
</tr>
</tbody>
</table>

19. Who did Karl Marx believe should control the means of production in an economy?
Thinking Like an Economist

20. Imagine that a school club to which you belong wants to raise money to go on a group trip. Write two or three paragraphs explaining how your club would answer the three basic economic questions as they relate to the fund-raiser. Consider these questions: If your school represents an economic system, what type would it be (traditional, command, market, mixed)? Within that system, how would the club answer the three basic economic questions? How might concepts like competition and profit incentive influence the outcome of the fund-raiser?

Critical Thinking

21. The BIG Idea Karl Marx predicted that capitalism would collapse and evolve into socialism and then communism. The opposite has proved to be true—capitalism has thrived in the world and no society has yet evolved into pure communism. Why do you think this is so? Support your answer with facts and examples.

Analyzing Visuals

24. Study the cartoon on the right, and then answer the following questions.

a. What does the line on the graph represent?

b. Why is making a profit more difficult now for ABX Corp.?

c. Toward what economic system are other countries apparently moving?
Should the best event tickets go to the highest bidder?

Suppose your favorite team makes the playoffs, or the hottest band is coming to play in your town. Should the best seats be available to everyone on a lottery or first-come, first-served basis? Or should they go to whomever pays the most? The major ticket seller, Ticketmaster, recently adopted a policy of selling the best seats through online auctions. Some economists predict that, once a concert’s true market value—its value to customers—is clear, the prices of all tickets go up. Others say early auctions allow promoters to assess demand, so remaining tickets may cost more or less. Should tickets go to the highest bidder?

NO! The true fans can’t afford good seats

Who can afford a $1,000 ticket? Certainly not most loyal, long-time fans or teenagers looking to get as close as possible to their favorite pop idol. So instead of people who enjoy and respect the particular band or team getting a once-in-a-lifetime opportunity to see their favorite act up close, it’ll be the highest bidder. Or fans will go to the poor house just to get a glimpse of their favorite artist.

It’ll be just like [Georgia] Tech football games, where most of the prime chair-back seats are empty because those seats belong to the biggest contributors and not fans. The “true” fans will be stuck in nosebleed seats, itching for a closer look the whole time.

—Kimberly Rieck, Sports Editor, Technique newspaper, Georgia Institute of Technology
Debating the Issue

1. Explaining  Why does the second writer believe that historically, concert tickets have actually been under-priced?

2. Choosing Sides  The two writers disagree on whether the highest bidders should get the best event tickets. Which writer do you agree with? Why?

Find Out More!

1. Analyzing  Using the Internet or other sources, check the difference between the prices of the best seats and the cheapest seats at an upcoming event you might like to attend. How do you think the promoters arrived at those prices? Is a better seat worth the difference in price?
unit 2

Practical Economics: How Theory Works for You

Chapter 3
Your Role as a Consumer

Chapter 4
Going Into Debt

Chapter 5
Buying the Necessities

Chapter 6
Saving and Investing

In this unit, read to find out...
- how basic economic principles can help you in your daily life.
- what pitfalls to avoid when going into debt.
- what you should be aware of before buying a vehicle or house.
- why saving and investing are sound economic habits to learn.
The **BIG Idea**
Buyers and sellers voluntarily interact in markets, and market prices are set by the interaction of demand and supply.

**Why It Matters**
Think about how you spend your money on things such as transportation, entertainment, food, and clothing. How do you make these economic choices? In this chapter, read to learn about what it means to be a consumer and make rational consumer choices.

**Economics ONLINE**

**Chapter Overview** Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 3—Chapter Overviews to preview chapter information.
Do you spend a lot of money on small, day-to-day items such as coffee, fast food, and candy, or do you prefer to save up your money for larger purchases? Either way, wise buying decisions will help you get the most out of the products you buy now and will enable you to meet your long-term financial goals. In this section, you’ll learn how to spend—or not spend—your income wisely.
Disposable and Discretionary Income

Main Idea After people pay taxes, their remaining income may be saved or spent on essential or nonessential items.

Economics & You What do you plan to do after high school? How important is money to you when you consider your career plans? Read on to learn about the factors that affect how much income a person earns.

You and everyone around you are consumers and, as such, play an important role in the economic system. A consumer is any person or group that buys or uses goods and services to satisfy personal needs and wants. Consumers spend on a wide variety of things—food, clothing, housing, automobiles, and movie tickets, for example.

A person’s role as a consumer depends on his or her ability to consume. This ability to consume, in turn, depends on available income and how much of it a person chooses to spend now or save.

Income can be both disposable and discretionary. Disposable income is the money income a person has left after all taxes have been paid. People spend their disposable income on many kinds of goods and services. First, they buy the necessities: food, clothing, and housing. Any leftover income, which can be saved or spent on extras such as luxury items or entertainment, is called discretionary income.

Education, occupation, experience, and health can all make differences in a person’s earning power and thus in his or her ability to consume. Figure 3.1, for example, shows how education level affects income. Where a person lives can also influence how much he or she earns—wages in some regions of the country are higher than in other regions. Inheriting money or property also affects earning power.

Reading Check Identifying On what two things does the ability to consume depend?

Spending Choices Discretionary income can be spent on entertainment, such as movie tickets.
Decision Making as a Consumer

Main Idea Consumer decisions involve comparing available alternatives.

Economics & You Think about a recent purchase you made. What were your reasons for buying the item? Read on to learn the steps to making good consumer decisions.

Spending choices involve several decisions. The initial decision a consumer must make is whether to buy an item in the first place. This may sound so basic as to be unnecessary to mention, but how many times do you actually think about the reasons for the purchase you are about to make? When deciding how to spend your money, do you concentrate on items you need first, and then consider items you want? Do you consider the trade-offs involved? As we will see, consumer decisions involve three main considerations.

Scarce Resources After you have decided to make a purchase, at least two scarce resources are involved—income and time. Before you spend your money, you need to invest time in obtaining information about the product you wish to buy. Suppose, for example, that you wish to buy a mountain bike. How can you obtain information about the characteristics of the numerous brands and models and the prices of each? You should first visit retail stores and do some research on the Internet to compare prices. The time spent researching online or visiting stores to check models and prices is a cost to you. This time, and the money you eventually spend on the mountain bike, cannot be used for anything else.

Figure 3.1 Earning Power

Several factors can influence how much income a person has. One important factor is education. As you can see, the number of years of education you have has a direct effect on your income.

Economic Analysis Using Charts How much can you expect to make per year if you graduate from high school but do not attend college?

<table>
<thead>
<tr>
<th>Amount of Education</th>
<th>Median Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Males</td>
</tr>
<tr>
<td>Not a high school graduate</td>
<td>$19,802</td>
</tr>
<tr>
<td>High school graduate</td>
<td>$27,526</td>
</tr>
<tr>
<td>Some college</td>
<td>$35,023</td>
</tr>
<tr>
<td>Bachelor’s degree</td>
<td>$55,188</td>
</tr>
<tr>
<td>Professional degree</td>
<td>$88,216</td>
</tr>
</tbody>
</table>

Opportunity Cost  How U.S. consumers spend their income is shown in Figure 3.2 above. Almost all of the steps in consumer decision making, like the choices represented in the graph, involve an opportunity cost. Remember from Chapter 1 that opportunity cost is the value of the highest alternative choice that you did not make. When considering this cost, you should think not only about whether you should buy an item in the first place, but also about the quality of the item if you do choose to buy it.

In general, a high-quality product costs more than a medium- or low-quality product. Suppose that you want to buy new cross-training shoes and are trying to decide between two different pairs. One model has a pump system that allows you to get a closer fit on your ankle, and the other does not. The pump system model costs $80 more than the other model. If you choose the higher-priced shoe, you will sacrifice $80. The opportunity cost of the pump model over the lesser-quality model shoe is whatever else you would have chosen to buy with that $80.

When considering opportunity costs, you should think carefully about whether the features of the higher-quality product are important to you, or whether you would rather spend the extra money elsewhere. In our training shoes example, for instance, think about whether a pump system is really something you need or want in a shoe. Is this feature really important to you? Or would you rather spend the $80 on something else?
Rational Choice When you make consumer decisions based on opportunity cost, you are engaging in rational choice. Economists define rational choice as the alternative that has the greatest perceived value.

Rational choice involves choosing the best-quality item that is the least expensive from among comparable-quality products. As a consumer, you will make rational choices when you purchase the goods and services you believe can best satisfy your wants.

Do not get the impression that wise consumers will all make the same choices. Remember the definition: A rational choice is one that generates the greatest perceived value for any given expenditure. Each person’s value system for his or her expenditures is different. Rational choices that are based on careful consumer decision making will still lead to billions of different consumer choices yearly.

Explaining What does it mean to make a rational consumer choice?

Vocabulary
1. Explain the significance of: consumer, disposable income, discretionary income, rational choice.

Main Ideas
2. Identifying Copy the diagrams below, and in them list four items you would like to purchase now (Spending) and four items you would like to save for and buy later (Saving).

Critical Thinking
3. The BIG Idea From your spending web in question 2, list the items you are willing to give up in order to buy items in your savings web, and explain why.

4. Explaining What kinds of products are purchased with disposable income?

Applying Economics
5. Rational Choice Choose a product you like and create two advertisements. The first ad should emphasize why buying this product is a rational choice. The second ad should appeal to the fun or light side of the product and the desire to buy it, even if it’s not a rational purchase.
GUIDE TO READING

Section Preview
In this section, you will learn the three basic buying principles that will help you to make effective consumer choices.

Content Vocabulary
- competitive advertising (p. 72)
- informative advertising (p. 72)
- bait and switch (p. 72)
- comparison shopping (p. 73)
- warranty (p. 74)
- brand name (p. 74)
- generic brand (p. 74)

Academic Vocabulary
- principle (p. 70)
- accurate (p. 71)

Reading Strategy
Outlining Complete an outline like the one below by listing the important points of the section.

Three Basic Buying Principles
1. Gathering information
   A.
   B.
2. Using advertising wisely
   A.
   B.
   C.
3. Comparison shopping
   A.
   B.

ISSUES IN THE NEWS
—from BusinessWeek

INTERNET ADS The 30-second television ad. To the creative directors at Madison Avenue’s largest ad agencies, it is their focus, their world, their definition of happiness. Such spots are the means to glory, whether it’s from a showy debut during the Super Bowl or a prestigious award at the annual Cannes Advertising Festival.

Online ads, on the other hand, have largely been ignored. Top agencies often outsource them to specialists or give them to separate in-house staffs. Some of the best creative minds just haven’t been into the Net.

. . . [Advertisers] have to devote more creative talent to cyberspace. What they have found is that sparking people’s interest online is as challenging as keeping them engaged when they’re watching TV with a remote control.

The goal of advertisements is to win your consumer dollars, and advertisers are willing to spend millions of dollars to attract your attention to their products. Because of the problems of scarce income and time, however, your goal should be to obtain the most satisfaction from your limited income and time. In this section, you’ll learn about three basic buying principles that can help you and all consumers achieve this goal.
Gathering Information

**Main Idea** Consumers should be well informed before making a purchase.

**Economics & You** Why do you think many people are reluctant to spend time researching a potential purchase? Read on to learn about why it is important to gather information before buying a product.

Suppose again that you want to buy a mountain bike. How should you go about selecting one? First, you have to obtain information about mountain bikes. You could ask for friends’ opinions, or you could go to different stores and discuss the good and bad points of various brands and models with salespeople. You could also conduct online research. Actually, as a wise consumer, you would do all of these things before making your purchase.

**How Much Information Should You Obtain?** Information is costly because obtaining it involves your time. How much time should you spend? The buying principle to follow is: Obtain only as much information as is worthwhile. What, however, does *worthwhile* mean? The value of your time and effort spent gathering information should not be greater than the value you receive from making the best choice of product for yourself.

**Developing a Consumer Knowledge Base** As you shop for different products, you will begin to develop a consumer knowledge base. Information you obtain looking for a mountain bike might help you someday to make decisions about choosing a car or a laptop. Simply getting salespeople to give you *accurate* information is a skill that you can acquire and sharpen over time.

One relatively easy way to obtain much information in a short amount of time is to use a standard search engine on the Internet. You might also want to read reviews other people have written about different brands and models of the product you wish to buy. Also, visit numerous sites that offer the product for sale and compare prices, warranties, and other information.

**Help for Consumers**
Many publications, in print and on the Internet, can help you learn about a product before you buy it. One good print publication is the magazine *Consumer Reports*, which tests and rates a wide variety of products.

**Reading Check**
Analyzing Why is it important to develop a consumer knowledge base?
Using Advertising Wisely

Main Idea Consumers should carefully consider the claims of advertisers.

Economics & You Has an advertisement ever persuaded you to buy a product you weren’t planning to buy? Why? Read on to learn about how to use advertising wisely.

Advertising is all around you—on television, the Internet, billboards, and so on. In general, advertising can be classified as competitive or informative. Advertising that attempts to persuade consumers that a product is different from and better than any other is competitive advertising. Companies use it to take customers away from competitors or to keep customers they already have. Informative advertising aids consumers by providing useful information about a product. See Figure 3.3 below for more information on these types of advertising. Some companies use false advertising that misrepresents the quality, features, or true price of goods. A common example of this is bait and switch. The bait is an advertised item at an unrealistically low price. Then, when the consumer gets to the store, a salesperson points out all the bad features of the advertised item. The salesperson then shows the customer higher-priced models and points out all their good features—the switch. This practice is both deceptive and illegal.

Contrasting Explain the difference between competitive and informative advertising.

Figure 3.3 Advertising

- When you are studying an advertisement for a product, it is important to carefully evaluate the information presented in the ad.

A. Competitive Advertising

Ads for well-established brand names and products, such as Dell computers and Nike shoes, are often of this type. Competitive ads, which may also be called persuasive ads, generally concentrate on appealing to people’s emotions.

competitive advertising: advertising that attempts to persuade consumers that a product is different from and superior to any other

informative advertising: advertising that benefits consumers by providing useful information about a product

bait and switch: ad that attracts consumers with a low-priced product, then tries to sell them a higher-priced product
Comparison Shopping

**Main Idea** The best price for an item can be found through comparison shopping.

**Economics & You** What factors influence where you shop? Do you always “shop around” for the best price? Read on to learn about the importance of comparison shopping.

After you have gathered as much information as possible about the make and model of the product you want, you must decide *where* to buy it. It is generally worthwhile to get information on the types and prices of products available from different stores or companies. This process is known as **comparison shopping**.

To efficiently comparison shop, read newspaper advertisements, make telephone calls, browse the Web, visit different stores, and talk with friends who already have the product. Armed with prices that you have obtained from these sources, negotiate with local merchants to get them to match (or come close to) the lowest price.

Comparison shopping can be time-consuming. As with gathering information on a product, the value of your time and effort spent comparison shopping should not be greater than the value you receive from making the best choice of product for yourself. Comparison shopping can be especially useful under certain circumstances, such as when you are buying a very expensive or complex item, or when the quality or price of the product varies greatly.

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**B. Informative Advertising** This type of advertising may contain information about the price, quality, and special features of a product. Be careful, though—informative advertising may also be competitive in nature.

**Economic Analysis**

**Comparing** What do competitive and informative advertising have in common?
When you comparison shop, the most obvious influence on your decision will be price. Don’t forget, however, to find out which store offers the best warranty, or the promise made by a manufacturer or seller to repair or replace a product if it is found to be faulty within a certain period of time.

Another consumer choice is between buying brand-name and generic products. A brand name is a word, picture, or logo on a product that helps consumers distinguish it from similar products. Brand-name products are usually sold nationwide and are backed by major companies. With generic brands, there is no brand name at all, and it is difficult to know who made the product.

**warranty:** promise made by a manufacturer or a seller to repair or replace a product within a certain time period if it is found to be faulty

**brand name:** word, picture, or logo on a product that helps consumers distinguish it from similar products

**generic brand:** general name for a product rather than a specific brand name given by the manufacturer

**Vocabulary**

1. Explain the significance of: competitive advertising, informative advertising, bait and switch, comparison shopping, warranty, brand name, generic brand.

**Main Ideas**

2. **Summarizing** List at least three ways you might go about developing a consumer knowledge base.

3. **Organizing** Create a chart like the one below, and list some key characteristics of each type of ad.

<table>
<thead>
<tr>
<th>Competitive</th>
<th>Informative</th>
<th>Bait and switch</th>
</tr>
</thead>
</table>

**Critical Thinking**

4. **The BIG Idea** Go back and study the outline you made while reading this section. Then explain why some people might make “unreasonable” purchases even if they are aware of basic buying principles.

**Applying Economics**

5. **Negotiating** Think of an item you would like to purchase. Construct an argument to present to a merchant to get a better price for this item than the one advertised. Consider using the Internet, checking prices at other merchants, warranties, brand names, and other issues discussed in this section. Write or record what you would say to the merchant.
Oprah Winfrey emerged from an underprivileged childhood in rural Mississippi to become one of the wealthiest and most powerful women in the United States. Today, she heads the HARPO Entertainment Group—a movie, television, and video production company headquartered in Chicago. Winfrey also hosts the widely acclaimed The Oprah Winfrey Show, the number-one television talk show in the world for more than 20 years. It is seen by 9 million viewers a day in the United States and is broadcast in 117 countries.

Oprah believes that her success can be attributed, in part, to her philosophy of helping others:

“As a rule, we are a society that has based our lives and importance in our lives on how much we can accomplish through material goods. In the end what matters is how were you able to serve and who were you able to love.”

Because she believes that education is the door to freedom, she has donated millions of dollars to provide for students who have merit but no means. In 2002 she expanded her global humanitarian efforts in South Africa, where 50,000 children received gifts of food, clothing, athletic shoes, school supplies, books, and toys.

On her Web site, www.oprah.com, viewers of The Oprah Winfrey Show can find, in addition to advice on many topics, a comprehensive list of resources related to the show.

“This show’s still the thing for me. It gives me the platform to try to figure out how do you get people to lead better lives? How do you get fathers to spend more time with their children?”

Checking for Understanding

1. **Explaining** What is meant by the phrase “students who have merit but no means”?
2. **Synthesizing** Why would Oprah care whether or not fathers spend more time with their children?
Most Americans are concerned with the reliability of the products and services they use. Many private groups and government agencies work to ensure the well-being of consumers. Consumers themselves, however, must be well informed about potential issues with products and services they purchase, and they must be proactive in their buying habits. In this section, you’ll read more about consumer rights and responsibilities.
Consumer Rights

Main Idea Legislative protection of consumer rights has grown steadily since the 1960s.

Economics & You Have you ever been dissatisfied with a product you bought? Did you take steps to fix the problem? Read on to learn about your rights as a consumer.

Consumerism is a movement that started in the 1960s to educate buyers about the purchases they make and to demand better and safer products from manufacturers. Businesses can no longer assume it is the buyer’s responsibility to know whether a product is safe, food is healthful, or advertising is accurate.

In 1962 President John F. Kennedy sent the first consumer protection message to Congress. In the message, he outlined four consumer rights:

- the right to safety—protection against goods that are dangerous to life or health.
- the right to be informed—information for use not only as protection against fraud but also as the basis for reasoned choices.
- the right to choose—the need for markets to be competitive and for government to protect consumers in markets where competition does not always exist, such as electric service.
- the right to be heard—the guarantee that consumer interests will be listened to when laws are being written.

President Richard Nixon later added a fifth right:

- the right to redress—the ability to obtain from the manufacturers adequate payment in money or goods for financial or physical damages caused by their products.

Reading Check Examining What effect did consumerism have on businesses?
Consumer Responsibilities

Main Idea Consumers can resolve problems most effectively by accepting certain responsibilities.

Economics & You Take a moment to think about your responsibilities at home, work, and school. Then read on to learn about your responsibilities as a consumer.

Using President Kennedy’s list, Congress passed consumer-protection legislation. Today, consumers dissatisfied with a specific product can complain to the store manager or to the manufacturer. They also may take the case to small-claims court. In addition, many private and government agencies are available to help consumers.

Among the private groups that aid consumers are local citizens’ action groups and local chapters of the Better Business Bureau, found in many major cities and some smaller ones. These bureaus give consumers information on products and selling practices and help settle disagreements between buyers and sellers. Numerous state and federal agencies also have programs to aid consumers.

You have consumer responsibilities as well as rights. If a product or service is faulty, it is the consumer’s responsibility to initiate the problem-solving process. See Figure 3.4 below for a list of steps for consumers to take, as recommended by the Bureau of Consumer Protection.

Figure 3.4 The Consumer’s Role

Chances are, one day you will have a problem with a product or service and will need to seek a replacement product or a refund. This process will be much simpler if you keep careful records of your purchases and always retain your receipts. If you do have a problem with a product or service, the Bureau of Consumer Protection suggests you take the steps listed in the chart on the right.

Economic Analysis

Explaining Why is it important to retain copies of receipts of all major purchases?

Consumer Responsibilities

1. Report the problem immediately. Do not try to fix a product yourself, because doing so may cancel the warranty.
2. State the problem and suggest a fair and just solution—replacement, refund, etc.
3. Include important details and copies of receipts, guarantees, and contracts to support your case.
4. Describe any action you have taken to try to correct the problem.
5. Keep an accurate record of your efforts to get the problem solved. Include the names of people you have spoken to or written to and the dates on which you communicated.
6. Allow each person reasonable time to solve the problem before contacting another source.
7. If you need to contact the manufacturer in writing, type your letter or send an e-mail directly. Keep a copy.
8. Keep cool. The person who will help you solve your problem is probably not responsible for causing the problem.
The era of online shopping has presented some new challenges for consumers who use the Internet to make purchases. If you choose to shop online, you have the responsibility to make sure you are buying from a reputable, trustworthy source. Be sure to read any confidentiality and disclosure agreements. Also, remember that you should never enter your personal and financial information into a link that was sent to you by a business or company.

Another responsibility of consumers is to exhibit ethical behavior by respecting the rights of producers and sellers. For example, a responsible consumer will not try to return a used item just because it has been advertised elsewhere for a lower price. It’s better to research various prices before you make a purchase.

**Sellers’ Rights**
You have the responsibility to behave ethically if you need to return a product or get a refund on a service. You should not return a product just because you find the item at a lower price elsewhere. Also, you should never try to return a product that has been damaged through your own actions.

**ethical behavior**: acting in accordance with moral convictions about right and wrong.

**Describing** What actions can dissatisfied consumers take?

---

**Review**

**Vocabulary**
1. Explain the significance of: consumerism, ethical behavior.

**Main Ideas**
2. Synthesizing Create a chart like the one below, and for each consumer right listed, think of an example that demonstrates it.

<table>
<thead>
<tr>
<th>Consumer Right</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right to safety</td>
<td></td>
</tr>
<tr>
<td>Right to be informed</td>
<td></td>
</tr>
<tr>
<td>Right to choose</td>
<td></td>
</tr>
<tr>
<td>Right to be heard</td>
<td></td>
</tr>
<tr>
<td>Right to compensation</td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**
3. The **BIG Idea** Think of what it means for consumers and businesses to act ethically, and write three examples of each.

4. **Synthesizing** Some people assume that businesses will take advantage of them. Pretend that you own a business, and write a letter to a newspaper explaining why you would not take advantage of customers.

**Applying Economics**
5. **Consumer Activism** Suppose the people of an area are upset with water pollution caused by a local business. What are three ways that they might address this issue? Use the Internet or contact a consumer agency to help answer this question.
REVENGE OF THE IRATE SHOPPER

Retailers are hurt by word-of-mouth complaints.

Check It Out! In this chapter you learned about consumer rights and responsibilities. The following article highlights how stores are affected by disgruntled customers.

Caveat Vendor: That disgruntled shopper snarling at the manager isn’t the problem. It’s the customer who complains about the store to friends. A new study shows that people told about a friend’s or relative’s bad shopping experience are up to five times as likely to avoid the store in question as the original unhappy customer.

One reason is that the tales of annoyance tend to be embellished with each telling. By the fifth rendition or so, “the sales clerk who was just unresponsive has become abusive,” says Paula Courtney, president of Verde Group, a Toronto retail consultant that conducted the study with the Jay H. Baker Retailing Initiative at the Wharton School.

The survey of roughly 1,200 U.S. shoppers . . . delivers some particularly bad news to the big-box stores. It seems that customers of mass merchandisers like Wal-Mart, Target, and Kmart share their negative experiences with an average of six people, double to triple the audience sought by customers who’ve had negative experiences at other retailers.

—Reprinted from BusinessWeek

Think About It

1. Making Connections According to the story above, why does one person’s bad shopping experience lead to a fivefold reduction in customers to the store?

2. Extending As a responsible consumer, what should you do if you have a negative experience at a store?
■ **Consumer decision making** deals with consumers’ choices about how to spend their income.

![Visual Summary]

Before making purchases, especially of big-ticket items, consumers should **gather information** and compare products from different sources.

In the United States, **consumer rights** are protected by congressional legislation. Along with these rights, though, come **consumer responsibilities**. Savvy consumers are aware of both and seek a balance between the two.
Review Content Vocabulary

1. Imagine that you earn $100 mowing lawns. You decide to spend it rather than save it. Write a paragraph explaining what factors will help you decide how to spend your money. Use all of the following terms.

- consumer
- disposable income
- discretionary income
- rational choice
- informative
- advertising

2. Imagine that you work for the Better Business Bureau, and you have been asked to write a brochure advising people on how to be smarter consumers. Write the introductory paragraph of your brochure using the following terms.

- consumerism
- competitive advertising
- bait and switch
- ethical behavior

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

- region
- perceive
- principles
- accurate
- similar
- assume
- guarantee

3. Wages might be higher in one _________ than they are in another part of the country.

4. Consumers can spend their money more wisely by following simple _______, or rules.

5. A generic product might be very _________ to a competing brand-name product.

6. Consumers need _________ information to make informed buying decisions.

7. Consumerism seeks to _________, or ensure, consumer rights in the marketplace.

8. Advertising seeks to change the way buyers _________ products and competitors.

9. Buyers should not _________ that advertising is accurate and fair.

Review the Main Ideas

Section 1 (pp. 65–69)

10. What is the difference between disposable and discretionary income?

11. What are four factors that affect a person’s earning power?

12. What is a rational consumer choice?

Section 2 (pp. 70–74)

13. What are three important buying principles?

14. How should you decide how much time to spend gathering information before you make a purchase?

15. What is the goal of competitive advertising? What is the goal of informative advertising?

Section 3 (pp. 76–79)

16. Complete the graphic organizer by listing some consumer rights and responsibilities discussed in this chapter.

<table>
<thead>
<tr>
<th>Consumer Rights</th>
<th>Consumer Responsibilities</th>
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</table>

17. Who protects consumers’ rights?

18. What changes did the consumerism movement bring about?
Problem Solving
Jolene, a high school student, has $200 that she would like to spend on electronics. She could choose to buy an MP3 player for entertainment or a used computer of her own to help her do her homework. She wants to make a rational choice about her purchase based on opportunity costs.

19. What steps might Jolene take to help her decide which product to buy?

20. What would be the opportunity cost of choosing to buy an MP3 player?

21. Imagine you are in Jolene's situation, and conduct research on the steps you listed in question 19. Use a chart like the one below to record any information you find. Finally, write down what your decision would be, and then explain why.

<table>
<thead>
<tr>
<th>Step</th>
<th>Information</th>
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<tbody>
<tr>
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<td>3</td>
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</table>

Decision:

Critical Thinking
22. The BIG IDEAS Why do some people buy mostly brand-name products while other people buy mostly store-label products?

23. Examining Examine the advertisement below, then answer the questions that follow.

a. What type of advertisement is this—competitive or informative? Why?
b. What audience does the advertisement target? How do you know?

Analyzing Visuals
24. Study the cartoon below, and then answer the following questions.
   a. What is a demographic?
   b. According to the cartoon, why do retailers value consumers in the demographic to which the boy apparently belongs?
A Day on the Town  First, you go downtown to meet a friend for lunch. Later, a friend invites you to a movie. On the way to the theater, you stop and buy gasoline for your car. Check the map below to see what your day might cost in various cities around the world.*

*All prices have been converted to U.S. $.

**New York City, United States**
- Subway fare, one way: $1.50
- Fast food hamburger: $4.50
- Gasoline, one gallon: $3.15
- Movie ticket: $12.00

**London, England**
- Subway fare, one way: $2.00
- Fast food hamburger: $4.50
- Gasoline, one gallon: $6.36
- Movie ticket: $11.00

**Buenos Aires, Argentina**
- Subway fare, one way: $0.15
- Fast food hamburger: $1.58
- Gasoline, one gallon: $2.21
- Movie ticket: $3.21

**Vancouver, Canada**
- Subway fare, one way: $1.13
- Fast food hamburger: $2.79
- Gasoline, one gallon: $4.35
- Movie ticket: $13.43
Thinking Globally

1. **Comparing** In which city would your day on the town cost the most? The least?

2. **Making Inferences** Look at the prices for Mumbai. How do you think most people get around the city—by car or by public transportation? Why?

3. **Critical Thinking** Which items seem to vary the most in price? Why do you think this is?
The **BIG Idea**
Governments and institutions help participants in a market economy accomplish their financial goals.

**Why It Matters**
Have you ever taken out a loan or used a credit card? If so, why did you make the decision to borrow? Were you able to easily pay back the amount? In this chapter, read to learn how to apply for credit and how to use credit wisely.

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**Economics ONLINE**

**Chapter Overview** Visit the *Economics Today and Tomorrow* Web site at [glencoe.com](http://glencoe.com) and click on Chapter 4—Chapter Overviews to preview chapter information.
GUIDE TO READING

Section Preview
In this section, you will learn about the advantages and disadvantages of using credit to make purchases.

Content Vocabulary
- credit (p. 88)
- principal (p. 88)
- interest (p. 88)
- installment debt (p. 88)
- durable goods (p. 88)
- mortgage (p. 89)

Academic Vocabulary
- enormous (p. 87)
- period (p. 88)

Reading Strategy
Contrasting As you read the section, complete a table similar to the one below by listing the advantages and disadvantages of using credit to purchase a good or service.

Using Credit

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
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Americans use credit to make many purchases. The total amount of funds borrowed and lent each year is enormous. In addition to individuals borrowing funds, the federal, state, and local governments all borrow funds, too. The nation’s economy, in fact, depends on individuals and groups being able to buy and borrow on credit. In this section, you’ll learn what credit is and why people use it.

ISSues In ThE NeWs
— from MSNBC.com

‘TIS THE SEASON TO CHARGE Shoppers are racing from store to store this holiday season, with credit cards clutched tightly in hand and visions of future bills dancing in their heads.

One-half of Americans say they worry about the money they owe, and many say they worry most of the time about their overall debts, an Associated Press poll found.

Those debts can come from home and car loans as well as credit cards. . . . Three-fourths [of people polled] said they have credit cards. Four in 10 of those with credit cards said they will use plastic to help pay for their holiday spending this year.

. . . Most people with credit cards said they carefully manage the debts on those cards, which often have high finance charges on unpaid balances. A sizable minority of them admitted to having serious problems with credit cards.
Credit and Installment Debt

**Main Idea** The price of credit is the interest charged on the amount borrowed.

**Economics & You** Have you ever purchased something using credit? Why or why not? Read on to learn about the price of credit.

**Credit** is the receiving of funds either directly or indirectly to buy goods and services today with the promise to pay for them in the future. The amount owed—the debt—is equal to the principal plus interest. The **principal** is the amount originally borrowed. The **interest** is the amount the borrower must pay for the use of someone else’s funds. That “someone else” may be a bank, credit union, credit card company, or store.

Any time you receive credit, you are borrowing funds and going into debt. Taking out a loan is the same as buying an item on credit. In both cases, you must pay interest for the use of someone else’s purchasing power.

One of the most common types of debt is **installment debt**. Consumers repay this type of loan with equal payments, or installments, over a specific period of time; for example, 36 equal payments over 36 months. Many people buy **durable goods**, or manufactured items that last longer than three years, on an installment plan. Automobiles, refrigerators, washers, and other appliances are considered durable goods. People can also borrow cash and pay it back in installments. **Figure 4.1** below shows the growth in consumer installment debt.

**Figure 4.1  Increase in Borrowing**

- More and more Americans are choosing to buy durable goods on credit.

**Graphs in Motion**

See StudentWorks™ Plus or go to glencoe.com.

**Economic Analysis**

Using Graphs By about how much did consumer debt increase between 1997 and 2006?

**Figure 4.1  Increase in Borrowing**

- More and more Americans are choosing to buy durable goods on credit.

**Consumer Installment Debt**

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<td>Billions of dollars</td>
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<tr>
<td>$1,200</td>
<td>$1,500</td>
<td>$1,800</td>
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Source: Standard & Poor's.
The length of the installment period is important in determining the size of the borrower’s monthly payments and the total amount of interest he or she must pay. A longer repayment period results in a smaller monthly payment. For example, Figure 4.2 above shows that if the repayment of a loan is spread over three years (36 months), the monthly payments will be smaller than if the loan were repaid in two years (24 months). There is a trade-off, however. The longer it takes to repay an installment loan, the greater the total interest the lender charges, and so the total payment will be greater.

The largest form of installment debt in this country is what people owe on mortgages. A mortgage is an installment debt owed on real property—houses, buildings, or land. Interestingly, most people who owe a mortgage on their home do not consider themselves deeply in debt. Because people must have housing, they think of a mortgage as being a necessary monthly payment not similar to other kinds of debt. A mortgage is a debt, however, because somebody has provided the owner with funds to purchase property. In return, the owner must repay the loan with interest in installments over a number of years. As with other forms of installment debt, the longer the repayment period is, the greater the final total payment will be.

Explaining What is installment debt? Give one example of a common form of installment debt.
Why People Use Credit

The use of credit allows the borrower to enjoy consumption now rather than later.

**Economics & You** Imagine that you want to buy a new car. Would you rather use credit to buy it now, or save your money and pay cash for it later? Why? Read on to learn about why people decide to use credit.

Many things that Americans buy on credit are “big-ticket” items—products such as automobiles, electronics equipment, and major home appliances. People often feel forced to buy such items on credit because they believe these products are essential and they want them immediately. They do not want to wait. Of course, consumers are not really “forced” to buy most goods and services on credit. They could decide instead to save the funds needed to make their purchases.

Some might say that you would be better off saving and waiting to buy a pickup truck, for example. During the years you are saving for the truck, however, you forgo the pleasure of driving it. Many people do not want to postpone purchasing an important durable good. They would rather buy on credit and enjoy the use of the item now rather than later.

Another reason for going into debt is to spread the payments over the service life of the item being purchased. For example, people do not buy a truck or car to have it sit in the garage. What they buy is the availability of the vehicle each day, week, month, and year that they own it.

**Figure 4.3 Buying on Credit**

No hard-and-fast rules can tell you whether or not to buy on credit. This list of questions, however, can help you determine if you are making a wise decision.

**Checklist for Buying on Credit**

1. Do I really require this item? Can I postpone purchasing the item until later?
2. If I pay cash, what will I be giving up that I could buy with these funds?
3. If I borrow or use credit, will the satisfaction I get from the item I buy be greater than the interest I must pay?
4. Have I done comparison shopping for credit? (In other words, after you have determined that you are not going to pay cash for something, you should look for the best loan or credit deal, including the lowest interest rate and other conditions of repayment.)
5. Can I afford to use credit now?

**Economic Analysis Synthesizing** Read number 2 in the list on the right. In economic terms, what would you call the other item that you must give up buying if you pay cash now for the first item?
The decision to borrow or use credit involves whether the satisfaction the borrower gets from the purchases is greater than the cost of the interest payments. It is basically a question of comparing costs and benefits. The benefit of borrowing is being able to buy and enjoy the good or service now rather than later. The cost is whatever the borrower must pay in interest or lost opportunities to buy other items or earn interest on the amount put into a savings account or investment.

The benefit of borrowing is something only you can decide. You and every other borrower, however, should be aware of the costs involved. Figure 4.3 can help you decide when to use credit. It can also help you avoid the improper use of credit by overspending.

Analyzing On what question should the decision to use credit be based?

Critical Thinking
4. The BIG Idea Look back at the table you made at the beginning of the section listing the advantages and disadvantages of using credit. Study your lists, and then explain why some people are overwhelmed by debt.

5. Explaining Why are banks willing to lend funds to people?

Applying Economics
6. Calculating Interest Imagine that you buy a used car for $10,000 and the simple interest rate on the loan is 11%. What will your total payments be at the end of 24 months?
There are two major types of credit—using credit cards and borrowing directly from a financial institution. Although they differ in their services, they all charge interest on the funds they lend. In this section, you’ll learn about financial institutions, charge accounts, and credit cards—and why you should be aware of the high interest rates they sometimes charge.
Types of Financial Institutions

Main Idea Financial institutions borrow funds at one interest rate and lend it at a higher rate.

Economics & You Chances are, you will have to take out a loan in the future, whether to pay for college, buy a car, or purchase a home. From whom should you borrow? Read on to learn about the different types of financial institutions available to consumers.

Once you have decided to take out a loan, you should first comparison shop. To gather information about borrower requirements, interest rates, and payment schedules, check various lending agencies in person, over the phone, or at their Web sites.

Commercial Banks The first place you might think to go for a loan is a commercial bank. Commercial banks today control the largest amount of funds and offer the widest range of services. These services include offering checking and savings accounts and loans to individuals. They also transfer funds among banks, individuals, and businesses.

Savings and Loan Associations A savings and loan association (S&L), like a commercial bank, accepts deposits and lends funds. S&Ls make many mortgage loans to families. They also finance commercial mortgages and auto loans. Their interest rates for loans are often slightly less than those for commercial banks.

Savings Banks Savings banks were first set up to serve the small savers who were overlooked by the large commercial banks. Most savings banks, like S&Ls, lend funds for home mortgages, along with personal and auto loans. Since 1980, savings banks, like commercial banks, have also been able to offer services similar to checking accounts.

Commercial Banking At some point, you have probably been inside a commercial bank, one of the most popular of the common financial institutions for consumers.
Credit Unions Union members and employees of many companies often have a credit union. A credit union is owned and operated by its members to provide savings accounts and low-interest loans only to its members. Credit unions primarily make personal, auto, and home improvement loans, although larger credit unions offer home mortgages as well. In general, credit unions offer higher interest rates on savings and charge lower interest rates on loans than other financial institutions.

Finance Companies A finance company takes over contracts for installment debts from stores and adds a fee for collecting the debt. The consumer pays the fee in the form of slightly higher interest than he or she would pay to the retailer. Retailers use this method to avoid the risks involved in lending money to consumers.

A consumer finance company makes loans directly to consumers at high rates of interest—often as much as 15 percent a year or more. The people who use consumer finance companies are usually unable to borrow from other sources with lower rates because they have not repaid loans in the past or have an uneven employment record.

Contrasting What is the difference between a commercial bank and a credit union?

Borrower Beware One type of consumer finance company specializes in “payroll advances.” In a payroll advance, almost anyone who can prove he or she has a steady job can get a small loan, with the understanding that the loan will be paid back on the next payday. The catch, however, is that these institutions charge very high fees for such advances—sometimes as much as 30% of the paycheck itself. People can get into trouble using such a system, as they may get trapped in a spiral of debt, borrowing again and again and paying out more and more in fees each time. Eventually, they might wind up owing an entire paycheck in fees alone!
Charge Accounts and Credit Cards

**Main Idea** Charge accounts and credit cards extend credit directly to an individual or business.

**Economics & You** Do you own a credit card? Does having such a card affect your spending habits? Read on to learn more about this type of direct credit.

A second major type of credit is extended directly to an individual or business, without that person or business having first to borrow any funds. This credit may be in the form of a charge account or a credit card.

**Charge Accounts** A *charge account* allows a customer to buy goods or services from a particular company and pay for them later. Department stores generally offer three main types of charge accounts. A *regular charge account*, also known as a 30-day charge, has a credit limit, or a maximum amount of goods or services a person or business can buy on the promise to pay in the future. At the end of every 30-day period, the store sends a bill for the entire amount. No interest is charged if the entire bill is paid at that time. If it is not, interest is charged on the unpaid amount, often at a high interest rate.

A *revolving charge account* allows you to make additional purchases from the same store even if you have not paid the previous month’s bill in full. Usually you must pay a certain portion of your balance each month. Interest is charged on the amount you do not pay. Of course, if you pay everything you owe each month, no interest is charged. This type of account also has a credit limit.

Major items such as sofas, televisions, and refrigerators are often purchased through an *installment charge account*. The items are purchased and paid for through equal payments spread over a period of time. Part of the amount paid each month is applied to the interest, and part is applied to the principal. This continues until the item is paid in full.

**Other Charge Options**

Sometimes you will hear stores offering special deals, such as “90 Days Same as Cash.” This means that the store will give you longer than the usual 30-day period to pay off a bill—in this case, 90 days—without charging interest. Often, though, if a person fails to pay the balance within the extended time period, the store will charge a higher interest rate than usual.
**Credit Cards** A credit card, like a charge account, allows a person to make purchases without paying cash. The difference is that credit cards can be used at many kinds of stores, restaurants, hotels, and other businesses throughout the United States and even foreign countries. Visa, MasterCard, and others issue cards through banks. These cards can be used to purchase items in stores that accept them, or they may be used to borrow funds up to a certain limit. This gives consumers access to loans at all times without having to apply for them.

There is another method of payment known as a debit card. Although debit cards look like credit cards, they do not provide a loan or extend credit. See Figure 4.4 below for more information on debit cards.

**A. Using a Debit Card**
When you use a debit card in a store, the card reader will usually ask you to select “debit” or “credit.”

**B. Selecting “Debit”**
If you select “debit,” you will need to type in a PIN number. You will not have to provide a signature, and from many stores, you can get cash back from your account when you use this payment method.

**C. Selecting “Credit”**
Remember that if you select “credit,” the money will still come directly out of your account. By selecting credit, you usually do not need to type in a personal identification number (PIN). Instead, you will sign a receipt.

**Comparing and Contrasting** How are charge accounts and credit cards similar? How are they different?

**Debit Cards**
Debit cards make cashless purchases easier by letting customers transfer funds electronically from their bank accounts directly to stores, restaurants, gas stations—almost anywhere transactions take place. Debit cards were first available in the 1970s, but they did not catch on with the public until the 1990s. By 2006, debit cards had become a more popular payment method than checks.

Remember when using a debit card that it is not the same as a credit card. The funds will be taken directly from your checking account, usually within 72 hours. Debit cards do not provide loans or credit.

**Economic Analysis**
Contrasting How are debit cards different from credit cards?
Finance Charges and Annual Percentage Rates

Main Idea: The cost of credit can be expressed as a finance charge or as an annual percentage rate.

Economics & You: Do you think that lenders should be allowed to charge fees to customers who use credit, in addition to what the customer originally paid for the item? Why or why not? Read on to learn about the cost of credit.

The terms finance charge and annual percentage rate tell the consumer the same thing—the cost of credit. Each, however, is expressed in a different way.

Finance Charges: The finance charge is the cost of credit expressed in dollars and cents. It must take into account interest costs plus any other charges connected with credit. For example, yearly membership fees for the use of a credit card are included in the finance charge.

The way finance charges are computed is an important factor in determining the cost of credit. Store charge accounts and credit cards use one of four methods to determine how much people will pay for credit: previous balance, average daily balance, adjusted balance, or past due balance. Each method applies the interest rate to an account’s balance at a different point during the month. The different methods can result in widely varying finance charges. In order to determine which method is used, you may have to call or write to the credit issuer.

<table>
<thead>
<tr>
<th>Type of Method</th>
<th>How Finance Charge Is Computed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previous balance</td>
<td>Charge is computed on the month’s opening balance, even if the bill has been paid in full by the time the finance charge is figured. There is no benefit in paying off a debt early with this method.</td>
</tr>
<tr>
<td>Adjusted balance</td>
<td>Payments made during the month are deducted from the opening balance. Charge is then computed on the balance due the last day of the month. With this method you can save the most if you pay your bill as soon as possible.</td>
</tr>
<tr>
<td>Average daily balance</td>
<td>Charge is applied to the sum of the actual amounts owed each day during the billing period, divided by the number of days in that period. Payments and credits—return of goods—are subtracted on the exact date of payment. With this method you can save the most if you pay your bill as soon as possible.</td>
</tr>
<tr>
<td>Past due balance</td>
<td>No finance charge is applied if full payment is received within a certain period, usually within 25 days after the date of the last billing statement. If full payment is not received, then a finance charge for the unpaid amount is added to the next month’s bill.</td>
</tr>
</tbody>
</table>
Annual Percentage Rates  The annual percentage rate (APR) is the cost of credit expressed as a yearly percentage. Like the finance charge, the APR must take into account any noninterest costs of credit, such as a membership fee.

Knowing which creditor is charging the most for credit would be very difficult without some guide for comparison. The APR provides that guide by allowing consumers to compare costs regardless of the dollar amount of those costs or the length of the credit agreement. Suppose creditor A is charging an APR of 16 percent, while creditor B is charging 17 percent, and creditor C is charging 18½ percent. On a yearly basis, creditor C is charging the most for credit and creditor A the least.

**Summarizing**  What are four ways that lenders can determine finance charges?

---

**Vocabulary**

1. **Explain** the significance of: commercial bank, savings and loan association, savings bank, credit union, finance company, charge account, credit card, finance charge, annual percentage rate (APR).

**Main Ideas**

2. **Summarizing** Create a diagram like the one below to list the types of financial institutions discussed in this section and describe their main functions.

<table>
<thead>
<tr>
<th>Financial Institutions</th>
<th>Type</th>
<th>Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

---

**Critical Thinking**

3. **The BIG Idea**  Although credit abuse can cause serious financial problems, credit is an important part of our economy. What are advantages of allowing people and businesses to borrow money?

4. **Determining Cause and Effect**  What is the disadvantage of not paying a total bill at the time it is due?

**Applying Economics**

5. **Synthesizing**  Imagine you are the parent of a teenager about your age, and you are instructing him or her to use credit in a safe and wise way. Write or record one paragraph that would relate the pros and cons of what you have learned about credit.
How do you apply for credit? What factors determine whether or not you will be approved for credit? Perhaps more importantly, how can you dig yourself out of debt if your payments are more than you can handle? In this section, you’ll learn what makes a person eligible for credit. You’ll also learn ways to handle your debts before they get out of control.
Will You Be Able to Get Credit?

Main Idea Lenders determine creditworthiness by evaluating a borrower’s credit history.

Economics & You If a friend wanted to borrow money, would you lend it to him or her? Read on to learn about how a borrower’s creditworthiness is determined.

Several factors determine a person’s creditworthiness. When you apply for credit, you usually will be asked to fill out a credit application. Then the lender will hire a credit bureau, a private business, to do a credit check. This investigation will reveal your income, any current debts, details about your personal life, and how well you have repaid debts in the past.

The information supplied by the credit bureau provides the creditor with a credit rating for you. This is a rating of the risk—good, average, or poor—involved in lending funds to a specific person or business. (See Figure 4.5.)

Though past history of credit use is important in deciding a person’s creditworthiness, the creditor also looks at three other factors: your capacity to pay, your character, and any collateral you may have.

Capacity to pay considers how much debt you have in relation to your income. If you have changed jobs frequently or been unemployed for long periods, your capacity to pay will be considered questionable. Character refers to a person’s reputation as a reliable and trustworthy person. Lenders also consider collateral, or the size of your capital or personal wealth. Collateral is important because it indicates your past ability to save and accumulate. It also indicates your present ability to pay off a loan, because even if you lose your job, you could sell off some collateral in order to make the payments.

What Hurts Your Credit Rating?

- Late payments
- High debt-to-income ratio
- Having many open accounts
- Previous bankruptcy
- Unemployment
- Legal trouble
A credit score is a mathematical model that evaluates many types of information in a credit file. It is used by a lender to help determine whether a person qualifies for a particular credit card, loan, or service. Generally, the higher the score, the less risk the person represents. People with higher scores are also able to get better interest rates than people with low scores. How can you obtain your credit score?

**Step 1** One easy way to find out your credit score is to log on to AnnualCreditReport.com and request a free copy of your credit report. Federal law states that you can receive one free credit report every 12 months from each of the three national consumer credit reporting companies: Equifax, TransUnion, and Experian.

**Step 2** When you order your credit report from one of the three reporting companies, you may purchase your credit score at the same time. Credit scores generally range from 300 to 850. This table shows where your credit stands depending on your credit score. Any score above 620 is considered respectable.

<table>
<thead>
<tr>
<th>Credit Score</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>700+</td>
<td>Excellent</td>
</tr>
<tr>
<td>680–699</td>
<td>Good</td>
</tr>
<tr>
<td>620–679</td>
<td>Fair</td>
</tr>
<tr>
<td>580–619</td>
<td>Poor</td>
</tr>
<tr>
<td>Under 580</td>
<td>Very Poor</td>
</tr>
</tbody>
</table>

**Economic Analysis**

**Determining Cause and Effect** What factors might negatively affect your credit score?

Usually when a financial institution makes a loan, it will ask for collateral from the borrower. The collateral may be the item being purchased or something of value the borrower already owns. The borrower then signs a legal agreement allowing the lender to claim the collateral if the loan is not repaid. A loan that is backed up with collateral in this way is called a **secured loan**. Sometimes financial institutions will lend funds on a person’s reputation and a promise to repay. Such a loan is called an **unsecured loan**. The interest rate charged on unsecured loans is usually much higher than the rate for secured loans.

A bank will also sometimes lend funds to a person if he or she has a cosigner. A **cosigner** is a person who signs a loan contract along with the borrower and promises to repay the loan if the borrower does not.

**Reading Check** Evaluating Why is collateral important to lenders?
Responsibilities as a Borrower

Maintaining a good credit rating is important for obtaining credit at favorable interest rates.

Economics & You Have you ever borrowed from a friend or parent and not paid them back? What were the consequences? Read on to learn about your responsibilities as a borrower.

Credit use carries responsibilities. If you do not pay your debts on time, the lender may have to hire a collection agency to help recover the funds. If you never pay, the lender has to write it off and take a loss. These costs are passed on to all consumers in the form of higher interest rates. Also, you will get a bad credit history. You will then have a difficult time when you really need credit in the future—to buy a house, for example.

Another responsibility as a borrower is to keep a complete record of all the charges you have made. You also must notify the credit-card issuer immediately if your card is lost or stolen.

What if you’ve lost control of your debt? Financial planners advise you to make a list of everything you owe, what the interest rate is, and what the payments are. Concentrate on paying the high-interest credit cards first, and pay more than the minimum payment, or it will take you years to reduce the debt.

Predicting Consequences Why is it a bad idea not to pay off your debts?

Vocabulary
1. Explain the significance of: credit bureau, credit check, credit rating, collateral, secured loan, unsecured loan.

Main Ideas
2. Summarizing Use a diagram like the one below to list the three factors, besides previous credit history, that a credit bureau will check to determine creditworthiness.

Review

Critical Thinking
3. The BIG Idea What are three possible consequences of not meeting your responsibilities as a borrower?

4. Contrasting What is the difference between a secured loan and an unsecured loan?

Applying Economics
5. Synthesizing Business owners, like consumers, have credit concerns. Allowing customers to buy on credit can be risky, but businesses lose customers if they do not accept credit. Write a policy that you would post in your store for credit customers. Use terms you learned in this chapter.
BAD CREDIT: BREAKING THE CYCLE

Young adults can learn to control credit card spending.

Check It Out! In this chapter you learned about credit and going into debt. In this article, read to learn why charging everything from your cell phone to pizza is a bad idea.

Kristy Wilson and her husband had a nagging feeling that their spending might have spiraled out of control. When they finally sat down to look at their finances, they realized they’d racked up $30,000 in credit card debt. Wilson and her husband aren’t the only young adults whose debt has daunted them in recent years. The average credit card debt among 25- to 34-year-olds was $5,200 in 2004, 98% higher than in 1992.

For many, credit card debt can seem insurmountable. But don’t despair. These strategies may help ease the burden:

1. Assess the Situation. Before you can start cutting your debt, you need to itemize all your financial obligations.

2. Play Hardball. Your creditors want their money back, and they may be more flexible than you think. Explain what you can afford, and see if you can negotiate a modified payment plan.

3. Get Good Information. Your local state attorney general, Better Business Bureau, or consumer-protection agency might have information about resources near you.

4. Lose the Expensive Debt. Keep paying your minimums on all your cards, but focus your buying power on getting rid of one creditor at a time, starting with the card that’s charging you the highest rates.

5. Knuckle Down. Kristy Wilson transferred higher-interest-rate credit debt to more affordable cards while she and her husband were grappling with their $30,000 burden. They did another little thing: the magic secret. “We just spent less,” Wilson says.

—Adapted from BusinessWeek

Think About It

1. Recalling What is the average credit card debt among 25- to 34-year-olds?

2. Summarizing Describe five strategies to help ease debt burden.
To protect consumers, the federal and state governments regulate the credit industry. Some states have set a maximum on the interest rates charged for certain types of credit. The federal government has also passed laws designed to increase the flow of credit information to consumers. In this section, you’ll learn about these laws and how they protect consumers from unfair credit practices.
Laws Protecting Borrowers

Main Idea Laws have been enacted to protect borrowers against unfair lending practices and to help them make informed decisions.

Economics & You What do you think might happen if there were no laws protecting people who borrow? Read on to learn about these laws and how they protect your rights as a consumer.

There are many laws designed to protect consumers who borrow. Here we look at some important federal laws and then explore state laws in general.

The Truth in Lending Act The Truth in Lending Act of 1968 was the first of a series of major federal laws that greatly expanded the government’s role in protecting users of consumer credit. This act requires creditors to keep consumers fully informed about the costs and conditions of borrowing.

The Equal Credit Opportunity Act In 1974 Congress enacted the Equal Credit Opportunity Act (ECOA) as an addition to the Truth in Lending Act. Among other things, those who provide credit cannot deny you such credit solely on the basis of your race, religion, national origin, gender, marital status, or age. Also, no one can deny you credit simply because your income might come from public assistance benefits.

State Usury Laws A law restricting the amount of interest that can be charged for credit is called a usury law. Some states set up different maximum rates for different types of consumer credit. Maximum rates on charge accounts and credit cards, for example, are often about 18 percent a year, or 1 ½ percent per month. Consumer finance agencies, in contrast, can often charge higher rates because their loans involve higher risks.

Identifying The Equal Credit Opportunity Act prohibits discrimination in giving credit on the basis of what six characteristics?

usury law: law restricting the amount of interest that can be charged for credit.

Women and Credit

Before the Equal Credit Opportunity Act of 1974, many creditors would not approve a married woman for credit unless her husband signed the application as well. Now, only joint applications require the signatures of both spouses.
Personal Bankruptcy

Main Idea Personal bankruptcy should be used only as a last resort to relieve the financial burden of debt.

Economics & You Have you ever found yourself in the position of owing someone more than you were able to quickly pay back? What steps did you take to fix the situation? Read on to learn about personal bankruptcy.

   Every day in the United States, thousands of families get into financial trouble because they have ignored the total costs of all their borrowing. They have too many credit cards, too many charge accounts, and own a home that has too large a mortgage. Just because someone offers you credit or allows you to borrow does not mean that you should accept. Buying on credit is a serious consumer activity.

   If debtors take out too many loans, use too many credit cards, and pile up debts that they cannot pay off, they may have to file personal bankruptcy. When a bankruptcy is approved through a bankruptcy court, debtors must give up most of what they own, which is then distributed to their creditors. The Constitution authorizes Congress to establish bankruptcy laws. Certain debts, such as taxes, must continue to be paid, however.

bankruptcy: the state of legally having been declared unable to pay off debts owed with available income

Using Credit

   Just because credit card companies make it easy to obtain credit does not mean that you should accept their offers. Relying too much on credit cards can result in major credit problems and even bankruptcy.
If you declare personal bankruptcy, be aware that the bankruptcy proceedings remain on your credit record for 10 years. During this period, it is very difficult to reestablish credit and borrow funds for items such as a new car or home. That is why choosing bankruptcy to get out of credit problems should be a last resort. Also, when you declare bankruptcy, you are making sure that your creditors will never be paid off (at least not in full) for what they loaned out.

In 2005, Congress passed extensive amendments to federal bankruptcy laws. It is now more difficult to avoid paying off student loans, for example.

Explaining Why is declaring bankruptcy considered a “last resort” for people in financial trouble?

Vocabulary
1. Explain the significance of: usury law, bankruptcy.

Main Ideas
2. Identifying Tracking your credit rating is increasingly important. Using a chart like the one below, list the three credit bureaus that give free credit reports.

Critical Thinking
3. The BIG Idea Why does the U.S. government set rules for the regulation of credit?

4. Summarizing Why are consumer finance agencies often permitted to charge higher interest rates than other lending institutions?

Applying Economics
5. Bankruptcy Research the two types of bankruptcy known as Chapter 7 and Chapter 13. Which requires debtors to set up a repayment plan? Which deletes the debt completely? What are the long-term effects of each type on one’s future?
Dave Ramsey claims that he has an unusual way of looking at the world:

“My wife, Sharon, says I’m weird, and truthfully—I am weird. But there’s a reason. Starting from nothing, by the time I was 26 I had a net worth of a little over a million dollars.”

And then he lost it all, including a $4 million real estate portfolio. The reason? He had borrowed millions of dollars, and when the loans were called in, he couldn’t pay them.

After considerable study and introspection, Ramsey came to the realization that before he could manage money, he had to manage himself. He also realized there were millions of other Americans in the same fix:

“We have become a nation of consumers instead of a nation of producers. We are spoiled. No one wants to wait and save money for purchases. . . . There’s so much money to be made by the credit [card] companies that consumers are always going to be encouraged to spend, spend, spend beyond their means through the use of credit.”

In 1988 he established a consumer counseling service to help others who were suffering from financial stress. He reaches them through broadcasting, publishing, and seminars. His message is simple:

“Live on a written monthly plan—a budget. . . . It’s not hard to add and subtract and to understand that if you spend more than you make you’re going to be broke all your life and deeply in debt.”

Checking for Understanding

1. **Describing** What led to Dave Ramsey’s financial problems?

2. **Theorizing** In what ways could a budget help someone stay out of debt?
The cost of credit is the interest charged on the amount borrowed. The longer the loan period, the higher the amount of interest paid.

<table>
<thead>
<tr>
<th>$1,000 Installment Loan at 9% Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Term of loan</td>
</tr>
<tr>
<td>Monthly payments</td>
</tr>
<tr>
<td>Total interest</td>
</tr>
<tr>
<td>Total payments</td>
</tr>
</tbody>
</table>

The two main sources of credit are credit cards/charge accounts and financial institutions.

Lenders look at your credit history to determine your creditworthiness. It is important to manage your credit wisely and avoid situations that will hurt your credit rating.

What Hurts Your Credit Rating?
- Late payments
- High debt-to-income ratio
- Having many open accounts
- Previous bankruptcy
- Unemployment
- Legal trouble
Review Content Vocabulary

1. Write a paragraph or two explaining credit and debt to young people. Use all of the following terms.
   - credit
   - principal
   - interest
   - charge account
   - credit card
   - finance charge
   - annual percentage rate (APR)

2. Now write a paragraph explaining to young people how they can get credit and what protects them from unfair credit practices or uncontrollable circumstances. Use all of the following terms.
   - credit check
   - unsecured loan
   - credit rating
   - collateral
   - secured loan

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. enormous
b. period
c. previous
d. access
e. accumulate
f. concentrate
g. series
h. contrast

3. Installment debt allows consumers to repay a loan over a _______ of time.

4. A person in debt should _______ on paying off high-interest credit cards first.

5. Loans give people _______ to goods that they might not be able to afford otherwise.

6. The Truth in Lending Act was the first of a _______ of laws dealing with consumer credit.

7. The credit rating of a person who has declared bankruptcy would _______ sharply with the rating of a person with good credit.

8. A consumer can always improve his or her credit rating, despite _______ mistakes.

9. The total amount of consumer debt in the United States is _______.

10. Debt can _______ quickly when a consumer has multiple credit cards, car loans, student loans, and a mortgage.

Review the Main Ideas

Section 1 (pp. 87–91)

11. What do you have to pay when you borrow?

12. How is taking out a loan similar to buying an item on credit?

13. What type of goods do people typically use installment debt to buy?

14. Why do people use credit?

Section 2 (pp. 92–98)

15. Fill in a chart like the one below to list and describe the types of lending institutions in the American economy.

<table>
<thead>
<tr>
<th>Type of Institution</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

16. What is the difference between a charge account and a credit card?

17. How does a debit card work?

Section 3 (pp. 99–102)

18. What does a credit check reveal?

19. What is the difference between a secured and an unsecured loan?

20. What are your responsibilities as a borrower?

Section 4 (pp. 104–107)

21. What does the Equal Credit Opportunity Act of 1974 prohibit?

22. What kind of law restricts the amount of interest that can be charged for credit?
**Math Practice**

Imagine that you charge $1,000 on a credit card and stop using it. The interest rate is fixed at 15%. You can pay $50 per month. Answer the following questions about credit card debt.

23. If there were no interest charges, how long would it take to pay off the balance?

24. With interest charges included, it would in fact take you 35 months to pay off the debt. Why?

25. When you finish paying off your debt, you will have paid a total of about $1,140. What is the extra $140 above your original $1,000 charge? Why do you pay this?

**Critical Thinking**

26. The BIG Idea In deciding whether to pay cash or use credit for a purchase, what are the benefits and drawbacks of each choice?

27. Determining Cause and Effect If John declares personal bankruptcy, how does it affect him? How does it affect his creditors? Other consumers? Retailers? Fill in a graphic organizer like the one below to answer these questions.

```
John
Other consumers
John's creditors
Retailers

Effects of Bankruptcy
```

28. Predicting What might happen if a person took out a payroll advance for several weeks in a row?

**Analyzing Visuals**

29. Study the two “Terms and Conditions” statements for credit cards on the right, and then answer the following questions.

   a. Why would you want to avoid getting cash advances with either card?

   b. Why do you think Credit Card A has a 0% APR for six months?

   c. Based on the annual and monthly fees, which card costs more per year to have?

   d. Which offer is the better deal overall? Why do you think so?
chapter 5

Buying the Necessities

The BIG Idea
Scarcity is the basic economic problem that requires people to make choices about how to use limited resources.

Why It Matters
What are the costs of owning a car? How much should you budget for clothes and food? In this chapter, read to learn how to shop wisely for the necessities.

Economics ONLINE

Chapter Overview  Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 5—Chapter Overviews to preview chapter information.
GUIDE TO READING

Section Preview
In this section, you will learn about a variety of ways to save when shopping for food.

Content Vocabulary
- club warehouse store (p. 115)
- convenience store (p. 115)
- private-labeled products (p. 116)

Academic Vocabulary
- potential (p. 115)
- regional (p. 116)

Reading Strategy
Comparing and Contrasting As you read, complete a table like the one below by listing the benefits and costs of the money-saving habits discussed in the section.

<table>
<thead>
<tr>
<th>Habit</th>
<th>Benefit(s)</th>
<th>Cost(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparison shopping</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Using club warehouse stores</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Using convenience stores</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buying store brands</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Using coupons</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

PRODUCTS In The News

—from Time

A NEW TAKE ON PIZZA  Hold the ice cream!
How do you reinvent one of the world’s favorite quick snacks? Competing teams of culinary inventors think they have a novel answer: pizza in a cone. Eating a slice on the run can be messy, so food scientists have cooked up a new conical concept that is catching on in Europe and will soon hit the U.S.

This summer, Konopizza expects to open shops in Indonesia, Kuwait, Spain, and Greece.

But Konopizza has an American competitor in Crispy Cones, [which] features not just pizza but also a range of conical chow, including chicken, chili, and fruit. Besting the Konopizza prep time of three minutes, Crispy Cones is counting on partially prebaked cones to cut retail oven-to-plate time to just 45 seconds.

“Food should be as portable as a phone,” [says Nir Adar, founder of Crispy Cones.]

▲ Crispy Cone Pizza

▲ Crispy Cone Pizza

— courtesy of crispycones

Americans consume a great variety of foods. They can choose from thousands of different food products and buy them at thousands of stores. Hundreds of brands offer numerous choices. With pizza alone, Americans can choose fresh-baked or frozen, deep dish or thin crust, meat lovers’ or vegetarian, or even pizza in a cone. In all, American consumers spend hundreds of billions of dollars a year on food. In this section, you’ll learn how to get the most from your food dollars.
Comparison Shopping

Main Idea  Shopping for food involves many considerations, including brands, sizes, quantities, unit prices, freshness, the availability of coupons, and store locations.

Economics & You  How much do you spend per week on food? Is there any way you could spend less? Read on to learn about ways to save on food by comparison shopping and planning ahead.

Because American families spend so much on food, comparison shopping is important. It involves making comparisons among brands and sizes before you buy. You need to decide not only what to shop for but where to shop as well.

A consumer should do only as much comparison shopping as is worthwhile, however. It does not pay for a shopper to go far out of his or her way to shop at a store that has only a few needed items at low prices. The additional costs of time and transportation would outweigh any potential savings.

Remember, your time has an opportunity cost. The more time you spend comparison shopping for food, the less time you have to do anything else.

Predicting Consequences
What is the opportunity cost of comparison shopping?

A. Club Warehouse Stores  Although these stores generally offer lower prices than grocery stores, you must buy most items there in bulk. Also, these stores often require people to become members in order to shop in them, and there is usually a membership fee involved. You need to make sure your potential savings on the items you will buy will be more than the other costs. Two popular club warehouse stores in the United States are Costco and Sam's Club.
Trade-Offs in Stores

Main Idea Deciding what food to buy involves numerous trade-offs.

Economics & You Which resource is more important to you: time or money income? Read on to learn about trade-offs between saving time and saving money income when shopping for food.

Americans typically do their food shopping either in grocery stores or in club warehouse stores, which charge lower prices than grocery stores do. Club warehouse stores sell a limited number of brands and items. Although these stores offer the largest potential savings for your food dollars, there is a trade-off. Most food items are only available in large quantities, such as a “value-pack” of soup with 24 cans. Unless your family is large and eats canned soup regularly, you will have unused cans of soup in your cupboard for a long time. Therein lies an opportunity cost. You have tied up your funds in an inventory of food.

Occasionally, you may want to use a convenience store, such as 7-Eleven, for just that reason—because it’s convenient. These stores are usually open 16 to 24 hours a day, but they carry only a limited selection of items, and they are considerably more expensive than grocery stores. See Figure 5.1 for more information on club warehouse and convenience stores.

B. Convenience Stores Although these stores are easily accessible, the selection of items is very limited, and you will pay a much higher price for most items than you would in a regular grocery store. You should shop in these stores only when you really need to save time.

Economic Analysis Explaining What are the benefits and drawbacks of buying items in bulk?
Brand-Name, Private-Labeled, and Bulk Foods

When you go grocery shopping, many of the food items have well-known brand names. Some food stores also carry regional brands that are found only in certain areas of the country.

As an alternative to relatively more expensive national brands, some grocery stores and club warehouse stores carry their own store-brand products. These are also called private-labeled products. According to some consumer surveys, it is possible to save as much as 40 percent by buying such products. You can often save even more by purchasing bulk items. See Figure 5.2 below for more information on these kinds of items.

There is often a trade-off between quality and price in the products you buy. A lower-priced store-brand dishwasher soap might leave a slight film on your drinking glasses, for example, compared to a more expensive national-brand alternative.

Often you will find that the larger the quantity of any item you buy in a supermarket, the lower the per-unit price. Most states require stores to provide unit pricing for food and other products. This practice makes it easy to compare prices not only for different brands, but for different sizes of the same brand. For example, the price of milk might be expressed in terms of cents per ounce. You can then tell how much you save per ounce if you buy milk in larger containers.

**Figure 5.2 Store-Brand and Bulk Foods**

- Some food products are available in store-brand and bulk forms. Both store-brand and bulk foods usually have a lower price than brand-name products.

**A. Bulk Products**

Bulk products are sold in large quantities, usually at club warehouse stores. Also, as shown here, they can be sold loosely—that is, you can take as much or as little as you want, and you will generally pay a lower price per unit.

**B. Store-Brand Products**

Store-brand products are the products retailers sell as their own brands. They may bear the name of the retailer selling them, such as Kroger or Safeway, or they may be sold under an entirely different name such as “Best Yet,” which is sold only at KMart.

**Economic Analysis**

**Contrasting** What is the difference between store-brand and bulk products?
Cents-Off Coupons  Many manufacturers give cents-off coupons. The use of cents-off coupons, however, requires time—the time to collect and match them to items when shopping. Because time is a scarce resource, you have to decide if the amount you save using coupons is worth the time you spend. In addition, coupons tempt you to buy brand-name products you might not otherwise buy—thus not saving you much at all.

Store Discount Cards  Most grocery-store chains now issue store discount cards, which they might refer to as “advantage cards” or “loyalty cards.” Using these cards is optional, but customers who choose to use the cards pay lower prices on some items. Store owners say the cards reward their loyal customers by offering discounts. The cards have drawn criticism from consumers’ groups, though, who claim that rather than paying reduced prices, card holders are really paying the usual price, and non-card holders are paying an inflated price. Also, the cards are used to track customers’ spending habits for marketing purposes. Some people feel that this practice is an invasion of customers’ privacy.

Summarizing  What are the alternatives to paying full price for national-brand food products?

Vocabulary
1. Explain the significance of: club warehouse store, convenience store, private-labeled products.

Main Ideas
2. Compare and Contrast  Use a diagram like the one below to list an advantage and a disadvantage of each item listed.

<table>
<thead>
<tr>
<th></th>
<th>Advantage</th>
<th>Disadvantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Club warehouse store</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Convenience store</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Buying in bulk</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea  What trade-offs are involved in comparison food shopping?
4. Determining Cause and Effect  Why should you not shop when you are hungry or thirsty?

Applying Economics
5. Variable Pricing  Choose three food items and compare their prices at four different stores by looking at ads or by visiting the stores. Explain why you believe each store had similar or different prices for each item.
Russell Simmons

- Founder, Def Jam Records and Phat Farm Clothing
- Chairman, President, and CEO, Rush Communications, Inc.
- Chairman, Hip-Hop Summit Action Network
- Winner of the 2003 Tony Award for Def Poetry Jam on Broadway and the 2002 Peabody Award for the HBO production, Russell Simmons Presents Def Poetry

While still in college, Russell Simmons became manager of his brother Joseph’s rap group, Run-DMC. This was in the late 1970s, and the music industry considered hip-hop to be a temporary fad. As Simmons later noted, “If the music business understood hip-hop in the beginning, I wouldn’t have built Def Jam.” He was referring to the wildly successful recording company that he cofounded with Rick Rubin in the 1980s and which was eventually sold in 1999 to Universal Music Group. Simmons’s share of the profits from the sale came to $100 million.

Def Jam was just the beginning of Simmons’s hip-hop-based business ventures that included the Phat Farm clothing company (sold in 2004 for $140 million), television shows, a credit-card company, a movie production house, an advertising agency, and more. He explains his success by crediting others:

“I’ve been blessed to find people who are smarter than I am, and they help me to execute the vision I have.”

Even though he has been referred to as an “extreme entrepreneur,” there’s more to Russell Simmons than making huge amounts of money. He’s a dedicated practitioner of yoga and a vegan, for example. (“I don’t eat anything that runs away from me.”) He also devotes considerable amounts of time and money to helping correct what he sees as social ills:

“I think we’re all connected. In fact, you realize as you grow older that you’re the least important as just a single individual, that you’re a part of the whole, as opposed to the whole being you.”

Checking for Understanding

1. Why does Simmons believe he has been successful in achieving his vision?
2. Extending the Content What did Simmons mean when he said, “If the music business understood hip-hop in the beginning, I wouldn’t have built Def Jam.”?
GUIDE TO READING

Section Preview
In this section, you will learn methods to help you make wise consumer choices when shopping for clothes.

Content Vocabulary
- durability (p. 121)
- service flow (p. 121)

Academic Vocabulary
- factor (p. 119)
- equivalent (p. 122)

Reading Strategy
Organizing Complete a web diagram like the one below by listing the factors discussed in this section that determine clothing value.

Determining Clothing Value

PRODUCTS In The NeWS
—-from CNN.com

Who Cares About Pairs? It’s one of life’s greatest mysteries: What ever happened to the other sock? Some cite rogue washing machines that feed on the helpless foot-warmer. Others blame mischievous sock fairies who spirit away the otherwise understated fashion fundamentals. . . . People have been losing and clashing socks since they first appeared on people’s feet. A little more than two years ago, a few friends met in San Francisco, California, intent on turning the phenomenon into a business. . . . Conceived of in 2003, LittleMissMatched has exploded in the past year. . . . The fledgling company sells socks that do not match, in a variety of colors and patterns. . . . The patterned socks come in four color systems, characterized . . . as “fabulous,” “marvelous,” “kooky,” and “zany.” It adds up to 8,911 possible combinations—enough that a person could wear a different pair of LittleMissMatched socks every day for 24 years.

▲ LittleMissMatched socks

A mericans spend over $400 billion annually on clothing and other personal products. Most people could reduce clothing expenditures by purchasing only a few very durable items. The clothes, however, would not serve another purpose—variety. In this section, you’ll learn that variety, for Americans, is typically the motivating factor involved in clothing choice.
Comparing Clothing Value

Main Idea Clothing value depends on style, durability, and cost of care, as well as purchase price.

Economics & You Do you look for comfort, style, or certain brand names when shopping for clothes? How important are price and durability? Read on to learn how to make wise clothing choices.

Comparison shopping is an important part of buying wisely. Comparing value in clothing means more than simply purchasing an item from the store that offers the best price. Clothing value depends on at least three other factors: style, durability, and cost of care. (See Figure 5.3 below.)

Style Clothing styles and trends change often, especially for young people. Today, many department stores offer very trendy clothes at reasonable prices. Some of these department stores also offer store-brand clothing labels that are similar to the store-brand grocery items discussed in the previous section. Store-brand clothing, like store-brand food, is generally less expensive than national brands. Nevertheless, it often represents the latest trends.

Careers Handbook See pages R76–R80 to learn about becoming a fashion designer.

Figure 5.3 Clothing Value

When making clothing purchases, many people want to have different looks for different occasions. Also, people who live in places where the climate changes need different wardrobes for summer and winter.

A. Style We often buy clothing that we believe reflects our self-image. Personal taste also has a big influence on the types of clothing people buy. For some people, wearing designer-label clothing, such as Abercrombie & Fitch, is important, and they will often spend more on clothing that bears this label than they would have spent on a similar, nondesigner product.
**Durability**  The ability of an item to last is known as **durability**. The longer a piece of clothing—or any item—lasts, the more durable it is. When you purchase an item of clothing, you are purchasing it for the service flow that it yields. **Service flow** is the amount of time you will be able to use a product and the value you place on this use. If you buy a jacket that will last three years and costs $300, the cost per annual service flow is $100.

Before you shop, you may want to research what kinds of fabrics tend to last longer. Keep in mind, though, that if you are purchasing trendy, inexpensive clothing, durability might not be a very important factor. If you believe the item may be in fashion for only a year or two, you might not care whether it lasts much longer than that.

**Cost of Care**  The cost of care is another factor in assessing value. Two shirts or blouses may cost the same, but one may require dry cleaning, which is more expensive than machine washing. Also, if an item requires hand washing, this will cost you in terms of the time that it will take to physically wash the item. When deciding on the best choice in a clothing purchase, you must consider these kinds of maintenance costs.

**Reading Check**  **Explaining** What is service flow?

---

**Economic Analysis**

**Synthesizing**  Why might a person who lives in Ohio spend more on clothes than a person who lives in Florida?
More for Less

**Main Idea** Consumers have many alternatives to buying clothing at full retail price.

**Economics & You** Do you look for sales when you shop for clothing? Read on to learn about ways to spend less on clothing.

The cost of clothing has decreased significantly over the years. Seventy years ago, a good suit cost about $40, which took an average consumer almost 80 hours to earn. Today a comparable suit sells for just over $500, but costs the average worker the equivalent of about 40 hours of work.

Even though a smaller percentage of one’s budget goes to clothing purchases now than in the past, it is still the wise consumer who looks for ways to save on clothing. Over the last couple of decades, consignment stores, or stores that sell used clothing at lower prices than new, have grown in popularity. Often, you can find very trendy clothing at low prices at consignment stores.

**One Way to Save**

At a consignment store, you can bring in used clothing of your own, and if the store accepts it, you will be given either cash or a credit on any future purchase you make at the store. These stores will generally grant you a higher amount in credit than in cash, to encourage you to shop at their store.
Another way to save on clothing is to buy it on sale. Most major department stores have frequent clothing sales, and holidays are often good times to look for clothing as stores will hold more sales when they think people will be off work and shopping.

Stores also frequently hold seasonal sales. For example, at the end of winter, a store might have a big sale on winter coats in order to get rid of their coat inventory and make room for spring and summer items. If you plan ahead on your wardrobe, you can save a lot through seasonal sales.

You can also sometimes save when you shop online, where there are thousands of clothing Web sites. Just enter “discount clothing” in any search engine, and you will find a great many sites that offer deals on clothes. Because clothing sales are so numerous throughout the year, however, it is easy to become a bargain fanatic—buying sale items that you don’t need just because they are on sale. Before going shopping, make a list of the clothing you require. Having this list along may help you keep your spending within limits.

Determining Cause and Effect Why do Americans spend a smaller percentage of their budget on clothing now than in the past?

Review

Vocabulary
1. Explain the significance of: durability, service flow.

Main Ideas
2. Identifying In a diagram like the one below, list one consideration you should keep in mind for each clothing value factor listed.

| Style | Durability | Care |

Critical Thinking
3. The BIG Idea What is your opportunity cost of comparison shopping for clothes?

4. Explaining When are the best times, usually, for taking advantage of clothing sales?

Applying Economics
5. Evaluating Purchases Think of the last article of clothing you bought and how much you paid for it. Then make a chart listing how the article rates in terms of style, durability, and cost of care. Do you think you made a good purchase? Why or why not?
GUIDE TO READING

Section Preview
In this section, you will discover the costs and responsibilities involved in both renting and buying a place to live.

Content Vocabulary
- lease (p. 126)
- security deposit (p. 126)
- closing costs (p. 128)
- points (p. 129)

Academic Vocabulary
- obtain (p. 128)
- involve (p. 128)

Reading Strategy
Organizing Complete a web diagram like the one below by listing the major costs involved in buying a home.

ISSues In ThE NeWS
— from Fortune

A RENTER’S MARKET Why are rents keeping cool while prices keep getting hotter? Because a large [number] of today’s buyers aren’t purchasing homes to live in. The U.S. is creating 1.2 million new households a year, yet we’re building about two million homes and condos. So 800,000 units are serving not as primary residences but as investments or as second and third homes.

These houses and condos often go back on the market as rentals, since owners need the income to cover the mortgage payments and taxes. The glut is keeping rents down.

In most big coastal cities, it now costs 40% to 70% as much to rent as to own. Home prices in those places have either doubled or almost doubled since 2000. But in most of them, rents have barely budged.

Deciding whether or not to buy a house is one of the most important financial decisions most people will make. Some people will save for years in order to buy a small house. Others take out huge mortgages to purchase large homes. Still others are content to rent a house, condo, or apartment most of their lives. In this section, you’ll learn about the advantages and disadvantages of both renting and buying.
Should You Rent or Buy?

Main Idea  There are advantages and disadvantages both to buying a home and renting a place to live.

Economics & You  Have you ever thought about where you will live when you get out on your own? Read on to learn about the pros and cons of renting or buying a home.

The average American family spends about one-fourth to one-third of its income on housing. Therefore, deciding whether to rent or buy is one of the most important decisions a person can make.

When young adults first start out on their own, they will often rent an apartment or small house before they think about buying. There are many reasons why people often initially rent. First, buying a house generally requires a substantial down payment of many thousands of dollars. Renting an apartment, on the other hand, usually requires only a security deposit and one or two months’ rent up front. Renters also do not have to pay maintenance costs or real estate taxes. Renting also allows people greater mobility; if renters want to find a different place to live, or if they want to move to another town or state, they don’t have to worry about trying to sell property first.

Eventually, though, many people will choose to buy a home. Again, financial benefits are a driving consideration. Ownership of a home provides significant income tax benefits to the owner. Also, houses build up equity, which is the market value of the property minus the mortgage amount still owed. Home ownership is often a good investment, as houses often appreciate, or go up, in value, although this can depend on the neighborhood and the housing market at the time.

Explaining  Name two advantages of renting.

Buying  In addition to the long-term financial benefits of home ownership, people who choose to buy also experience the pride of ownership, and they have the freedom to remodel or improve the property as they wish. In turn, they give up the freedom of easy mobility.
Renter Rights and Responsibilities

Main Idea Renters should read their leases carefully to understand their rights and responsibilities.

Economics & You Do you know anyone who lives in an apartment, or have you ever experienced a conflict with a landlord? Read on to learn about the rights and responsibilities of renters and landlords.

If you decide to rent, you will most likely be asked to sign a lease, or contract, that contains several clauses. As a prospective tenant, you should read the lease carefully. Most leases are for one to three years, although sometimes you may pay extra to get a six-month or nine-month lease. Often a lease will limit how an apartment can be used. The lease may forbid pets, for example, or forbid anyone other than the person named on the lease from living there. In signing a lease, the tenant is usually required to give the owner a security deposit, or funds for the owner to hold in case the rent is not paid or the apartment is damaged. The security deposit, usually equal to one month’s rent, is returned after the tenant has moved out. The amount returned depends on the condition of the apartment, as determined by the landlord.

Among the rights of tenants is the use of the property for the purpose stated in the lease. Tenants also have the right to a certain amount of privacy. A landlord usually needs the renter’s permission to enter an apartment. In turn, the tenant’s responsibilities include paying the rent on time, taking reasonable care of the property, and notifying the landlord if repairs are needed.

The tenant is also required to give notice, or a formal warning, if he or she plans to move before the term of the lease is up. In this event, the landlord may ask for several months’ rent to pay for any time the apartment is empty before a new tenant moves in.

Restrictions May Apply

If you have pets and are trying to rent, be sure to ask the landlord about this issue. Some landlords do not allow pets at all, while others allow some animals but not others. You may have to put down an extra security deposit if you have pets.
Follow these tips if you are planning on signing a lease on an apartment or other rental unit.

## Clauses in Rental Leases

### Avoid these types of clauses in leases:

1. **Confession-of-judgment clause:** The lawyer for the rental owner has the right to plead guilty for you in court if the owner thinks his or her rights have been violated. With a confession-of-judgment clause—illegal in some states—you are admitting guilt before committing any act.

2. **Inability-to-sue clause:** You give up your right to sue the owner if you suffer injury or damage through some fault of the owner, such as neglected repair work.

3. **Arbitrary clauses, or those based on one's wishes rather than a rule or law:** The owner has the right to cancel the lease because he or she is dissatisfied with your behavior.

### If possible, add these clauses to your lease:

1. A list of the appliances that come with the apartment—dishwasher, garbage disposal, and air conditioner, for example.

2. The apartment community facilities you have been promised—recreation room, parking space, swimming pool—and whether you must pay extra for their use.

3. Any other promises made by the owner, such as painting the apartment (and what color).

4. The right to cancel your lease if you are transferred to a job in another city. Usually you must agree to pay a certain amount to do this, which should be stated in the lease.

5. The right to put in lighting fixtures, shelves, and so on, and have them remain your property when you move.

---

Landlords have responsibilities too. In many states, landlords must make sure that their apartments have certain minimum services, such as heat, and that they are fit to live in. Landlords may also have to obey building safety laws. For example, fire escapes and smoke detectors may be required. Leases usually call for the landlord to make repairs within a reasonable amount of time. In many states, a tenant has the right to pay for the repairs and withhold that amount of rent if the landlord does not make the repairs. **Figure 5.4** above details more important information about leases.

---

**Identifying** Whose responsibility is it to make repairs to an apartment?
Purchasing a House

Main Idea Potential home buyers need to consider many different costs before deciding to purchase a house.

Economics & You Do you plan to own a house someday? Why or why not? Read on to learn about the financial obligations of owning a home.

When you decide to buy a house, it is important that you do not take on financial obligations that are beyond your budget. As a general rule, no more than a third of your total income should go toward your mortgage payment and other costs. (See Figure 5.5 below.)

One of the major challenges facing any home buyer is obtaining the mortgage. You will remember from Chapter 4 that a mortgage is the installment debt that you take on when you buy a house or other piece of property. If you buy a house for $200,000 and make a $40,000 down payment, you will need to obtain a mortgage for the remaining $160,000. The mortgage will then be repaid in monthly installments that include interest on the loan. Property taxes, homeowner’s insurance, and mortgage insurance are often included in your mortgage payment as well.

At the time of purchase, in addition to the down payment, you will need funds for closing costs. These are costs involved in arranging for the mortgage or in transferring ownership of the property. Closing costs can include fees for such items as the title search, legal costs, loan application, credit report, house inspections, and taxes. Although the person buying the house usually pays these fees, the seller may agree to pay part or all of them if this will make it easier to sell the house.

Figure 5.5 The Cost of Ownership

- There are many expenses involved in owning a home apart from the mortgage payments. Remember, though, that owning a home builds equity and is often a good investment.

Economic Analysis Explaining Why do lenders often charge points when someone takes out a mortgage?
When you are arranging for a mortgage, it is important to know about points, which are included in closing costs. **Points** are the fees paid to the lender and computed as a percentage of the loan. Each point the lender charges equals 1 percent of the amount borrowed. Lenders charge points—usually one to four—when they believe that the current interest rate is not high enough to pay the expenses involved in handling the mortgage and still make a profit. When interest rates are up, on the other hand, lenders will sometimes waive points to attract home buyers. In any event, you should attempt to negotiate points with the lender. You also have the option of going to a different lender.

**Analyzing** Aside from the down payment on the house itself, what other fees must you pay up front when buying a home?

**Vocabulary**

1. **Explain** the significance of: lease, security deposit, closing costs, points.

**Main Ideas**

2. **Comparing** In a chart like the one below, list the advantages of buying and renting.

<table>
<thead>
<tr>
<th>Buying Advantages</th>
<th>Renting Advantages</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. **The BIG Idea** Based on the advantages and disadvantages of buying and renting that you’ve read about in this section, do you think you would like to rent or buy a house when you live independently? Explain your choice.

**Applying Economics**

4. **Analyzing a Lease** Go to an apartment complex office and ask for a copy of a lease. Bring the lease to class and read the contents. Then make one list of the renter’s responsibilities and another list of the penalties for breaking the lease. Do you think the terms of the lease are fair? Why or why not?
As with every decision in life, when you decide to buy a car, you are going to make a trade-off that involves an opportunity cost. You will have to decide what type of vehicle to buy, whether to buy new or used, and whether gas efficiency or engine size is more important to you, for example. In this section, you will learn about some of the important things to consider when shopping for a car.
Buying a Car

Main Idea Buying a car involves comparing many variables, such as the initial purchase prices, repair histories, warranties, and styles of different makes and models.

Economics & You Have you ever bought or considered buying a car? If so, what factors did you consider? Looks? Safety? Fuel efficiency? Price? Read on to learn about what to look for when buying a car.

Buying a car involves several considerations. One is the amount of money and time spent shopping for the car. Another is the amount of money and time spent in actually purchasing the car. Because of limited resources, most people have to borrow funds to buy a car. The costs of the loan are the down payment, the monthly payments on the principal, and the interest on the loan.

New or Used? The first decision you must make is whether to buy a new or used car. New cars are more expensive, of course, but they will generally cost less in repairs over the first several years. If you buy a used car, be sure to check out the vehicle’s history first and make sure the car is in good condition. It’s a good idea to have a used car checked over by an independent mechanic before purchasing it.

Registration Fee The owner of an automobile must pay a state licensing fee, or a registration fee, to use the car. Usually the fee must be paid annually. Some states now offer a two-year registration option. In many states, the amount of the fee varies depending on the car’s age, weight, type, and value.

Extended Warranty One way to guard against having to pay for major repairs is to buy extended warranty coverage. New-car warranties generally protect owners for all major repairs except tune-ups and damage resulting from improper use of the automobile. New-car warranties usually last only a few years, or up to a certain limit of miles or kilometers. These warranties, however, can often be extended for another one, two, or three years by paying additional money when the car is purchased.

Evaluating On what factors does a car registration fee generally depend?
Operating a Car

Main Idea Operating a car is expensive, involving the costs of gasoline, routine maintenance, major repairs, depreciation, and insurance.

Economics & You Do you own a car? Aside from the initial purchase, how much do you spend every month on the car’s day-to-day use? Read on to learn the costs involved in operating a vehicle.

Normal Maintenance and Major Repairs The amount of normal maintenance—oil and filter changes and minor tune-ups—depends on the amount the car is driven and how carefully the owner maintains the car. Major repairs are those that are normally unexpected and expensive. They include rebuilding the transmission and replacing the exhaust system. No one can guarantee that an automobile will not require major repairs while you own it, but you can follow certain steps to reduce the probability.

You should check the repair records of different cars before deciding on a particular make and model. If you are considering a used car, you should also take it to a diagnostic center, or have a mechanic check it. Sometimes dealers offer warranties on used cars for a limited time period, such as 30 days, or you can purchase a warranty covering a longer period of time.

Figure 5.6 How Car Insurance Rates Are Set

When you buy automobile insurance, the rate you are charged is determined by your gender, driving experience, and a range of other factors.

Factors Affecting Automobile Insurance Rates

1. The type of car you drive. Insurance companies consider the safety record of a car and the costs to repair it if it is involved in an accident.
2. Where you drive. If the rate of thefts and accidents is high in an area, the risk to the insurance company is greater. A city, for example, would have more thefts and accidents than would a rural area. Therefore, the rate the insurance company charges in a city will be higher.
3. What you use the car for. If you drive your car for business on a daily basis, the rate will be higher than if you use it only for errands and occasional trips.
4. Marital status. In general, married men and women have lower accident rates than single men and women and, therefore, pay lower insurance rates.
5. Safety record. If you have a history of accidents and traffic tickets, then you will be charged a high rate. Whether a new driver has had driver education is often considered in determining a rate.
6. Grades. Many insurance companies offer better rates to teenage drivers who get good grades.
7. Number of drivers. The more drivers who use a particular car, the higher the insurance rate will be.

Analyzing Why do you think some insurance companies give lower rates to students with good grades?
Depreciation  

Depreciation—a decline in value over time—takes place as an item wears out or becomes outdated. Age is the major factor. A car loses value every year even if it is not driven because an automobile is a durable good. All durable goods deteriorate, or become worse over time. Another cause of depreciation is the technology and features of new makes and models. These changes make older models obsolete.

The amount of depreciation caused by physical wear and tear varies. It depends on how hard a car is driven, how far it is driven, and how well it is maintained. Generally, cars depreciate about 20 percent each year.

Insurance  

A major cost of owning an automobile, especially for new drivers, is insurance. Many states require that liability insurance be purchased before an automobile can be licensed. Liability insurance pays for bodily injury as well as property damage if you are in an accident.

Insurance companies classify drivers in various ways, usually according to age, gender, and marital status. Rates depend on the category into which a person fits. The categories, in turn, are based on statistics showing that different types of drivers have different accident rates. Young people, for example, almost always have to pay higher insurance rates.

Figure 5.6 shows factors in addition to age and gender that affect insurance rates. Rates cannot vary too widely, however, because states set limits on the rates that companies can charge.

Describing  

What factors affect a car’s rate of depreciation?

Vocabulary  

1. Explain the significance of: registration fee, liability insurance.

Main Ideas  

2. Identifying  

Use a diagram like the one below to list six factors to consider when purchasing a vehicle.

- Buying a Car
-  

Review  

3. Examining  

What two costs of operating a vehicle are based on state requirements?

Critical Thinking  

4. The BIG Idea  

What trade-offs are involved in buying a vehicle?

Applying Economics  

5. Insurance Rates  

Choose a car you would like to purchase in the future, and then search the Internet for insurance rates in your area for that vehicle. Which company offers the best rate for your age group?
EAT YOUR HYBRID VEGGIES

From scarlet corn to tortilla-like lettuce, innovation is hitting the produce section.

Check It Out! In this chapter you learned about buying the necessities, including food. This article shows how shopping for healthy food has entered a whole new dimension.

Even for shoppers used to the riot of colorful fruits and veggies in a suburban grocery store, a walk through the produce aisle at the Harris Teeter supermarket in Mount Pleasant, S.C., is a feast for the eyes. There are exotic fruits like the kiwanos, with orange skin and white flesh that tastes of banana, watermelon, and cucumber. The spiky fruits are so odd that when they roll through checkout, even the cashiers can’t always I.D. them. But also piled high on the shelves are cobs of corn with scarlet kernels that look like old-fashioned wild maize....

The corn is custom-bred to have high levels of anthocyanin, an antioxidant usually found in blueberries. Down the way are some funny-looking artichokes—purple, thanks to a similar enrichment with anthocyanin.

Innovation is sweeping through the farm sector, bringing surprises that go beyond exotic fruits jet-shipped from the ends of the earth. In many cases it is consumers who are influencing produce breakthroughs, just as they forced agribusiness to take organic food seriously. Years ago seed companies courted farmers with new seed varieties that promised big harvests of veggies that could stay fresh for seemingly impossible lengths of time. Today’s consumers are less interested in, say, rubbery tomatoes that last forever on a shelf, and more attracted to healthful produce that actually tastes good.... These new fruits and veggies aren’t being cooked up using genetic engineering. Scientists employ older methods, such as crossbreeding different varieties of the same plant, but with a high-tech spin.

—Reprinted from BusinessWeek

Think About It

1. Explaining According to the article, who has influenced the rise of innovative fruits and vegetables?

2. Theorizing Which type of consumer would buy hybrid vegetables—one concerned with price, one concerned with taste, or one concerned with health? Explain your answer.
When buying any necessities, including food and clothing, there is often a trade-off between quality and price.

When deciding whether to rent or buy a home, you should consider the advantages of each option.

<table>
<thead>
<tr>
<th>Advantages of Renting</th>
<th>Advantages of Owning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower monthly costs</td>
<td>Building equity</td>
</tr>
<tr>
<td>Greater mobility</td>
<td>Tax benefits</td>
</tr>
<tr>
<td>No maintenance</td>
<td>Pride of ownership</td>
</tr>
<tr>
<td>responsibilities</td>
<td></td>
</tr>
</tbody>
</table>

When buying a car, you will have many trade-offs to consider before deciding what type of vehicle is best for you.

<table>
<thead>
<tr>
<th>New</th>
<th>Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fuel efficient</td>
<td>Powerful engine</td>
</tr>
<tr>
<td>Under warranty</td>
<td>No warranty</td>
</tr>
<tr>
<td>Lower insurance</td>
<td>Higher insurance</td>
</tr>
</tbody>
</table>
Review Content Vocabulary
1. Write a paragraph or two explaining how one can be a wise consumer when shopping for necessities such as food, clothing, housing, and cars. Use all of the following terms.
   - club warehouse store
   - convenience store
   - private-labeled products
   - durability

Review Academic Vocabulary
Choose the letter of the term that best completes each sentence.
   a. potential  b. significant  c. regional  d. factor  e. equivalent  f. obtain  g. involved  h. status
2. Some brands are ______ because they are only available in certain areas of the country.
3. Trendiness is often a ______ in young people's clothing choices.
4. Insurance companies check drivers' marital ______ because married people tend to be safer drivers.
5. A security deposit is often ______ to one month's rent.
6. Leases protect both landlords and tenants from many ______ problems that might arise.
7. Customers can ______ necessities from a convenience store for a higher price.
8. There are many decisions ______ in buying a new car, including price, style, brand, and color.
9. The cost of a home is usually the most ______ expense in a family's budget.

Review the Main Ideas
Section 1 (pp. 113–117)
10. When comparison shopping, what factors should you consider in deciding where to shop and what to buy?
11. What is the trade-off involved when you buy a generic brand rather than a brand-name product?
12. What are some advantages and disadvantages to shopping at club warehouse stores?

Section 2 (pp. 119–123)
13. What four factors influence the kind of clothing choices people make?
14. In general, what is the relationship between how long an article of clothing will last and its price?

Section 3 (pp. 124–129)
15. Fill in a chart like the one below listing the advantages and disadvantages of owning a home versus renting.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Owning</th>
<th>Renting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registration fee</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Security deposit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Disadvantages</th>
<th>Owning</th>
<th>Renting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liability insurance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

16. List three responsibilities of tenants and three responsibilities of landlords.
17. Name at least two things you should look for in a rental lease.

Section 4 (pp. 130–133)
18. If you get a loan to buy a car, what expenses must be included in the cost of buying the car?
19. What is included in the cost of operating an automobile?
Math Practice

20. Determine the per-unit price of each product listed in the chart below.

<table>
<thead>
<tr>
<th>Product</th>
<th>Size or Quantity</th>
<th>Price</th>
<th>Price per Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Milk (national brand)</td>
<td>1/2 gallon (64 oz.)</td>
<td>$1.97</td>
<td></td>
</tr>
<tr>
<td>Milk (store brand)</td>
<td>1 gallon (128 oz.)</td>
<td>$3.15</td>
<td></td>
</tr>
<tr>
<td>Laundry Detergent X</td>
<td>70 oz. (40 loads)</td>
<td>$6.99</td>
<td></td>
</tr>
<tr>
<td>Laundry Detergent X</td>
<td>210 oz. (120 loads)</td>
<td>$15.98</td>
<td></td>
</tr>
</tbody>
</table>

21. Which milk is the better buy? Why?

22. Why might some people consider the other choice of milk to be better despite the price difference?

23. Which laundry detergent is the better buy? Why?

Critical Thinking

24. The BIG Idea  Most people’s ability to spend is limited by the amount they earn. This means that income is a scarce resource, and people must make choices about how to use it. So, if a family’s rent unexpectedly increases but their income does not, how might they adjust to this unavoidable change in their budget?

25. Evaluating  Look over the expenses identified in this chapter as necessities (food, clothing, housing, vehicles). What other expenses in life would most people consider to be necessities? Why?

Analyzing Visuals

26. Study the cartoon on the right, and then answer the following questions.

   a. What necessary expenses are shown in this cartoon?
   b. Why does the man decide to stay home?
   c. How are oil prices affecting the man even if he does avoid driving?
Can you use your buying power to change society?

THE ISSUE

“Buying power” is the ability and willingness of a certain segment of the population to buy certain goods or services. America’s 32 million teenagers spend about $159 billion a year. They also influence buying decisions for another $300 billion. That’s a lot of buying power. Can teen buying power be used for more than acquiring things? That is, can individual shopping choices actually change American culture?

THE FACTS

Have you ever bought sneakers and later found out they were made by a child laborer in a developing country? Some people would refuse to buy that brand. Whenever you buy a product, you’re endorsing the product and the company that made it.

Throughout history, consumer activists have used economic power to create social change, in everything from environmental issues to employee working conditions. One tactic used is the boycott, a practice in which consumers stop buying a company’s products until the company changes the way it operates.

Another way to influence change is through investment choices. Some consumers invest only in companies they consider socially responsible. Still others protest what they consider over-commercialization of the culture by refusing to become “walking ads.” They cover up company names and logos on clothing, shoes, and other gear—or buy products without them.

---

Teens' Sources of Income

- **Boys**
  - Parents: 77%
  - Odd jobs: 73%
  - Allowance: 40%
  - Regular job: 26%

- **Girls**
  - Parents: 87%
  - Odd jobs: 65%
  - Allowance: 36%
  - Regular job: 22%

THE ECONOMIC CONNECTION: YOUR ROLE AS A CONSUMER

As mergers create larger and larger corporations, the companies become so powerful that some people believe the average person cannot influence their activities. But consumers still have “the power of the pocketbook.”

Just as product quality, availability, and opportunity cost affect purchasing and investment decisions, many people also take a company’s ethics into consideration.

Whenever a group of consumers becomes a sizeable market—like teenagers—companies listen to what they want. That’s why boycotts can succeed, if enough people support them. According to consumer advocate Ralph Nader, it doesn’t take a huge drop in sales to convince companies to heed customers’ wishes—2 to 5 percent will do it. In some cases, the mere threat of a boycott creates change.

One of the most famous boycotts occurred in 1955, when African Americans stopped using the Montgomery, Alabama, bus system after Rosa Parks was arrested for refusing to give her seat to a Caucasian man. What began as an economic boycott resulted in a U.S. Supreme Court ruling that ended bus segregation.

A nationwide boycott of table grapes from 1965 to 1970 achieved better living conditions and higher wages for migrant farm workers. A 1986 boycott to protect Central American rainforests cut sales at a major fast-food chain by 12 percent, causing the company to stop importing beef from cattle raised on deforested land. Consumers working with nonprofit organizations have convinced several large clothing retailers not to sell fur. They also convinced a major pet-supply chain to stop selling parrots, and their activism has created a market for cosmetics that are not tested on animals. In 2006 students at 20 U.S. universities and in several other countries boycotted a soft-drink manufacturer for water pollution and union interference at bottling plants. Consumer campaigns also convinced cruise ship lines to stop dumping toxic waste into the oceans.

CONCLUSION

Companies spend a lot of money creating recognizable brands and making customers feel good about them so that they’ll continue to buy their products. Just as citizens can use the power of the vote to change government, consumers can use the power of the dollar to change how companies do business. That’s putting your money where your values are.

Analyzing the Impact

1. **Synthesizing** Have you ever chosen to buy or not to buy something because of the company’s reputation, or would you do so in the future? Explain why or why not.

2. **Critical Thinking** Do you think consumer activism is necessary? Why or why not?
The BIG Idea
Governments and institutions help participants in a market economy accomplish their financial goals.

Why It Matters
In this chapter, read to learn about reasons for saving, as well as various investment possibilities and the risks associated with them.

Economics ONLINE
Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 6—Chapter Overviews to preview chapter information.
If you have a part-time job, you may already be saving some of your income for a future use, such as buying the latest gaming system or continuing your education. Don’t be discouraged if you can save only a small amount, as saving something is better than saving nothing. As you read this section, you’ll learn why saving is important to you and the economy as a whole.
Deciding to Save

**Main Idea** Savings consist of income set aside for future use.

**Economics & You** Think of a time you wanted something that you couldn’t afford. Did you save to buy it? Read on to learn about the benefits of saving.

Economists define **saving** as the setting aside of income for a period of time so that it can be used later. Any saving that you do now may be only for purchases that **require** more funds than you have at one time. When you are self-supporting and have more responsibilities, you will probably save for other reasons.

When an individual saves, the economy as a whole benefits. Saving provides funds for others to invest or spend. Saving also allows businesses to expand, which provides increased income for consumers and raises the standard of living.

Generally, when people think of saving, they think of putting their funds in a savings bank or other financial institution where it will earn interest. Interest is the payment people receive when they lend funds, or allow someone else to use their funds. A person receives interest on a savings plan for as long as funds are in the account.

You have many options regarding places in which to put your savings. As you learned in Chapter 4, the most common places are commercial banks, savings and loan associations, savings banks, and credit unions. In shopping for the best savings plan, you need to consider the trade-offs. Some savings plans allow immediate access to your funds but pay a low rate of interest. Others pay higher interest and allow immediate use of your funds, but require a large **minimum** balance.

**Personal Finance Handbook**
See pages R6–R9 to learn more about saving.

**Reading Check** Predicting Consequences What are three benefits of saving?

▼ Savings accounts, like checking accounts, can be accessed electronically.

**HI & LOIS**

**CHIP OPENED UP HIS OWN SAVINGS ACCOUNT TODAY!**

**AND IT’S SET UP FOR ELECTRONIC BANKING**

**NOW YOU CAN TRANSFER MONEY DIRECTLY INTO MY ACCOUNT WITH THE PUSH OF A BUTTON!”**
Savings and Investing

Savings Accounts and Time Deposits

Savings accounts and time deposits offer a variety of maturities and are insured by agencies of the federal government.

Economics & You Where do you keep what you save? At home, or in a bank? Read on to learn about the different types of saving plans available to you.

Figure 6.1 above outlines several options for saving. A basic savings account is an interest-earning account that has no set maturity. Funds from such accounts can be withdrawn at any time without penalty to the account owner.

A money market deposit account (MMDA) is another type of account that pays relatively high rates of interest and allows immediate access to one’s funds through checks. The trade-off is that these accounts have a $1,000 to $2,500 minimum balance requirement. Customers can usually make withdrawals from a money market account in person at any time, but they are allowed to write only a few checks a month against the account.

Where to Save?

<table>
<thead>
<tr>
<th>Type of Account</th>
<th>Minimum Deposit?</th>
<th>Rate of Interest?</th>
<th>Availability of Funds?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings</td>
<td>No</td>
<td>Low</td>
<td>Immediate</td>
</tr>
<tr>
<td>Money market</td>
<td>$1,000 to $2,500</td>
<td>High</td>
<td>Immediate</td>
</tr>
<tr>
<td>Time deposit</td>
<td>$1,000</td>
<td>High</td>
<td>Depends on maturity; penalty for early withdrawal</td>
</tr>
</tbody>
</table>

A. How to Save Following the steps listed here will start you on the road to saving.

Steps to Saving

- Determine reasons to save.
- Determine amount of funds to set aside.
- Decide what type of account you will use.
- Decide frequency of deposit.
- Decide when to invest a portion of what you have saved.

B. Where to Save You have several choices about the type of savings account to open first.

Economic Analysis

Analyzing What type of account should you open if you have at least $1,000 to put away and you will not need the funds for a long time?
Time Deposits  The term time deposits refers to a wide variety of savings plans that require a saver to deposit his or her funds for a certain period of time. The period of time is called the maturity, and it may vary from seven days to eight years or more. Time deposits are often called certificates of deposit (CDs), or savings certificates. CDs state the amount of the deposit, the length of time until maturity is reached, and the rate of interest being paid.

Time deposits offer higher interest rates than regular savings accounts. (See Figure 6.2 below.) The longer the maturity, the higher the interest rate that is paid. For example, a CD with a short-term maturity of 90 days pays less interest than a CD with a 2-year maturity. Savers who cash a time deposit before maturity pay a penalty.

Insuring Deposits  When the stock market collapsed in 1929, the resulting financial crisis wiped out many people’s entire savings. Congress passed, and President Franklin Roosevelt signed, legislation to protect many types of deposits. This legislation created the Federal Deposit Insurance Corporation (FDIC). In addition to savings accounts, money market deposit accounts, and CDs, the FDIC also protects funds in regular checking accounts.

Skills Handbook  See page R57 to learn about Understanding Interest Rates.

Figure 6.2  Savings Choices

While a regular savings account allows you ready access to your funds, a time deposit, such as a CD, earns more interest income. If you have funds that you will not need for a while, you should choose a time deposit, as it will pay you more in the long run.

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount invested</th>
<th>Interest rate</th>
<th>Original investment plus interest income after 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings</td>
<td>$1,000.00</td>
<td>0.8%</td>
<td>$1,008.00</td>
</tr>
<tr>
<td>CD</td>
<td>$1,000.00</td>
<td>4.0%</td>
<td>$1,040.00</td>
</tr>
</tbody>
</table>

Money Now or Later?

Economic Analysis

Using Charts  At the interest rates shown, at the end of a year, how much more will you have if you put your funds into a CD rather than a savings account?
Today there are several federal agencies that insure most banks and savings institutions. The major one besides the FDIC is the National Credit Union Association (NCUA). Through these federal agencies, each depositor’s funds in a particular savings institution are insured up to $100,000. If an insured institution fails, each depositor will be paid the full amount of his or her savings up to $100,000 for each legally separate account.

Federal deposit insurance has started to change with the times. Beginning on January 1, 2011, the $100,000 deposit insurance limit will be adjusted by the amount of inflation that occurred over the previous five years. Also, some special retirement accounts now have a limit of $250,000.

**Comparing** What are the benefits and drawbacks of savings accounts? Of time deposits?

---

**Review**

**Vocabulary**

1. Explain the significance of: saving, interest, savings account, money market deposit account, time deposits, maturity, certificates of deposit.

**Main Ideas**

2. Summarizing In a table like the one below, list one advantage and one disadvantage of each savings method listed.

<table>
<thead>
<tr>
<th></th>
<th>Savings Account</th>
<th>CD</th>
<th>Money Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disadvantage</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Describing How does interest make money for savers?

**Critical Thinking**

4. The **BIG** Idea Why is it best not to invest more than $100,000 in one account?

5. Comparing and Contrasting What is the difference between a basic savings account and a time deposit?

**Applying Economics**

6. Calculating Interest With $1000 in the bank at 0.5% simple interest monthly, how much will you make in one year? With $1,000 debt on your credit card at 2% simple interest each month, what will you pay that year?
Investing: Taking Risks With Your Savings

GUIDE TO READING

Section Preview
In this section, you will learn about different types of investments and the risks that they carry.

Content Vocabulary
- stockholders (p. 147)
- capital gain (p. 147)
- capital loss (p. 147)
- tax-exempt bonds (p. 148)
- savings bonds (p. 149)
- Treasury bills (p. 149)
- Treasury notes (p. 149)
- Treasury bonds (p. 149)
- broker (p. 150)
- over-the-counter market (p. 151)
- stock market indexes (p. 151)
- mutual fund (p. 152)
- money market fund (p. 152)

Academic Vocabulary
- design (p. 153)  
- scheme (p. 153)

Reading Strategy
Comparing  Use a chart like the one below to compare stocks and bonds.

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Definition</th>
<th>When Does It Pay?</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bonds</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

ISSUES IN THE NEWS

—from CNNMoney

THINKING AHEAD  In 1891, Asa Candler, an Atlanta entrepreneur, paid pharmacist John Pemberton $2,300 for the formula to his weird brown health drink named Coca-Cola. Last year the company had revenue of $22 billion.

Back in 1961, $2.7 million seemed like a lot of money for a hamburger stand and some golden arches—in today’s dollars, that would be $16.8 million—but Ray Kroc took the plunge. Forty-four years later, there are more than 30,000 McDonald's franchises throughout the world, and the company grossed $19.1 billion last year.

Malcolm Glazer was ridiculed when he paid $192 million for the hapless Tampa Bay Buccaneers in 1995. But after a 2003 Super Bowl win, the team is now valued at more than $700 million.

People keep their savings in banks and savings and loan associations because they want a safe rate of interest. If people are willing to take a chance on earning a higher rate of return, however, they can invest their savings in other ways. Stocks and bonds offer investors greater returns, but, at least for stocks, with more risk. As you read this section, you’ll learn what stocks and bonds are, and why they carry a risk.
Stocks and Bonds

Main Idea  Stockholders are owners of a corporation, and bondholders are creditors of a corporation.

Economics & You  Would you rather save what you earn, or risk it in the hopes of earning more? Read on to learn about investing in different types of stocks and bonds.

Corporations are formed by selling shares of stock (also called securities). By issuing stock for sale, a company obtains funds for use in expanding its business. Shares of stock entitle the buyer to a certain part of the future profits and assets of the corporation selling the stock. The person buying stock, therefore, becomes a part owner of the corporation. As proof of ownership, the corporation issues stock certificates.

Stock Returns  Stockholders, or owners of stock, benefit from stock in two ways. One is through dividends, the return a stockholder receives on the amount that he or she invested in the company. The corporation may declare a dividend at any time during a year. Dividends typically are paid only when the company makes a profit. The other way people benefit from stock is by selling it for more than they paid for it. Some people buy stock just to speculate, hoping that the price will increase greatly so they can sell it at a profit.

Capital Gains and Losses  Suppose a person buys stock at $20 a share and sells it for $30. The profit of $10 per share is called a capital gain. Of course, the value of stock may also fall. If a person decides to sell stock at a lower price than he or she paid for it, that person suffers a capital loss. Money may be made or lost on bonds in much the same way.

Personal Finance Handbook

See pages R6–R9 to learn more about investing.
Bonds  Instead of buying stock, people with funds to invest can buy bonds. A bond is a certificate issued by a company or the government in exchange for borrowed funds. It promises to pay a stated rate of interest over a stated period of time, and then to repay the borrowed amount in full at the end of that time. A bondholder lends for a period of time to a company or government and is paid interest on that amount. At the end of the period, the full amount of the borrowing is repaid. This period of time is called the bond’s maturity.

Unlike buying stock, buying a bond does not make a bondholder part owner of the company or government that issued the bond. The bond becomes part of the debt of the corporation or government, and the bondholder becomes a creditor. Figure 6.3 below lists these and some other differences between stocks and bonds.

Tax-Exempt Bonds  Local and state governments also sell tax-exempt bonds. The interest on these types of bonds, unlike bonds issued by companies, is not taxed by the federal government. Interest that you earn on bonds your own city or state issues is also exempt from city and state income taxes. Tax-exempt bonds are good investments for wealthier people who would otherwise pay high tax rates on interest earned from investments.

---

tax-exempt bonds: bonds sold by local and state governments; interest paid on the bond is not taxed by the federal government

---

**Figure 6.3 Differences Between Stocks and Bonds**

- Stocks and bonds can both be good investments, but there are key differences between them that investors should be aware of before making any purchasing decisions. Be sure you have studied these differences before investing in either option.

**Stocks**

1. All corporations issue or offer to sell stock. That act is what makes them corporations.
2. Stocks represent ownership.
3. Most stocks do not have a fixed dividend rate.
4. Dividends on stock are paid only if the corporation makes a profit.
5. Stocks do not have a maturity date. The corporation issuing the stock does not repay the stockholder.
6. Stockholders usually elect a board of directors who control the corporation.
7. Stockholders have a claim against the property and income of a corporation only after the claims of all creditors (including bondholders and holders of preferred stock) have been met.
**Savings Bonds** The U.S. government issues **savings bonds** as one of its ways of borrowing money. They range in face value from $50 up to $10,000. The purchase of a U.S. savings bond is similar to buying a bank’s certificate of deposit. Savings bonds are attractive because they are very safe, and because the interest earned is not taxed until the bond is turned in for cash.

A person buying a savings bond pays half the bond’s face value. You could purchase a $50 bond, then, for only $25. The bond increases in value every 6 months until its full face value is reached. If you choose to redeem a U.S. savings bond before it matures, you are guaranteed a certain rate of interest, which changes depending on rates of interest in the economy.

**T-Bills, T-Notes, and T-Bonds** The Treasury Department of the federal government also sells several types of larger investments. **Treasury bills** mature in a few days to 26 weeks. The minimum amount of investment for Treasury bills is $1,000. **Treasury notes** have maturity dates of 2 to 10 years, and **Treasury bonds** mature in 30 years. Notes and bonds are sold in minimums of $1,000. The interest on all three of these government securities is exempt from state and local income taxes, but not from federal income tax.

**Reading Check** Explaining What are two ways that investors can benefit from stocks?
Ownership of stocks and bonds can be transferred on centralized exchanges or in decentralized markets.

Economics & You If you had $500 to invest in stocks or bonds, how would you decide what to do? Read on to learn about different investment markets.

Stocks are bought and sold through brokers or on the Internet. A broker is a person who acts as a go-between for buyers and sellers. If an investor is interested in buying or trading corporate shares, he or she can contact a brokerage firm, which will perform the service for a fee.

Thousands of full-service brokerage firms throughout the country buy and sell stocks daily for ordinary investors. The fees they charge to perform the trades—up to $500—depend on the dollar amounts invested or traded. Today, however, if an investor has an account with an Internet brokerage firm, the cost for the same trade may be as low as $7.

There are well over 100 online brokerage firms, with more springing up on the Web every day. It is estimated that 20 million American investors use the Internet to make trades every year.

Stock Exchanges Brokerage houses communicate with the busy floors of the stock exchanges. The largest stock exchange, or stock market, is the New York Stock Exchange (NYSE) in New York City. There are also supplemental stock exchanges and regional exchanges—such as the Chicago Exchange—and exchanges in other countries—such as the London and Tokyo stock exchanges. To be listed on these exchanges, a corporation offering stock must prove to the exchange that it is in good financial condition. Most of the companies traded on stock exchanges are among the largest, most profitable corporations in the country.

Buying Stocks or Bonds If you decide to buy stocks or bonds, you will need to contact a broker. You pay the broker a fee to purchase the stock at one of the stock exchanges.
Over-the-Counter Markets
Stocks can also be sold on the over-the-counter market, an electronic marketplace for stocks not listed on the organized exchanges. The largest volume of over-the-counter stocks are quoted on the National Association of Securities Dealers Automated Quotations (NASDAQ) national market system, which merged with the American Stock Exchange in 1998.

Unlike organized stock exchanges, over-the-counter stocks are not traded in any specific place. Brokerage firms hold shares of stocks that they buy and sell for investors. For example, assume that XYZ Corporation is a company that sells computers. If an investor wanted to buy stock in it, he or she would check the NASDAQ listings in the local newspaper or on the Internet. This table of over-the-counter stocks would list XYZ Corporation, the number of shares of stock sold the day before, and the price at which shares were bought and sold that day. The investor would then call a broker or use the Internet to buy a certain number of shares. Usually stocks are sold in amounts of 100 shares, but some brokers will handle smaller amounts.

Stock Market Indexes
Almost every weekday, there is news about what happened to the stock market indexes, of which there are many. Such indexes are based on what happened to the stock prices of various listed companies. The most well known is the Dow Jones Industrial Average—often called “The Dow.” This index involves 30 major industrial companies in the United States. There is also the Standard & Poor’s 500 (S&P 500). The S&P 500 index tracks the stock prices of 500 companies.

Bond Markets
The New York Exchange Bond Market and the American Exchange Bond Market are the two largest bond exchanges. Bonds, including U.S. government bonds, are sold over-the-counter and on the Internet.

There is an enormous variety of individual bonds to choose from. If you decide to invest in bonds, you will probably want to contact a financial adviser to help you find a bond that matches your needs and expectations.
Mutual Funds  Many people invest in the stock market by placing some of their savings in a **mutual fund**, an investment company that pools the funds of many individuals to buy stocks, bonds, or other investments. Most mutual funds hold a variety of stocks or bonds. Losses in one area are likely to be made up by gains in another.

Most mutual funds use the S&P 500 as the yardstick against which they compare their returns on stocks. The long-run return from **index funds** is higher than can be expected from almost any other investment. By investing in a broad-based index fund, investors will almost surely do better over the long run than by investing in individual stocks or in a managed mutual fund. A **managed mutual fund** is one in which the managers adjust the mix of stocks and move often in and out of the market to try to generate the highest total return.

Money Market Funds  One type of mutual fund, called a **money market fund**, normally uses investors’ funds to buy the short-term debt of businesses and banks. Most of these funds allow investors to write checks against their account. Any check, however, must be above some minimum amount, usually $500. The investor then earns interest only on the amount left in the account.

Banks and savings and loan associations offer a similar service, called **money market deposit accounts** (MMDAs). A major advantage of MMDAs is that the federal government insures them against loss. Mutual funds and money market funds are not insured by the federal government.

**Reading Check**  What is a mutual fund? Name three types of mutual funds.

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*Bull and Bear Markets*

When listening to news about the stock market, you may have heard the terms “bull market” and “bear market.” A bull market refers to a period of time when stock prices move up steadily. Investors expect this trend to continue, and they buy stock. In a bear market, stock prices have been dropping for a period of time, and investors sell stock in expectation of lower profits.

This famous bull statue stands near Wall Street in New York City.
Government Regulations

**Main Idea**
Securities markets are heavily regulated to protect investors.

**Economics & You**
Do you feel more comfortable investing, knowing that the federal government is able to regulate the stock market? Read on to learn about some of the laws controlling the stock market.

The stock market is heavily regulated today, at both the state and federal levels. The Securities and Exchange Commission (SEC), created by the Securities Exchange Act of 1934, is responsible for administering all federal securities laws. It also investigates any dealings among corporations, such as mergers, that affect the value of stocks.

Congress passed the Securities Exchange Act in an attempt to avoid another stock market crash like that of 1929. The act requires that, to inform investors, any institution issuing stocks or bonds must file a registration statement with the federal government. Also, a briefer description, called a prospectus, must be given to each potential buyer of stocks or bonds. It lists the amount offered, the price, and the company’s projected use for the amount raised by the stocks or bonds.

States also have securities laws. These are designed to prevent schemes that would take advantage of small investors.

**Identifying**
What are the responsibilities of the SEC?

**Vocabulary**
1. Explain the significance of: stockholders, capital gain, capital loss, tax-exempt bonds, savings bonds, Treasury bills, Treasury notes, Treasury bonds, broker, over-the-counter market, stock market indexes, mutual fund, money market fund.

**Main Ideas**
2. Comparing Use a Venn diagram like the one below to compare stocks and bonds.

**Critical Thinking**
3. The BIG Idea Explain why stocks are riskier than bonds.

4. Comparing List five investments you could make if you had $10,000 in available funds. Rank them from highest to lowest in potential risk and return.

**Applying Economics**
5. Stocks In a newspaper or on the Internet, find the list of stock quotes in the NYSE and the NASDAQ. Analyze the quotes, and then choose a stock from each listing that you would buy if you had the available funds. Explain your choices.
Lilia Clemente has been called the Woman Wizard of Wall Street, and for good reason. In 1976 she invested savings of $25,000 to launch her own financial consulting company. Today, through her offices in New York and half a dozen Asian capitals, she controls funds totaling more than $7.5 billion.

Clemente was born to a wealthy family in the Philippines and traveled widely throughout Asia as a child. Her father, a well-connected lawyer, was involved in the drafting of the new Philippine constitution, and her mother, in addition to being a psychology professor and provincial governor, was the first female holder of a seat on the Manila Stock Exchange.

“My mother was a real role model. I thought it was natural for women to go into business and politics.”

Following her mother’s example, she was active in politics at the University of the Philippines while earning a bachelor’s degree in business administration. Later, at the University of Chicago, she was granted a master’s degree in agricultural economics and international trade. In her academic department, she was one of only seven women among 400 students.

“In a male world like finance, you have to think of yourself as a very special person. Each person has her own pluses and minuses. You have to turn your negatives into your own positives.”

Her intimate knowledge of Asia was certainly a positive. She realized early on that countries such as China, Thailand, and the Philippines would develop into important economic markets.

Checking for Understanding
1. Explaining What kind of impact did Clemente’s mother have on her life?
2. Hypothesizing Do you think Clemente would have achieved the same degree of financial success if she had been born poor? Explain your answer.
GUIDE TO READING

Section Preview
In this section, you will learn about special types of investment plans and how to decide what portion of your income to save and invest.

Content Vocabulary
- pension plans (p. 156)
- Keogh plan (p. 156)
- individual retirement account (IRA) (p. 157)
- Roth IRA (p. 157)
- diversification (p. 159)

Academic Vocabulary
- portion (p. 156)
- contribute (p. 157)
- overall (p. 159)

Reading Strategy
Organizing As you read the section, complete a diagram like the one below by listing five ways to invest for retirement.

ISSUES IN THE NEWS
—from the Columbus Dispatch

PLANNING AHEAD If a teenager has a paying job outside the home—as do 40 percent of high-school students—it makes sense to put her earnings into a . . . retirement fund. This could pay off big later on.

There is no minimum age for contribution to an IRA. So as soon as [a teenager] has earnings from work—baby-sitting, helping [a parent] at the office, or mowing lawns—she can open an account.

“At a hypothetical annual return of 8 percent, four years of $4,000 contributions during high school ($16,000) could be worth over $750,000 when the child turns 65,” says Kevin McKinley, author of Make Your Kid a Millionaire—11 Easy Ways Anyone Can Secure a Child’s Financial Future.

. . . Of course, it’s not always easy to get a teen to think about retirement, let alone persuade her to agree to save, rather than spend, her earnings.

O ne of the many reasons that people save is to send their children to college. Another is to make a down payment on a home. Yet another is for those years after people stop working. There are different methods of saving for retirement, each having different risks. As you read this section, you’ll learn about special savings plans and the amount of risk involved in these investments.
Investing for Retirement

Retirement is a major reason for saving and investing.

Economics & You Do you think much about retirement? Read on to learn ways to save for this time of life.

Although most people are eligible for Social Security when they retire, this plan does not provide enough income to live comfortably. It is important, therefore, for a person to save for and invest in his or her own retirement.

Many individuals have company-supported pension plans to save for retirement. One of the most common types is a 401(k) plan, in which a portion of your paycheck is withheld and the company matches the amount. A major benefit of such a plan is the tax savings. As long as your contribution does not exceed a certain amount, you do not have to pay federal income tax on the amount you put in—or on the amount the plan earns—until you withdraw funds from the plan at retirement.

Individual Pension Plans The Keogh Act of 1962 was passed to help self-employed people set up their own pension plans. The Keogh plan allows those people who are self-employed to set aside a maximum of 15 percent of their income up to a specified amount each year, and then deduct that amount from their yearly taxable income.

Figure 6.4 Retirement Plan Options

Today people have several choices in retirement plans.

<table>
<thead>
<tr>
<th>Types of Retirement Plans</th>
<th>401(k)</th>
<th>Keogh</th>
<th>IRA</th>
<th>Roth IRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company plan</td>
<td>❖ Company plan</td>
<td>❖ Self-employed plan</td>
<td>❖ Individual/married couple’s plan</td>
<td>❖ Individual/married couple’s plan</td>
</tr>
<tr>
<td>Portion of pay withheld and matched by company</td>
<td>❖ Portion of pay withheld and matched by company</td>
<td>❖ Up to 15% of yearly income set aside</td>
<td>❖ Tax-deferred contributions</td>
<td>❖ Contributions taxed</td>
</tr>
<tr>
<td>Tax deferred on income and interest</td>
<td>❖ Tax deferred on income and interest</td>
<td>❖ Amount is tax deductible</td>
<td>❖ Tax-deferred interest income</td>
<td>❖ Interest income never taxed</td>
</tr>
<tr>
<td>Maximum contribution limit</td>
<td>❖ Maximum contribution limit</td>
<td>❖ Maximum contribution limit</td>
<td>❖ Maximum contribution limit</td>
<td>❖ Maximum contribution limit</td>
</tr>
</tbody>
</table>

Economic Analysis

Comparing What do these retirement plans have in common?
Another form of retirement plan is the **individual retirement account (IRA)**. A person earning less than $30,000 can **contribute** up to $4,000 a year and deduct those contributions from taxable income. The benefit of an IRA is that the income you contribute to the IRA is not taxed in the year it is contributed. In addition, the interest you earn on that income is not taxed either. You pay the tax only when you take out funds from your IRA account, usually after age 59½.

A relatively new form of IRA is called the **Roth IRA**. Again, you are allowed to put up to $4,000 a year in a Roth IRA. You do not get to deduct your contributions from your taxable income, however. The benefit is that all of the interest you earn on your contributions to a Roth IRA is tax-free forever. Thus, when you take out funds from your Roth IRA account while you are retired, you pay no additional taxes. See **Figure 6.4** on the previous page for a summary of the major points of all of these retirement plans.

**Real Estate as an Investment**

Buying real estate, such as land and buildings, is another form of investing. For the past 50 years or so, buying a home, condominium, or co-op has proven to be a wise investment in many parts of the country. Resale values have soared at times, especially during the late 1970s. Although the housing market fluctuates, buying a home is usually a good investment in the long run. Buying raw, or undeveloped, land is generally a much riskier investment. No one can guarantee that there will be a demand in the future for a particular piece of land.

Real estate, either as raw land or as developed land, is not very easy to turn into cash on short notice. Sometimes real property for sale stays on the market for long periods of time. This difficulty in getting cash for your investment is one of the trade-offs involved when investing in real estate. You cannot get your funds as quickly as you could if you had invested in stocks, bonds, a bank CD, or some other savings plan.

**Reading Check**

**Contrasting** What is the difference between a 401(k) and an IRA?
How Much to Save and Invest?

**Main Idea** How much to save and invest is determined by each individual’s income, risk tolerance, and values.

**Economics & You** If you have money saved, would you be willing to invest it even if it meant risking losing it? Read on to learn how to decide how much of your money you should save and invest.

Saving involves a trade-off like every other activity. The more you save today, the more you can buy and consume a year from now, 10 years from now, or 30 years from now. You will, however, have less to spend today. Keep in mind that if you have debt, especially on a high-interest credit card, you may want to pay that off before diverting funds into savings. Also consider that if you expect to make a much higher income in the future than you do now, you have less reason to save a large percentage of today’s income. (See Figure 6.5 below.)

**Amount of Risk** So, how much of your savings should you risk in investment? When making this decision, remember that if you put a lesser amount in the more risky types of investments, you will have some security with your savings, and you will have some funds readily available should you need cash in a hurry. You may also have a chance of making high returns, but the higher the promised return, the greater the risk. Indeed, it’s impossible to obtain higher returns without taking more risk.

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**Figure 6.5  Savings Considerations**

- Periodically, you should reevaluate how much of your income you are saving. If you are at a point where you have accumulated debt on a credit card, for example, you may want to pay off your debt before putting funds into savings. At another time, if interest rates rise, you may want to save more and earn more interest.

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**Economic Analysis**

**Explaining** From what sources other than savings might you get funds for retirement?

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**How Much Should You Save?**

Ask yourself the following questions when you are deciding how much of your income to save:

1. How much do I spend on fixed expenses?
2. What are my reasons for saving?
3. How much interest can I earn on my savings, and how fast will my savings grow?
4. How much income will I be earning in the future?
5. What degree of risk am I willing to take?
6. How important is it that my savings be readily available in case I need immediate cash?
7. Will my standard of living at retirement depend largely on my accumulated savings?
Spreading Out Your Investments

Investing your savings in several different types of accounts lowers the overall risk. If one investment turns sour, the others may do better. Financial planners call spreading out your investments diversification. Mutual funds, for example, help you diversify.

When you have very little income and cannot afford any investment losses, you should probably put your savings in insured accounts in a local bank or savings and loan association, or you should buy U.S. government savings bonds. The greater your income and the more savings you have, the more you can diversify into stocks, corporate bonds, and so on.

Values Your values may also determine where you invest your savings. If you believe that your community needs more development, you might choose to put your savings in a local savings and loan that guarantees that a large percentage of its investments are made in community loans. You may also choose to invest in stocks issued by environmentally responsible companies or companies that have aggressive equal opportunity programs.

Reading Check Evaluating What questions should you ask yourself when deciding how much to save and invest at any given time?

Review

Vocabulary
1. Explain the significance of: pension plans, Keogh Plan, individual retirement account (IRA), Roth IRA, diversification.

Main Ideas
2. Summarizing Copy the chart below, and for each investment option listed, give one advantage.

<table>
<thead>
<tr>
<th>Investment Method</th>
<th>Advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension plan</td>
<td></td>
</tr>
<tr>
<td>Keogh plan</td>
<td></td>
</tr>
<tr>
<td>IRA</td>
<td></td>
</tr>
<tr>
<td>Roth IRA</td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea How does the federal government help people invest for retirement?

4. Comparing and Contrasting What is one advantage and one disadvantage of investing in real estate?

Applying Economics
5. Evaluating Investment Options Imagine you have $15,000 of funds to invest. Which type of funds or investments discussed in this section would you choose? Explain your answer.
Sifting through the blogosphere for financial advice.

Check It Out! In this chapter you learned about saving and investing. In this article, read to learn about a new way young people are helping one another save and invest for the future.

Jonathan Ping is not a financial guru. He’s not a certified financial planner. And he’s not a millionaire (yet). He’s simply a 27-year-old engineer living with his wife and dog in a rented house in Portland, Ore. Within the next 18 months he hopes to scrape up $100,000 for a down payment on a home, and he wants to build a net worth of $1 million by age 45. So far he’s at $88,953.

How do I know this? It’s in bold type in the top right-hand corner of his Web log, MyMoneyBlog.com, where Ping keeps a daily tally of his progress. He’s one of more than 150 bloggers, mostly 22 to 35, who have adopted an open-source approach to personal finance. Most keep their names secret, but that’s about all they hide. In stark contrast to their parents’ generation, for whom comparing incomes can be awkward, if not downright taboo, bloggers list financial information down to the dollar in retirement, brokerage, and savings accounts. They recommend investments, decry credit-card debt, and wallow together over high taxes, commenting on one another’s postings and leaving behind a road map for financial voyeurs. Ping writes: “If I mess up, you’ll know. If I come across a neat way to make or save money, you’ll read about it here. . . hopefully we’ll learn from each other and meet up in the Caymans some day.”

—Reprinted from BusinessWeek

Think About It
1. Summarizing What financial information can bloggers provide?
2. Contrasting How are young financial bloggers different from their parents?
Saving some of your income allows you to earn interest and put away funds for future purchases.

After you have accumulated savings funds, you may want to invest some of it to try to earn greater returns.

It is important to diversify your saving and investing, especially when looking toward retirement. In general, the greater the risk involved in any venture, the greater the potential return.
Review Content Vocabulary

1. Write a paragraph or two explaining some methods a person might choose to save or invest a $10,000 inheritance. Use all of the following terms.

   - savings account
   - interest
   - money market deposit account
   - time deposit
   - certificates of deposit

2. Write a paragraph or two explaining some of the special methods a person might choose to save for retirement. Use all of the following terms.

   - pension plan
   - Keogh plan
   - individual retirement account (IRA)

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

   a. require  b. minimum  c. designed  d. schemes  e. portion  f. contribute  g. overall

3. Saving helps people prepare for expenses that ______ more money than they usually spend.

4. Special retirement plans are ______ to encourage people to save for the future.

5. One must keep a ______ balance in some types of savings accounts to avoid paying fees.

6. Having a variety of types of savings and investments lowers one’s ______ risk.

7. It is a good idea to save a ______ of every paycheck for the future.

8. A person can ______ several thousand dollars to an IRA each year.

9. Securities laws help prevent ______ that try to take advantage of investors.

Review the Main Ideas

Section 1  (pp. 141–145)

10. What is interest on savings accounts? Why do banks pay interest?

11. Why is a bank certificate of deposit (CD) called a time deposit?

12. Why are deposits of up to $100,000 in banks and savings institutions often considered very safe?

Section 2  (pp. 146–153)

13. What is the basic difference between a stock and a bond?

14. What are two advantages of United States savings bonds?

15. What kind of investment company hires professionals to manage the investments of a pool of investors?

Section 3  (pp. 155–159)

16. What are three common types of retirement plans for individuals?

17. What are some of the factors one must consider when deciding how much to save in what kind of plan?

18. Fill in the graphic organizer below to show how a person might diversify (spread out) his or her retirement investments.

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>savings account</td>
<td></td>
</tr>
<tr>
<td>interest</td>
<td></td>
</tr>
<tr>
<td>money market</td>
<td></td>
</tr>
<tr>
<td>deposit</td>
<td></td>
</tr>
<tr>
<td>time deposit</td>
<td></td>
</tr>
<tr>
<td>certificates of deposit</td>
<td></td>
</tr>
</tbody>
</table>
Problem Solving

Imagine that you are out of school and have started working and saving. You want to keep from using credit cards or unnecessary loans as much as possible, so you make savings plans for major purchases and expenses.

19. Write down a short-term savings goal, such as saving to buy a new portable MP3 player. Explain the typical ways in which you can save for such a purchase.

20. Now write down a long-term savings goal, such as saving for college, a house, or retirement. Explain some methods you might use to achieve this goal.

21. What is the major difference between the two ways of saving?

22. Why is saving up for major purchases and expenses better than using credit cards or taking out loans?

Critical Thinking

23. The BIG Idea Suppose you have $300,000 that you want to save. The FDIC only insures up to $100,000. What can you do to make sure all your funds are insured by the FDIC?

24. Determining Cause and Effect How does buying a U.S. savings bond increase the U.S. government’s debt?

25. Synthesizing Assume that you have $100,000 in savings. Create a chart like the one below to list the investments you might make and what percentage of the $100,000 you would invest in each. In the last column, explain how your choices will achieve investment diversification.

<table>
<thead>
<tr>
<th>Investment Type</th>
<th>% of Funds</th>
<th>Diversification</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Analyzing Visuals

26. Study the cartoon on the right, and then answer the following questions.

a. According to the cartoon, what will the effect be of the drop in consumer confidence?

b. What effect will consumer spending have on savings rates? Why?

c. What is the relationship between consumer spending and saving?
Imagine being 30 years old and still paying off a slice of pizza you bought when you were in college. Sounds crazy, but for many people, credit-card debt built up in college stays with them for many years to come. Could the problem be solved by preventing credit-card companies from marketing to college students?

Credit card providers use methods that take advantage of students.

When students arrive on college campuses across our nation, they are bombarded with credit card applications. Credit card companies have card table displays, offering free hats, T-shirts, or other token gifts for the student to sign the application. Some students have no interest in a credit card but can't refuse a free T-shirt or the peer pressure to do what “everyone is doing.” When the credit card arrives in the student’s campus mail, some are generally surprised and start using the card.

One student’s story shows the problem. This student didn’t believe he signed up for a credit card. He thought he’d entered a drawing when he filled out a small card in exchange for a T-shirt. . . . When the credit card arrived, he thought he’d won. He used it and was very surprised when a bill arrived.

He ignored the bill, and with interest, collection fees, and penalties, the student now has a considerable amount of debt. . . . When the student discussed the issue with the credit card issuer, they suggested he ask his parents for assistance—something they should have suggested when he signed up for the card. We should ban them!

— Linda Chuhran, faculty member, Schoolcraft College, Livonia, Michigan
Credit cards are a reality our students must learn to live with.

Credit card vendors have been on my campus since at least 1989, when I was a freshman. There has to be some reason they were invited to campuses in the first place. . . . But now that there has been half a generation of former college students let loose on the world without the basic concepts of credit/debt management, everyone wants to yell “foul” instead of looking at any practical solutions or realities.

If there is true concern about stemming the tide of student debt, there needs to be credit/debt management initiatives established by schools. Solid credit habits can be built, with help, during college, and the benefits can be far reaching. Employers, as well as mortgage and loan companies, investigate credit histories. A poor credit rating can hurt a student’s work prospects more than a poor grade point average.

Credit card companies can lend support to this effort by providing credit specialists from their organizations to provide training. If schools can rise to the occasion of training about alcohol consumption, sexual assault, and other areas of concern, then they should be able to help students learn better credit control.

—Eric Beck, coordinator, Center for East Asian and Pacific Studies, University of Illinois, Urbana-Champaign

Debating the Issue
1. Explaining How do many credit-card companies get college students to sign up for credit cards?
2. Choosing Sides The two writers disagree on whether or not college students are mature enough to handle credit cards. Which writer do you agree with? Why?

Find Out More!
3. Synthesizing Use the Internet or other resources to find out the average credit-card debt of a student graduating from college today. Does this information change your opinion on whether credit-card companies should be banned from campuses? Why or why not?
Microeconomics: Markets, Prices, and Business Competition

Chapter 7
Demand and Supply

Chapter 8
Business Organizations

Chapter 9
Competition and Monopolies

In this unit, read to find out...
- how your consumer decisions affect prices.
- what risks and expectations you’ll have when starting a business.
- why competition among businesses is vital to the price you pay for goods and services.
Chapter 7

Demand and Supply

The BIG Ideas

1. Scarcity is the basic economic problem that requires people to make choices about how to use limited resources.

2. Buyers and sellers voluntarily interact in markets, and market prices are set by the interaction of demand and supply.

Why It Matters

In this chapter, read to learn about how the relationship between supply and demand sets the prices you pay for goods and services.

Economics ONLINE

Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 7—Chapter Overviews to preview chapter information.
The word demand has a special meaning in economics. Most American teenagers own a pair of sneakers. Because of high demand and high price, however, not everyone who wants a pair of Nike Air Force 1 sneakers is able to acquire this particular brand. As you read this section, you’ll learn that the idea of demand centers on people being both willing and able to pay for a product or service.
When you hear the term “market,” you probably think of a supermarket, clothing store, record shop, or other store you have visited. However, a “market” can be any place where buyers and sellers come together.

The Marketplace

Main Idea In a market economy, buyers and sellers set prices.

Economics & You Have you ever sold something on eBay? How did you decide what price to set? Read on to learn how people like eBay users follow basic ideas of demand and supply.

When you buy something, do you ever wonder why it sells at the particular price you paid? People do not usually think that individual consumers have any influence over the price of an item. In a market economy, however, consumers collectively have a great deal of influence on the prices of all goods and services. To understand this, let’s look first at how people in the marketplace decide what to buy and at what price. This is demand. Later, we’ll examine how the people who want to sell goods and services decide how much to sell and at what price. This is supply.

What is the marketplace? A market represents the freely chosen actions between buyers and sellers of goods and services. A market for a particular item or service can be local, national, international, or a combination of these. (See Figure 7.1 at the bottom of this page for more information on markets.)

demand: the amount of a good or service that consumers are able and willing to buy at various possible prices during a specified time period

supply: the amount of a good or service that producers are able and willing to sell at various prices during a specified time period

market: the process of freely exchanging goods and services between buyers and sellers

Figure 7.1 Examples of Markets

A. Stores Any place where you can buy food, clothing, or other items is a market.

B. Services A service is any activity that one person performs for another for a fee. Examples of services include haircuts, tutoring, and dental checkups. Any time or place these services are performed is an example of a market.
In a market economy, individuals decide for themselves the answers to the WHAT?, HOW?, and FOR WHOM? economic questions that you studied back in Chapter 2.

The basis of activity in a market economy is the principle of **voluntary exchange**. A buyer and a seller exercise their economic freedom by working toward satisfactory terms of an exchange of goods or services. For example, the seller of an automobile sets a certain price based on his or her view of market conditions. The buyer, through the act of buying, agrees to the product and the price. In order to make the exchange, both the buyer and the seller must believe they will be better off—richer or happier—after the exchange than before.

In a market economy, buyers have many choices about how to spend their income, and sellers have many choices about how to sell their products. With voluntary exchange, the seller’s problem of what to charge and the buyer’s problem of how much to pay is solved voluntarily in the market. Supply and demand analysis is a model of how buyers and sellers operate in the marketplace. Such analysis is a way of explaining cause and effect in relation to price.

**Reading Check**

**Explaining** How are prices set in a market economy?

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**C. Entertainment** Whenever we pay for entertainment, such as movies, concerts, and ball games, we are participating in a market.

**D. Internet Shopping** Over the last several years, the Internet has created a huge virtual market, home to millions of buyers and sellers.

**Economic Analysis**

**Making Comparisons** What characteristics do all these examples of markets have in common?
The Law of Demand

Main Idea The law of demand states that as price goes up, quantity demanded goes down, and vice versa.

Economics & You Can you think of a common household item that was once very expensive but is now much cheaper? Read on to find out how demand affects the prices of items you buy and use every day.

Demand, in economic terms, represents all of the different quantities of a good or service that consumers will purchase at various prices. It includes both the willingness and the ability to pay. A person may say he or she wants a new DVD. Until that person is both willing and able to buy it, however, no demand for DVDs has been created by that individual.

The law of demand explains how people react to changing prices in terms of the quantities demanded of a good or service. (See Figure 7.2.) There is an inverse, or opposite, relationship between quantity demanded and price. For example, if the price of a DVD is $15 many people will buy it. If the price went up to $20 fewer people would buy it, but many people who wanted the DVD would still buy it. Only a few people would buy the DVD if the price went up to $75. This example shows how the law of demand works.

Several factors explain the inverse relation between price and quantity demanded, or how much people will buy of any item at a particular price. These factors include real income, possible substitutes, and diminishing marginal utility.

Figure 7.2 The Law of Demand

- Consumers react to price changes.

Economic Analysis

Determining Cause and Effect What happens to the demand for an item if the price goes down?
Real Income Effect  No one—not even the wealthiest person in the world—will ever be able to buy everything he or she might possibly want. People’s incomes limit the amount they are able to spend. Individuals cannot keep buying the same quantity of a good if its price rises while their income stays the same. This concept is known as the real income effect on demand. It forces consumers to make trade-offs.

Suppose that you normally fill your car’s gas tank twice a month, spending $40 each time. If the price of gasoline rises, you may have to spend $50 each time. If the price continues to rise while your income does not, eventually you will not be able to fill the gas tank twice per month because your real income, or purchasing power, has dropped. To keep buying the same amount of gasoline, you would need to cut back on buying other things. The real income effect forces you to make a trade-off in your gasoline purchases. The same is true for every item you buy, particularly those you buy regularly.

The real income effect works in the opposite direction, too. If you are already buying $80 worth of gas each month, and the price of gas drops dramatically, your real income increases. You will have more purchasing power and will be able to spend the extra amount you save on gas on other things you want to buy.

Substitution Effect  Suppose there are two items that are not exactly the same but which satisfy basically the same need. Their cost is about the same. If the price of one falls, people will most likely buy it instead of the other, now higher-priced, good. If the price of one rises in relation to the price of the other, people will buy the now lower-priced good. This principle is called the substitution effect.

Suppose, for example, that you listen to both CDs and downloaded music. If the price of CDs rises dramatically, you will probably buy more music downloads and fewer CDs. Alternately, if the price of music downloads increases, you will probably buy more CDs. If the prices of CDs and music downloads both increase, you will most likely buy fewer of each and look for other ways to listen to music—for example, you may start listening to the radio or borrowing CDs from the library.
**Diminishing Marginal Utility**  Almost everything that people like, desire, use, or think they would like to use, gives satisfaction. The term that economists use for satisfaction is utility. **Utility** is defined as the power that a good or service has to satisfy a want. Based on utility, people decide what to buy and how much they are willing and able to pay at any given time. In deciding to make a purchase, consumers think about the amount of satisfaction, or use, they think they will get from whatever item they are thinking about buying.

Consider the utility that can be derived from buying a cold soft drink at a baseball game on a hot day. At $4 per cup, how many will you buy? That decision depends on the additional utility, or satisfaction, you expect to receive from each additional soft drink. Your **total** satisfaction will rise with each one bought. The amount of **additional** satisfaction, or **marginal utility**, however, will lessen with each additional cup bought. This example illustrates the **law of diminishing marginal utility**.

At some point, you will stop buying soft drinks. Maybe you don’t want to wait in line, or perhaps you are no longer thirsty. 

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**utility:** the ability of any good or service to satisfy consumer wants

**marginal utility:** an additional amount of satisfaction

**law of diminishing marginal utility:** rule stating that the additional satisfaction a consumer gets from purchasing one more unit of a product will lessen with each additional unit purchased

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**Diminishing Marginal Utility**

Regardless of how satisfying the first taste of an item is, additional satisfaction declines with additional consumption. Assume, for example, that at a price of $3.00 per bag of peanuts, you have enough after buying two bags. Thus, the value you place on additional satisfaction from a third bag of peanuts would be less than $3.00. According to what will give you the most satisfaction, you will spend the $3.00 on something else. Eventually you would receive no additional satisfaction from more peanuts, even if the vendor gave them to you for free.
As the cartoon shows, people often confuse wants with needs.

At that point, the satisfaction you get from the drink is less than the value you place on its cost. In general, people stop buying an item when the satisfaction from the next unit of the same item becomes less than the price they must pay for it.

What if, after the fifth inning, the price of soft drinks drops to $3? You might then buy at least one additional drink. Why? Remember, people will continue buying an item to the point at which the satisfaction from the last unit bought is equal to the price. At that point, people will stop buying. As the price of an item decreases, however, people will generally buy more.

Explaining What happens to the quantity demanded for an item if the price of the item goes up?

Vocabulary
1. Explain the significance of: demand, supply, market, voluntary exchange, law of demand, quantity demanded, real income effect, substitution effect, utility, marginal utility, law of diminishing marginal utility.

Main Ideas
2. Determining Cause and Effect Create a chart like the one below to show how each cause listed influences the quantity demanded for a given product or service.

<table>
<thead>
<tr>
<th>Cause</th>
<th>Effect on Quantity Demanded</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in real income</td>
<td></td>
</tr>
<tr>
<td>Decrease in real income</td>
<td></td>
</tr>
<tr>
<td>Price of substitutes</td>
<td></td>
</tr>
<tr>
<td>Utility</td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Ideas Think about what you have learned about diminishing marginal utility. Then think of three examples from your own experience, and explain how they demonstrate this concept.

4. Contrasting Describe the difference between the real income effect and the substitution effect.

Applying Economics
5. Real Income Effect Imagine that you make $1,000 per month at a part-time job. Make a budget for yourself that lists how much you spend on food, clothing, gas, entertainment, etc. Now imagine that the price of gas rises by $1 per gallon. How will this affect your budget? Revise your budget to include this price change.
IT’S A WHAT?

The latest craze among dog fanciers: Poodles crossed with other breeds.

Check It Out! In this chapter you learned how demand can increase as tastes and preferences change. In the following article, read to learn how a new breed of dog has created explosive demand.

Roll over, rover: Make room for doodles, the latest designer dogs—a mix of a poodle with another breed. The most popular hybrids are goldendoodles (golden retriever mix), Labradoodles (Labrador retriever), schnoodles (schnauzer), and cockapoos (cocker spaniel).

Aside from their shaggy good looks and friendliness, doodles are in demand because they usually don’t shed. “If you’ve ever lived with a golden or Lab, there’s a lot of hair,” says Rochelle Sundholm, owner of Spring Creek Labradoodles in Willamette Valley, Oregon. Another plus: They have poodle smarts without the stereotypical frou-frou yappiness. But doodles aren’t standardized, so there’s a lot of variability in appearance, personality, health—and price....

The American Kennel Club (AKC) doesn’t recognize doodle crossbreeds—and may not for a long time. “The reason people pay thousands of dollars for a purebred dog is for the hundreds, if not thousands, of years of pedigree,” says AKC spokeswoman Daisy Okas. Yet doodle pups fetch pedigree prices—anywhere from $400 to $3,000.

—Reprinted from BusinessWeek

### Most Popular Dog Breeds

<table>
<thead>
<tr>
<th>Decade</th>
<th>Breed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950s</td>
<td>Beagle</td>
</tr>
<tr>
<td>1960s and 1970s</td>
<td>Poodle</td>
</tr>
<tr>
<td>1980s</td>
<td>Cocker Spaniel</td>
</tr>
<tr>
<td>1990s to present</td>
<td>Labrador Retriever</td>
</tr>
</tbody>
</table>


Think About It

1. **Explaining** How are doodle dogs different from other breeds of dogs?
2. **Synthesizing** Why did demand for the newer breeds of doodle dogs grow so quickly? How did this affect the price of doodle dogs compared to the price of other non-AKC-accredited dogs?
In Section 1, you learned that quantity demanded is based on price. Demand, however, can be affected by a variety of factors, including changes in general economic conditions, the existence and price of substitutes, and changes in people’s tastes and preferences. Some of these other factors might explain the recent decrease in demand for Harley-Davidson motorcycles.
A demand curve is a graph that shows the relationship between the price of an item and the quantity demanded.

Economics & You If the price of a movie ticket suddenly went up to $20, how often would you go to the movies? What if the ticket price dropped to 50 cents? Read on to learn how this relationship between price and demand can be illustrated visually.

How can you learn to distinguish between a change in quantity demanded and a change in demand? And how do economists show these relationships in a visual way? It is said that a picture is worth a thousand words. In economics, the “picture” is often a graph that shows the relationship between two statistics or concepts.

The law of demand can be graphed. As you learned in Section 1, the relationship between the quantity demanded and price is inverse—that is, as the price of a good or service goes up, the quantity demanded goes down, and as the price goes down, the quantity demanded goes up.

Take a look at Table A and Graph B in Figure 7.3. These graphs show how the price of a particular good affects the quantity demanded.

Note how the table and the graph each use a different format to show the same thing. Each shows the law of demand—as price falls, quantity demanded increases. Also, note that in Graph B we refer to the quantity of DVDs demanded per year. We could also have used a time period of one day, one week, one month, two years, etc.

![Table A. Demand Schedule](image)

<table>
<thead>
<tr>
<th>Price per DVD</th>
<th>Quantity Demanded (in millions)</th>
<th>Points in Graph B</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20</td>
<td>100</td>
<td>A</td>
</tr>
<tr>
<td>$18</td>
<td>300</td>
<td>B</td>
</tr>
<tr>
<td>$16</td>
<td>500</td>
<td>C</td>
</tr>
<tr>
<td>$14</td>
<td>700</td>
<td>D</td>
</tr>
<tr>
<td>$12</td>
<td>900</td>
<td>E</td>
</tr>
<tr>
<td>$10</td>
<td>1,100</td>
<td>F</td>
</tr>
</tbody>
</table>

The numbers in this demand schedule show that as the price per DVD decreases, the quantity demanded increases.
demanded at each price. Table A is a demand schedule—a table of prices and quantity demanded. The numbers show that as the price of DVDs decreases, the quantity demanded increases. For example, at a cost of $20 each, 100 million DVDs will be demanded. When the cost decreases to $12 each, 900 million DVDs will be demanded.

In Graph B, the numbers from the schedule in Graph A have been plotted onto a graph. The bottom (or horizontal) axis shows the quantity demanded. The side (or vertical) axis shows the price per DVD. Each pair of figures showing price and quantity demanded represents a point on the graph. These points are labeled A through K.

Finally, the line connecting points A through K is the demand curve. A demand curve shows the quantity demanded of a good or service at each possible price. Demand curves slope downward (that is, they fall from the left to the right). When you study Graph B, you can see clearly the inverse relationship between price and quantity demanded. As price falls, quantity demanded increases, and vice versa.

Determining Cause and Effect

What causes a change in quantity demanded? How can this be shown visually using a demand curve?

**Demand Curve**

A demand curve shows the quantity demanded of a good or service at each possible price. Demand curves slope downward (that is, they fall from the left to the right). When you study Graph B, you can see clearly the inverse relationship between price and quantity demanded. As price falls, quantity demanded increases, and vice versa.

**Graph B. Demand Curve**

Here, the price and quantity demanded numbers from the demand schedule have been plotted on a graph and connected with a line. This line is the demand curve, which always falls from left to right.

**Economic Analysis**

Using Graphs

According to the demand curve, how many DVDs will be demanded at a price of $12 each?
Determinants of Demand

**Main Idea** A change in the demand for a particular item shifts the entire demand curve to the left or right.

**Economics & You** Think of a product or service you used to buy a lot of but don’t anymore. Did this happen because of changing trends, a change in your income, or something else? Read on to learn about various factors that affect demand.

Many factors can affect demand for a specific product or service. Among these factors are changes in population, changes in income, changes in people’s tastes and preferences, the availability and price of substitutes, and the price of complementary goods.

**Changes in Population** When population increases, opportunities to buy and sell increase. Naturally, the demand for most products then increases. This means that the demand curve for, say, flat-screen televisions, shifts to the right. At each price, more flat-screen televisions will be demanded simply because the consumer population increases. This concept is shown in the graph on the left. The demand curve labeled D1 represents demand for televisions before the population increased. The demand curve labeled D2 represents demand after the population increased.

In contrast, if population decreases, overall demand for products also decreases. At each price, fewer flat-screen televisions will be demanded. When this happens, the demand curve shifts to the left.

**Changes in Income** The demand for most goods and services depends on income. Your demand for DVDs would certainly decrease if your income dropped in half and you expected it to stay there. You would buy fewer DVDs at all possible prices. In the graph on the left, the demand curve D1 represents your demand for DVDs before your income dropped, and the demand curve D2 represents your demand for DVDs after your income dropped. If your income went up, however, you might buy more DVDs even if the price of DVDs doubled. Buying more DVDs at all possible prices would shift the demand curve to the right.
Changes in Tastes and Preferences  One of the key factors that determine demand is people’s tastes and preferences. Tastes and preferences refer to what people like and prefer to choose. When a product becomes a fad, more of the products are demanded and sold at every possible price. The demand curve then shifts to the right, as shown in the graph on the right. In the early 1990s, when Beanie Babies became a fad, the demand curve shifted from D1 to D2. As the popularity of this product died down, its demand curve then shifted back to the left.

Substitutes  As you learned in Section 1, substitutes are goods used in place of one another. The availability and price of substitutes also affect demand. For example, people often think of butter and margarine as substitutes. Suppose that the price of butter remains the same and the price of margarine falls. People will then buy more margarine and less butter at all prices of butter. This shift in the demand curve for butter is shown in the graph on the right. If, in contrast, the price of the substitute (margarine) increases, the demand for the original item (butter) also increases.

Complementary Goods  Complements are products that are generally bought and sold together. Digital cameras and flash memory, for example, are complementary goods. When two goods are complementary, the decrease in the price of one will increase the demand for it as well as its complementary good. If the price of digital cameras drops, for example, people will probably buy more of them. They will also probably buy more flash memory to use with the cameras. Therefore, a decrease in the price of digital cameras leads to an increase in the demand for flash memory. As a result, the demand curve for flash memory will shift to the right, as shown in the graph on the right. The opposite would happen if the price of digital cameras increased. In this case, the demand for the complement, flash memory, would decrease, and the demand curve would shift to the left.

Reading Check  Why does a change in population affect the demand curve?
The Price Elasticity of Demand

**Main Idea**
Elasticity of demand measures how much the quantity demanded changes when price goes up or down.

**Economics & You**
Do rising gas prices affect how much gas you are willing to buy? If not, then your demand for gas is inelastic. Read on to learn about price responsiveness, or elasticity.

The law of demand is straightforward: The higher the price charged, the lower the quantity demanded—and vice versa. If you sold DVDs, how could you use this information? You know that if you lower prices, consumers will buy more DVDs. By how much should you lower the price, however? You cannot really answer this question unless you know how responsive consumers will be to a decrease in the price of DVDs. Economists call this price responsiveness elasticity. The measure of the price elasticity of demand is how much consumers respond to a given change in price.

**Figure 7.4 Demand vs. Quantity Demanded**

- **Graph A. Change in Demand**
  This is caused by something other than a change in the product’s price, and it causes the entire demand curve to shift to the left or right.

- **Graph B. Change in Quantity Demanded**
  This is caused by a change in the price of a good, and it is shown as a movement along the demand curve.

**Economic Analysis**
**Determining Cause and Effect**
Which graph would be affected by the price of substitutes?
Elastic Demand  For some goods, a rise or fall in price greatly affects the amount people are willing to buy. The demand for these goods is considered *elastic*—consumers can be flexible about buying or not buying these items. For example, specific brands of coffee probably have a very elastic demand. Consumers consider the many competing brands of coffee to be almost the same. A small rise in the price of one brand will probably cause many consumers to purchase the cheaper substitute brands instead.

Another example of goods that are generally considered to have elastic demand are luxury items. Luxury items are things people might want but do not really need to survive. Expensive cars, high-end electronic items, and exotic vacations are all examples of luxury items. Some foods, especially expensive foods such as steak and lobster, are also considered luxury items. Because people do not need these things to survive, the demand for them is usually elastic.

Inelastic Demand  If a price change does not result in a substantial change in the quantity demanded, then demand for that particular good is considered *inelastic*. This means that consumers are usually not flexible with these items and will purchase some of the items no matter what they cost. In general, goods that are considered necessities, such as staple foods, spices like salt and pepper, and certain types of medicine, normally have inelastic demand.

Note that by using two demand curves together in one diagram—as shown in Figure 7.5 on page 184—you can compare a relatively inelastic demand with a relatively elastic demand at a particular price.
Chapter 7
What Determines Price Elasticity of Demand?

Why do some goods have elastic demand and others have inelastic demand? At least three factors determine the price elasticity of demand for a particular item: the existence of substitutes; the percentage of a person’s total budget devoted to the purchase of that good; and the time consumers are given to adjust to a change in price.

Clearly, the more substitutes that exist for a product, the more responsive consumers will be to a change in the price of that good. A diabetic needs insulin, which has virtually no substitutes. The price elasticity of demand for insulin, therefore, is very low—it is inelastic. The opposite is true for soft drinks. If the price of one goes up by very much, many consumers may switch to another.

The percentage of your total budget spent on an item will also determine whether its demand is elastic or inelastic. For example, the portion of a family’s budget devoted to pepper is very small. Even if the price of pepper doubles, most people will keep buying about the same amount. The demand for pepper, then, is relatively inelastic. Housing demand, in contrast, is relatively elastic because it represents such a large proportion of a household’s yearly budget.

Figure 7.5 Elasticity of Demand

- Curve A at the price of $5.50 could represent the inelastic demand for pepper. Even if the price of pepper dropped dramatically, you would not purchase much more of it.
- Curve B at $5.50 could represent the elastic demand for steaks. If the price drops just a little, many people will buy much more steak.

Economic Analysis
Explaining What determines whether goods have elastic or inelastic demand?

What Determines Price Elasticity of Demand?

- Curve A around this price demonstrates a relatively inelastic demand for a product. Even if the price dropped from $10 to $1, the quantity demanded would not increase very much.
- Curve B around this price demonstrates a relatively elastic demand for a product. Note that when the price drops by only $1—from $6 to $5—the quantity demanded increases dramatically.

Figure 7.5 Elasticity of Demand

See pages R4–R5 to learn more about budgeting.
Finally, people take time to adjust to price changes, and this time period also affects demand elasticity. If the price of electricity were to rise drastically tomorrow, you would have a hard time adjusting your behavior immediately. You would still need to use about the same amount of electricity as you used yesterday. Your demand for electricity, therefore, is inelastic.

As more time goes by, however, you will be able to adjust the amount of electricity you use, gradually using less and less. Maybe you start using light bulbs with lower wattages, or you get used to a warmer house in the summer and a colder house in the winter, or you add insulation to your attic. The longer the time allowed to reduce the amount of electricity you use, the greater the price elasticity of demand for electricity will be for you.

**Explaining** Why is the consumer demand for pepper relatively inelastic?

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**Vocabulary**

1. Explain the significance of: demand schedule, demand curve, complementary good, elasticity, price elasticity of demand, elastic demand, inelastic demand.

**Main Ideas**

2. Describing What does a demand curve show?

3. Identifying Create a diagram like the one below to show the determinants of demand.

**Critical Thinking**

4. The BIG Ideas If the price of Coca-Cola suddenly rose, what would happen to the demand for Pepsi? Why?

5. Contrasting Explain the difference between demand and quantity demanded.

**Applying Economics**

6. Demand Elasticity In the United States, is the demand for gasoline elastic or inelastic? Why? Make a chart listing as many situations as you can think of that might affect the demand elasticity of gas.
As you’ve learned, consumers demand products and services at the lowest possible prices. In contrast, suppliers like Microsoft exist to make a profit—hopefully, a big profit. As you read this section, you’ll learn about the law of supply and how it is geared toward making profits.
Profits and the Law of Supply

Main Idea  The law of supply states that as price goes up, quantity supplied goes up, and vice versa.

Economics & You  Would you be willing to work more hours at your job for the same wages? Read on to learn that businesses are only willing to supply more of something if their profits also increase.

To understand how prices are determined, you have to look at both demand and supply—the willingness and ability of producers to provide goods and services at different prices in the marketplace. The law of supply states that as the price of a good rises, the quantity supplied generally rises; as the price falls, the quantity supplied also falls. (See Figure 7.6 below.)

You may recall that with demand, price and quantity demanded move in opposite directions. With supply, a direct relationship exists between the price and quantity supplied. A direct relationship means that when prices rise, quantity supplied will rise, too. When prices fall, quantity supplied by sellers will also fall. Thus, a larger quantity will generally be supplied at higher prices than at lower prices. A smaller quantity will generally be supplied at lower prices than at higher prices.

The profit incentive is one of the factors that motivate people in a market economy. In the case of supply, the higher the price of a good, the greater the incentive is for a producer to produce more. The higher price not only returns higher revenues from sales but also covers the additional costs of producing more. This concept is the basis of the law of supply.

Reading Check  Explaining  What kind of relationship exists between price and quantity supplied?

Figure 7.6  The Law of Supply

- Suppliers react to price changes.

law of supply: economic rule stating that price and quantity supplied move in the same direction

quantity supplied: the amount of a good or service that a producer is willing and able to supply at a specific price
The Supply Curve

Main Idea A supply curve is a graph that shows the relationship between price and quantity supplied.

Economics & You How many extra hours would you be willing to work for $1? For $100? Read on to learn how the relationship between price and quantity supplied can be illustrated with a supply curve.

Remember that economists show the relationship between price and quantity demanded by using a demand schedule and a demand curve. Similarly, we can use special tables and graphs to illustrate the law of supply visually. (See Figure 7.7 below.) Using the example of DVD producers, the graphs in this figure show a visual relationship between the price of each DVD and the quantity of DVDs that producers are willing to supply at each price.

Table A in Figure 7.7 is the supply schedule, which is a table showing that as the price per DVD increases, the quantity that producers are willing to supply also increases. For example, at a price of $10 per DVD, only 100 million DVDs will be supplied. When the price increases to $15 each, however, 600 million DVDs will be supplied.

> Table 7.4 Supply Schedule

The numbers in this supply schedule show that as the price per DVD increases, the quantity supplied increases. At $16 each, a quantity of 700 million DVDs will be supplied.
In Graph B, the numbers from the schedule in Table A have been plotted onto a graph. Note that the bottom (horizontal) axis shows the quantity supplied, and the side (vertical) axis shows the price per DVD. Each intersection of price and quantity supplied represents a point on the graph. We label these points L through V.

When we connect the points in Graph B with a line, we end up with the **supply curve** for DVDs at the particular prices shown. A supply curve shows the quantities that producers are willing to supply at each possible price. It slopes upward from left to right.

You can compare the supply curve to the demand curve in **Figure 7.3** on page 179. In doing so, you will see that the two curves are similar. The main difference between them is that in looking at the supply curve, you can see that the relationship between price and quantity supplied is direct—or moving in the same direction. In the case of the demand curve, the opposite is true—the relationship between price and quantity demanded is inverse. Because of this key point, the slopes of the two curves will always be different.

**Describing** What does a normal supply curve look like?

**Reading Check**

**Economic Analysis**

According to the supply curve, how many DVDs will be supplied at a price of $14 each?
The Determinants of Supply

**Main Idea** A change in the supply of a particular item shifts the entire supply curve to the left or right.

**Economics & You** Why are iPods so much more common now than they were five years ago? Read on to learn about the factors that affect supply.

Many factors can affect the supply of a specific product. Four of the major determinants of supply (not quantity supplied) are the price of inputs, the number of firms in the industry, taxes, and technology.

**Price of Inputs** If the price of the inputs needed to make a product—raw materials, wages, and so on—drops, a producer can supply more at a lower production cost. This causes the entire supply curve to shift to the right. This situation occurred, for example, when the price of memory chips used in making computers fell during the 1980s and 1990s. Look at the graph on the left. Line S1 shows the supply of computers before the price of memory chips fell. Line S2 shows the increased supply of computers after the price of memory chips fell. After the price drop, more computers were supplied at any given price than before.

In contrast, if the cost of inputs increases, then the cost of production also increases, and suppliers will offer fewer goods for sale at every possible price.

**Number of Firms in the Industry** As more firms enter an industry, greater quantities of their product or service are supplied at every price, and the supply curve shifts to the right. The larger the number of suppliers, the greater the market supply. Consider DVD rentals, for example. If profits from movie and game rentals increase, the number of DVD rental stores supplying these items will increase as well. As more DVD rental stores enter the market, the supply curve for DVD rentals shifts to the right. This shift is shown in the graph on the left.

Conversely, if some suppliers leave the market, fewer quantities of their product or service are supplied at every price, and the supply curve shifts to the left. Sellers in a free-market economy are entering and leaving the market all the time.
**Taxes**  If the government imposes more taxes on the production of certain items, businesses will not be willing to supply as much as before because the cost of production will rise. The supply curve for products will shift to the left, indicating a decrease in supply. For example, if taxes on the production of silk scarves increased, businesses that sell silk scarves would supply fewer quantities at each and every price. Look at the graph on the right. Line S1 indicates the supply of silk scarves before the government raised taxes on this product. Line S2 equals the supply after the government raised taxes. Because of the increased cost of production caused by the taxes, the entire supply curve for silk scarves shifted to the left.

**Technology**  The use of science to develop new products and new methods for producing and distributing goods and services is called technology. Any improvement in technology will increase supply, as shown in the graph on the right. This is because new technology usually allows suppliers to make more goods for a lower cost. The entire cost of production is cut, and the supply curve shifts to the right.

**Reading Check**  Analyzing What happens to the supply curve when production costs increase?

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**Advances in Technology**  In the early 1900s, improved technology in the auto-making industry greatly reduced the amount of time and other resources needed to make many new automobiles. Therefore, a larger quantity supplied of autos was offered for sale at every price.
The Law of Diminishing Returns

Main Idea When a business wants to expand, it has to consider how much expansion will really help the business.

Economics & You Have you ever heard the expression, “Too many cooks spoil the soup”? Read on to learn why hiring more workers is not always the best option for businesses.

Imagine that you own a business, and you want to expand production. Assume you have 10 machines and employ 10 workers, and you hire an 11th worker. Now, production increases by 1,000 units per week. When you hire a 12th worker, however, production increases by only 900 per week. (See Figure 7.9.) If you continue to hire more workers, production will continue to increase, but the rate of increase will fall. Maybe there are not enough machines to go around, and perhaps the workers are getting in each other’s way. If you continue to hire still more workers, your overall output will eventually decrease.

Figure 7.8 Supply vs. Quantity Supplied

Graph A. Change in Supply This is caused by something other than price, and it causes the entire supply curve to shift to the left or right.

Graph B. Change in Quantity Supplied This is caused by a change in the price of a good, and it is shown as a movement along the supply curve.

Economic Analysis Determining Cause and Effect Which graph would be affected by a significant improvement in technology?
Demand and Supply

section 3

Vocabulary
1. Explain the significance of: law of supply, quantity supplied, supply schedule, supply curve, technology, law of diminishing returns.

Main Ideas
2. Summarizing Create a diagram like this to list the four determinants of supply.

Critical Thinking
3. The BIG Ideas How does the incentive of greater profits affect supply?

Applying Economics
5. Synthesizing Information Imagine that you produce baseball caps and distribute them to local stores. Create a graph showing the various prices and quantities supplied for your caps.

Figure 7.9 Diminishing Returns

- Normally after some point, if you are expanding production, the additional workers that you hire do not add as much to total output as the previous workers that you hired. Eventually, adding more workers will not produce additional output.

<table>
<thead>
<tr>
<th>Number of Workers</th>
<th>Additional Output</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>1,000</td>
</tr>
<tr>
<td>12</td>
<td>900</td>
</tr>
<tr>
<td>13</td>
<td>800</td>
</tr>
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<td>20</td>
<td>100</td>
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<tr>
<td>21</td>
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</tr>
</tbody>
</table>

Economic Analysis

Using Tables If you start with 12 workers and hire 6 more, by how many units will your additional output decrease?

This example illustrates the law of diminishing returns, which says that adding units of one factor of production increases total output. After a certain point, however, the extra output for each additional unit hired will begin to decrease.

Explaining Why is it important for business owners to understand the law of diminishing returns?

law of diminishing returns: economic rule that says as more units of a factor of production are added to other factors of production, after some point total output continues to increase but at a diminishing rate.
What do Beanie Babies, Cabbage Patch Kids, and iPods all have in common? At one point in time, they all were in short supply—and usually right before the December holiday season. Around that time of year, you can often see empty shelves in stores where the hot items have sold out. As you will read, shortages occur when the quantity demanded is larger than the quantity supplied at the current price.
Equilibrium Price

Main Idea In free markets, prices are determined by the interaction of supply and demand.

Economics & You When new video game systems first come out, they are often too expensive for most people to buy. What happens to the price of the systems over time? Read on to learn about equilibrium price, the point at which demand and supply meet.

In the real world, demand and supply operate together. As the price of a good goes down, the quantity demanded rises and the quantity supplied falls. As the price goes up, the quantity demanded falls and the quantity supplied rises.

Is there a price at which the quantity demanded and the quantity supplied meet? Yes. This level is called the equilibrium price. At this price, the quantity supplied by sellers is the same as the quantity demanded by buyers. One way to visualize equilibrium price is to put the supply and demand curves on one graph, as shown in Figure 7.10. Where the two curves intersect is the equilibrium price.

Figure 7.10 Equilibrium Price

How does the market reach an equilibrium price? Study the charts. If sellers think the price for DVDs will be $20, they will produce 1,100 million units, but buyers will purchase only 100 million. To get rid of the surplus, suppose sellers lower the price to $10 and are willing to supply 100 million DVDs. At this price, 100 million are supplied but 1,100 million are demanded, leaving a shortage. The price tends to change until it reaches equilibrium.

Market Demand and Supply Schedules

<table>
<thead>
<tr>
<th>Quantity Demanded (millions)</th>
<th>Price</th>
<th>Quantity Supplied (millions)</th>
<th>Surplus/Shortage (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>$20</td>
<td>1,100</td>
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<tr>
<td>1,100</td>
<td>$10</td>
<td>100</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Using Graphs According to the schedule and the graph, what is the equilibrium price and quantity demanded in this example?
When the supply or demand curves shift, the equilibrium price also changes. Note that the old equilibrium price was $15. But now the new demand curve intersects the supply curve at a higher price—$17.

What happens when there is an increase in the demand for DVDs? Assume that scientists prove that watching a lot of movies increases life span. This discovery will cause the entire demand curve to shift outward to the right, as shown in Figure 7.11 above.

What about changes in supply? You can show these in a similar fashion. Assume that there is a major breakthrough in the technology of producing DVDs. The supply curve shifts outward to the right. The new equilibrium price will fall, and both the quantity supplied and the quantity demanded will increase.

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Identifying What is the equilibrium price of a good?

Prices as Signals

Under a free-enterprise system, prices function as signals that communicate information and coordinate the activities of producers and consumers.

Economics & You Can you think of a recent event that affected the price of an everyday item such as gasoline? Read on to learn about shortages, surpluses, and their effect on prices.

In the United States and other countries with mainly free-enterprise systems, prices serve as signals to producers and consumers. Rising prices signal producers to produce more and consumers to purchase less. Falling prices signal producers to produce less and consumers to purchase more.
**Economic Analysis**

**Predicting** What happens to prices during a shortage if the market is left alone?

**Shortages** A shortage occurs when, at the current price, the quantity demanded is greater than the quantity supplied. If the market is left alone—without government regulations or other restrictions—shortages put pressure on prices to rise. At a higher price, consumers reduce their purchases, whereas suppliers increase the quantity they supply.

**Surpluses** At prices above the equilibrium price, suppliers produce more than consumers want to purchase in the marketplace. Suppliers end up with surpluses—large, undesired inventories of goods—and this and other forces put pressure on the price to drop to the equilibrium price. If the price falls, suppliers have less incentive to supply as much as before, whereas consumers begin to purchase a greater quantity. The decrease in price toward the equilibrium price, therefore, eliminates the surplus.

**Market Forces** One of the benefits of the market economy is that when it operates without restriction, it eliminates shortages and surpluses. Whenever shortages occur, the market ends up taking care of itself—the price goes up to eliminate the shortage. Whenever surpluses occur, the market again ends up taking care of itself—the price falls to eliminate the surplus. (See Figure 7.12 below for more information.) Now, let’s take a look at what happens to the availability of goods and services when the government—not market forces—becomes involved in setting prices.

---

**Shortages and surpluses can affect the price of a good or service.**

**A. Shortage** Natural disasters, such as floods and hurricanes, can cause temporary shortages of water and other essential goods.

**B. Surplus** If a business sets the price of a good too high or overestimates demand, it could wind up with a surplus of the good.

---

**Explaining** What causes shortages and surpluses to eventually disappear?
Price Controls

**Main Idea** Under certain circumstances, the government sometimes sets a limit on how high or low a price of a good or service can go.

**Economics & You** Do you think there are times the government is justified in setting prices on certain goods and services? Read on to learn why this sometimes happens.

The government sometimes gets involved in setting prices if it believes such measures are needed to protect consumers or suppliers. Also, special interest groups sometimes exert pressure on elected officials to protect certain industries.

**Price Ceilings** A **price ceiling** is a government-set maximum price that can be charged for goods and services. For example, city officials might set a price ceiling on what landlords can charge for rent. As Graph A of Figure 7.13 below shows, when a price ceiling is set below the equilibrium price, a shortage occurs.

**Figure 7.13** Price Ceilings and Price Floors

---

**Price Ceiling on Rent**

More people would like to rent at the government-controlled price, but apartment owners are unwilling to build more rental units if they cannot charge higher rent. This results in a shortage of apartments to rent.

**Graph A. Price Ceiling**

When the government gets involved in setting prices, price ceilings or price floors may result.

**Price Floor on Wages**

A fast-food restaurant wants to hire students at $4.15 an hour, but the government has set a minimum wage—a price floor—of $5.15 an hour.

**Graph B. Price Floor**

What is the surplus of workers when the hourly wage price floor is $5.15?
Effective price ceilings—and resulting shortages—often lead to nonmarket ways of distributing goods and services. The government may resort to rationing, or limiting, items that are in short supply. Shortages also may lead to a black market, in which illegally high prices are charged for items that are in short supply.

**Price Floors** A price floor, in contrast, is a government-set minimum price that can be charged for goods and services. Price floors—more common than price ceilings—prevent prices from dropping too low. When are low prices a problem? Assume that about 30 of your classmates all want jobs after school. The local fast-food restaurant can hire 30 students at $4.15 an hour, but the government has set a minimum wage—a price floor—of $5.15 an hour. At that wage, not all of you will get hired, which will lead to a surplus of unemployed workers as shown in Graph B of Figure 7.13. If the market was left on its own, you and all of your classmates would be working at the equilibrium price of $4.15 per hour.

**Predicting Consequences** What two problems might be caused by price ceilings?

**Skills Handbook**

See page R47 to learn about Making Predictions.

---

**Vocabulary**

1. Explain the significance of: equilibrium price, shortage, surplus, price ceiling, rationing, black market, price floor.

**Main Ideas**

2. Identifying Cause and Effect Create a diagram like the one below to show how shortages and surpluses affect prices.

3. Explaining How does a shortage of tickets to a professional sports event determine the price of those tickets?

**Critical Thinking**

4. The Big Ideas How are equilibrium prices determined?

5. Analyzing Visuals Look at the charts in Figure 7.13 on page 198. What would happen to the equilibrium price on apartment rentals if the price ceiling was raised to $700?

**Applying Economics**

6. Extending the Content In a free-market economy, how much and how often do you believe the government should intervene by setting price floors and ceilings? Why?
Economics is sometimes called “the dismal science,” but it becomes anything but dismal when filtered through the mind of University of Chicago professor Steven Levitt. The topics that this Harvard-educated economist writes about include teachers who fix test results, sumo wrestlers who throw matches, and drug dealers who live with their mothers. In the process he has become a lightening rod for controversy.

In Levitt’s view, economics is a science with excellent tools for gaining answers but a serious shortage of interesting questions. His particular gift is the ability to ask such questions. When asked why he investigates such problems as cheating sumo wrestlers, he replied, “Because it’s fun. The kind of problems I like are problems which look hard but are easy. Finding cheaters often has that characteristic.”

A popular approach to his research was published in 2005 in a book entitled *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, which Levitt cowrote with Stephen J. Dubner. The book refers to Levitt as a “rogue” economist, meaning he tackles economic issues in an unconventional way. As he explains,

“*When the book calls me a rogue, we mean it in the ‘mischievously playful’ sense. . . . The rogue I have in mind is someone who strays from the subjects deemed appropriate for an economist, fails to treat economics with the necessary sense of seriousness. . . .*”

**Checking for Understanding**

1. **Explaining** According to Levitt, what is the main problem with studying economics?
2. **Analyzing** What is meant by the term “rogue economist,” and why does Levitt consider himself one?
The **law of demand** states that as price goes up, quantity demanded goes down. As price goes down, quantity demanded goes up.

The **law of supply** states that as price goes up, quantity supplied also goes up. As price goes down, quantity supplied goes down.

The point at which the quantity demanded and the quantity supplied meet is called the **equilibrium price**.
Review Content Vocabulary

1. Write a short paragraph about demand using all of the following terms.
   - law of demand
   - quantity demanded
   - law of diminishing marginal utility
   - demand curve
   - price elasticity of demand

2. Write a short paragraph about supply using all of the following terms.
   - law of supply
   - law of diminishing returns
   - supply curve
   - shortage
   - equilibrium price
   - surplus

Review Academic Vocabulary

Choose the term that best completes each sentence below.

- analysis
- alternate
- visual
- concept
- specific
- incentive
- impose
- assume
- eliminate

3. Choice is a basic ________ in economics.
4. In a market economy, producers and consumers ________ that the market generally will take care of itself.
5. A demand schedule shows the quantities of a good or service that will be demanded at ________ prices.
6. Opening a business requires careful ________ of the market of your potential product or service.
7. If the government should ________ more taxes, businesses will supply less at all prices because the cost of production will rise.
8. In the case of supply, the higher the price of a good, the greater the ________ is for a producer to produce more.
9. If the price of your favorite soft drink goes up, you may choose to purchase an ________ brand.
10. If a surplus exists in the marketplace, a movement toward the equilibrium price will ________ the surplus.
11. A demand schedule shows data about prices and quantities demanded in a ________ way.

Review the Main Ideas

Section 1 (pp. 169–175)

12. What is the basis of most activity in a market economy?

13. What generally happens to quantity demanded when the price of a good goes up (and other prices stay the same)?

Section 2 (pp. 177–185)

14. What is the distinction between elastic and inelastic demand?
15. If income and population increase, what tends to happen to demand curves? (pp. 186–193)

Section 3 (pp. 186–193)

16. When the price of an item goes up, do suppliers tend to produce more or less of the item? Why?
17. What would an increase in taxes do to the position of the supply curve?

Section 4 (pp. 194–199)

18. If the price of a product is above its equilibrium price, what is the result?
19. Complete the graphic organizer by listing how producers and consumers act during surpluses and shortages.

<table>
<thead>
<tr>
<th>Surpluses</th>
<th>Producers</th>
<th>Consumers</th>
</tr>
</thead>
</table>

| Shortages | Producers | Consumers |
Math Practice

20. **Using Graphs** Nancy, the owner of a small café, is trying to set a price for the new sandwich she is offering. In order to do so, she wants to find the equilibrium price. She collects information on how many sandwiches she can expect to sell at different prices. Using the information below, create a graph of the supply and demand curves. Use the graph in Figure 7.10 on page 195 as an example. After you have created the graph, determine the equilibrium price of the new sandwich.

<table>
<thead>
<tr>
<th>Nancy’s Sandwiches</th>
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<tbody>
<tr>
<td></td>
<td>Quantity Demanded</td>
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<td></td>
<td>Quantity Supplied</td>
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</tbody>
</table>

Critical Thinking

21. **The BIG IDEAS** Some prices in the American economy almost never change, whereas others change all the time, even daily. Make a list of products whose prices change slowly, if at all. Make another list of products whose prices change quickly. Finally, write a short paragraph summarizing why prices change slowly or quickly for various products.

22. **Making Predictions** How do you think the market demand curve for pizza would be affected by (1) an increase in everyone’s pay, (2) a successful pizza advertising campaign, (3) a decrease in the price of hamburgers, and (4) new people moving into the community? Explain your answers.

23. **Making Comparisons** How do you think the price elasticity of demand for DVDs compares to that of insulin needed by diabetics? Why?

Analyzing Visuals

24. Study the cartoon on the right, and then answer the following questions.

a. According to the cartoon, why has demand for movies dropped?

b. What other reasons could there be for fewer people going to see the movies?

c. If demand for movies continues to drop, how will movie producers most likely respond?
Why are the salaries of professional sports stars so high?

**THE ISSUE**

In the 2004–2005 basketball season, the Miami Heat’s Shaquille O’Neal brought in a salary of almost 28 million dollars. Allan Houston of the New York Knicks and Chris Webber of the Philadelphia 76ers each earned over $17.5 million. Even on the pro basketball league with the lowest median salary, the New Jersey Nets, the players’ average earnings were close to a million dollars. These are very large salaries. Why do professional sports stars make so much money?

**THE FACTS**

Have you ever heard people complain about how many important, worthy professions, such as teaching and nursing, are underpaid, while professional baseball, football, and basketball players often make huge amounts of money? Study the charts below to compare the salaries of the 10 highest-paid NBA players in 2005 with those of 10 common U.S. professions. As you can see, the difference between what a top NBA player makes and what “ordinary Americans” make is huge. Yet, some people would argue that nurses benefit society greatly by saving lives, and teachers have a tremendous impact on the nation’s young people, while basketball players merely provide entertainment. So, from an economic standpoint, how can these salary differences be justified?

<table>
<thead>
<tr>
<th>The NBA’s Highest-Paid Players, 2004-2005</th>
<th>Median Salaries of 10 Common Professions 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Player</strong></td>
<td><strong>Team</strong></td>
</tr>
<tr>
<td>3. Chris Webber</td>
<td>Philadelphia 76ers</td>
</tr>
<tr>
<td>5. Jason Kidd</td>
<td>New Jersey Nets</td>
</tr>
<tr>
<td>6. Jermaine O’Neal</td>
<td>Indiana Pacers</td>
</tr>
<tr>
<td>7. Shareef Abdur-Rahim</td>
<td>Portland Trail Blazers</td>
</tr>
<tr>
<td>8. Ray Allen</td>
<td>Seattle SuperSonics</td>
</tr>
<tr>
<td>10. Zydrunas Ilgauskas</td>
<td>Cleveland Cavaliers</td>
</tr>
</tbody>
</table>

Source: usatoday.com
THE ECONOMIC CONNECTION: SUPPLY AND DEMAND

To a certain extent, all salaries are determined by supply and demand. A high demand for a certain profession, combined with a low supply of people able to perform the job, will generally result in a high salary for the job, and vice versa.

In the case of professional ball players, the law of supply and demand is especially important in setting salaries. The public likes to watch professional sports, and so there is a high demand for professional sports players. However, the number of people who are able to meet the physical and mental challenges of playing professional sports—that is, the supply of players—is relatively small. In this case, the demand exceeds the supply, which drives salaries up.

Also, professional basketball players are usually allowed “free agency”—that is, they are allowed to sell their services to any team willing and able to pay them what they want. When teams really want talented and popular players to play for them, they will bid against each other for the player, thus driving the players’ potential salaries higher and higher.

Compare that situation with the case of high-school teachers. Although teaching is a very difficult and demanding profession, many more people are able to meet the requirements to become a teacher than are able to play basketball at a professional level. Therefore, even though the nation needs many more teachers than pro ball players, the supply of certified teachers often meets or even exceeds demand—keeping teachers’ salaries relatively low and stable.

CONCLUSION

Just as the laws of supply and demand interact in the market to determine prices, they also work to determine the salaries of various professions. The first round of the 2005 NBA playoffs was viewed by over 100 million people, demonstrating a high demand for professional basketball players. However, very few people are able to play at the NBA level, so the supply of players is small. Whenever you have a very high demand combined with a very small supply, you will wind up with a very high price—or, as in this case, a Shaq-sized salary.

Analyzing the Impact

1. Synthesizing How do you think players’ salaries would be affected if free agency was not allowed? Why?

2. Critical Thinking How do you think the high salaries of ball players affect the ticket prices you pay? What might happen in the market if players’ salaries continue to rise?
The **BIG Idea**

The profit motive acts as an incentive for people to produce and sell goods and services.

**Why It Matters**

Imagine that you want to start a business. You will need to decide what your business will do, how you would like it to be structured, and whether you would like to work alone or with a partner. In this chapter, read to learn about the different ways that businesses are organized and what it takes to start a business.
How many times have you seen a product for sale and said, “That was my idea”? Or you see an item, nod your head, and think, “That’s a good idea. I wonder how they thought of that”? Many new products and services arise from personal inspiration—as in the case of David Burke’s flavor sprays. In this section, you’ll learn how to take your idea and start a business.
Getting Started

Main Idea Businesses are started by entrepreneurs who are willing to take risks.

Economics & You What are your talents? Can you think of a way to turn these skills into a marketable business? Read on to learn about how to start your own business.

Imagine that you have been tinkering with electronic equipment since you were a child. By now you can take apart and reassemble CD and DVD players, most computers, and other electronic equipment without difficulty. You are so good at repairing this kind of equipment that you have been doing it for friends and relatives for some time. Then an idea occurs to you: Why not charge people for your services? Why not go into business for yourself?

A person who starts his or her own business is an entrepreneur—a person willing to take a risk. People usually decide to start a business to gain profits, to “do something on their own,” or to be their own boss.

After making the decision to start a business, entrepreneurs must gather the relevant factors of production to produce their good or service and decide on the form of business organization that best suits their purposes. (You’ll learn about the different types of business organizations in Sections 2 and 3.)

Anyone hoping to become an entrepreneur must also learn as much as possible about the business he or she plans to start. This process includes learning about the laws, regulations, and tax codes that will apply to the business. An entrepreneur should also investigate potential competition.

entrepreneur: person who organizes, manages, and assumes the risks of a business in order to gain profits

Entrepreneurship

Entrepreneurs are willing to take risks to gain a profit and be their own bosses.

Careers Handbook
See pages R76–R80 to learn about becoming an electrician.
Help From Government

For a person who wants to start a small business, help is available. (See Figure 8.1 above.) The federal government’s Small Business Administration often helps finance startups, or new small businesses. State departments of commerce and community affairs also offer assistance. Many community college and university campuses have small-business development centers that are federally funded to help small businesses get started.

A small-business incubator might also aid businesses in your area. Just as incubators help hatch chicks, there are business incubators that help “hatch” small businesses. They are often operated with state and federal funds. A small-business incubator might provide a low-rent building, management advice, and computers. The incubator’s goal is to generate job creation and economic growth, particularly in economically depressed areas.

Help From the Internet

Although new entrepreneurs can get help from government agencies, the Internet also provides a huge amount of information on how to start a business. By using search engines, you can find Web sites that explain everything from putting together a business plan to learning the “secrets to success.”

Analyzing Why do entrepreneurs make the decision to start a business?
Elements of Business Operation

**Main Idea** There are four basic elements of business operation: expenses, advertising, record keeping, and risk.

**Economics & You** What stops you from starting your own business every time you have a good idea for a product or service? Read on to learn about the risks and expenses involved in business operation.

Every business must consider four basic elements: expenses, advertising, record keeping, and risk. (See Figure 8.2 below.)

**Expenses** You’ve probably heard the saying, “You have to spend money to make money.” This is true when considering business expenses: new equipment, wages, insurance, taxes, electricity, telephone service, and so on. And depending on the kind of job you do, you may need replacement parts. At first, you might buy parts only as you need them for a particular job. In time, you will find it easier to have an inventory, or supply of items that are used in your business.

**Figure 8.2 Elements of Business Operation**

- Every small business presents its owner with unique issues and challenges, but they all have some elements in common as well. These common elements include expenses, advertising, record keeping, and risk.

### A. Expenses

Expenses include the supplies you need to do your job. If you start a painting business, for example, your expenses will include brushes, paint, and ladders. As your business grows, you might buy more expensive equipment, like paint sprayers and sanders.

### B. Advertising

The cost of advertising can cut into profits, especially in the startup phase of a business.
Wages are an expense. Because you could be working for someone else and earning an income, you should pay yourself a wage equal to what you could earn elsewhere. It’s important not to forget this opportunity cost when you figure out the true profits and losses that your new business is making.

Will your business make a profit? Add your wages to your other expenses, including taxes. Then subtract your total expenses from your receipts, or the money income you’ve received from customers, and you will have your profit. Keep records of how much you owe and to whom, and of how much your business is taking in. You will need this information to do your taxes.

**Advertising** When you start a business, you must make potential customers aware that your goods or services are available for a price. You could have flyers printed and distributed to advertise your business. You could also buy advertising space in newspapers, in community newsletters, or on various Web sites.

**C. Record Keeping** Maintaining accurate records of your expenses and receipts is vital, especially when you’re doing your taxes.

**D. Risk** Many startups fail. If you work for a boss, your overall risks are usually small. As your own boss, your risks are greater, but so are your potential rewards.

**Economic Analysis**

**Examining** What expenses other than supplies might a small-business owner have?
Record Keeping  No matter how small your business, having a system to track your expenses and income is key to your success. Probably one of the first things you’ll need is a computer. You should also purchase or download from the Internet the programs that will allow you to track your expenses and receipts. These programs write checks, calculate your monthly profits and losses, tell you the difference between what you own and what you owe (called net worth), and so on.

The slips of paper that document your purchases of supplies—also known as receipts—must be filed in a safe place. All legitimate business expenses can be deducted from business receipts before taxes owed are calculated. Taxes are assessed only on net business income. Here is where you see how important record keeping is.

Risk  Every business involves risks. You must balance the risks against the advantages of being in business for yourself. For example, if you spend part of your savings to pay for advertising and equipment, you are taking a risk. You may not get enough business to cover these costs.

Predicting Consequences  What are the risks of starting your own business? What are the advantages?

Vocabulary
1. Explain the significance of: entrepreneur, startup, small-business incubator, inventory, receipts.

Main Ideas
2. Identifying  Copy the diagram below, and list four ways the government provides funds for businesses.

Critical Thinking
3. The BIG Idea  Explain why some people would rather risk taking a loss in a business of their own rather than work for a wage.

4. Determining Cause and Effect  Why is the government willing to provide start-up funds to entrepreneurs?

Applying Economics
5. Entrepreneurship  Find a business in your area owned by an entrepreneur. Invite the person to speak to your class, or interview the person and read the interview aloud to the class.
Businesses can be organized in a number of ways. As the story above shows, many young people dream of starting their own business and being their own boss. Single-owner businesses, however, are only one option available to people who want to work for themselves. In this section, you’ll learn that the two most common ways of organizing businesses in the United States are sole proprietorships and partnerships.

GUIDE TO READING

Section Preview
In this section, you will learn about common ways to organize a business.

Content Vocabulary
- sole proprietorship (p. 214)
- proprietor (p. 214)
- unlimited liability (p. 214)
- assets (p. 214)
- partnership (p. 215)
- limited partnership (p. 216)
- limited liability company (p. 216)
- joint venture (p. 216)

Academic Vocabulary
- potential (p. 215)
- temporary (p. 216)

Reading Strategy
Comparing As you read, complete a table like the one below by listing the advantages and disadvantages of three common types of business organizations.

<table>
<thead>
<tr>
<th>Business Type</th>
<th>Advantage(s)</th>
<th>Disadvantage(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sole Proprietorship</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Partnership</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Limited Partnership</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

PEOPLE IN THE NEWS
— from the Fresno Bee

Young Entrepreneurs Travis Pierce hasn’t graduated from high school yet, and he’s already thinking about how many businesses he would like to own. The Clovis High School student wants to open an entertainment club for young people, become an accountant, and dabble in real estate investment.

Although the 17-year-old student’s ideas may seem lofty, Travis joins a growing number of American teenagers interested in becoming their own bosses.

. . . Hoping to fuel young people’s interest in business, Junior Achievement and the U.S. Small Business Administration have created a Web site—www.mindyourownbiz.org—aimed at providing the tools and resources they need for becoming an entrepreneur. The SBA also has its own Web site, www.sba.gov/teens.
Sole Proprietorships

Main Idea  A sole proprietorship is a business owned and operated by one person.

Economics & You  If you were to start a business, would you rather work alone or with a partner? Read on to learn about businesses owned and operated by one person.

The most common form of business organization is the sole proprietorship, a business owned by one person. A proprietor is the owner of a business. The United States has about 18 million sole proprietorships. You probably have contact with many sole proprietorships without realizing it.

There are advantages and disadvantages to being a sole proprietor. A proprietor may get satisfaction from being the boss and creatively making the business into whatever he or she wants it to be. Running a business alone is demanding and time-consuming, however.

The financial risk also has advantages and disadvantages. If the business does well, the proprietor receives all the profits. Also, taxes on a sole proprietorship are usually low because a business owner pays income taxes only on profits. At the same time, the owner also has unlimited liability—complete legal responsibility for all debts and damages arising from doing business. Personal assets, or items of value such as houses, cars, jewelry, and so on, may be seized to pay off business debts.

Explaining  What is meant by unlimited liability? What effect does this have on a sole proprietor?

Figure 8.3  Two Types of Businesses

- Sole proprietorships and partnerships are two common ways that businesses are organized.

A. Sole Proprietorships
People who run their own businesses enjoy having creative control and being their own boss. Operating a sole proprietorship, though, is also a huge responsibility. The proprietor must handle all the decision making, even when the problem is unfamiliar.
Partnerships

Main Idea  A partnership is a business owned and operated by two or more individuals.

Economics & You Have you ever worked with a partner on a school project? What were some of the advantages and disadvantages of this arrangement? Read on to learn about partnerships in business.

Earlier in this chapter, we imagined that you had started an electronics repair business. Suppose your business is doing so well that your workload becomes overwhelming, leaving you little time to do anything else. You could expand your business by hiring an employee. You also need financial capital to buy new equipment, but you would rather not take out a loan. So, you decide to take on a partner.

In a partnership, two or more individuals own and operate a business. Partners sign an agreement that is legally binding. It describes the duties of each partner, the division of profits, and the distribution of assets should the partners end the agreement.

Partnerships are usually more efficient than proprietorships because each partner can work in his or her area of expertise. As with sole proprietorships, taxes tend to be low because partners pay income tax only on their share of the profits. Because the partners have to work together, however, decision making is often slower, and disagreements can lead to problems.

A partnership’s borrowing potential is generally very good. Because the combined value of the partners’ personal and business assets is usually greater than that of a sole proprietor, creditors are willing to lend more because these same assets can be taken over if the partnership fails to repay the loan.

B. Partnerships  Like sole proprietorships, partnerships offer the pride of having ownership of a business. In partnerships, however, the responsibility of running the business rests on two or more people. The partners need to be able to compromise and work together.

Economic Analysis

Explaining Why do partners often have an easier time obtaining funding than sole proprietors do?
limited partnership: special form of partnership in which one or more partners have limited liability but no voice in management

limited liability company: type of business enterprise that protects members against losing all of their personal wealth; members are taxed as if they were in a partnership

joint venture: partnership set up for a specific purpose for a short period of time

Some partnerships are specialized. In a limited partnership, not all of the partners are equal. One partner is called the general partner. This person (or persons) assumes all of the management duties and has full responsibility for the debts of the partnership. The other partners are limited because they only contribute funds or property to the business. They have no say in the management of the business, but they also have no liability for business losses other than their initial investment.

Another type of business structure that creates benefits for businesspersons is called a limited liability company. In this type of business enterprise, so-called members often do not have to worry about losing their personal wealth if the business fails with a lot of debts. Limited liability companies are similar to corporations (which you will read about in the next section), but they are taxed as if they were partnerships.

Finally, a joint venture is a temporary partnership created to accomplish a specific task for a short period of time. Once the task is completed, the joint venture is ended. A common example is when investors purchase real estate and then resell the property for a profit.

Determining Cause and Effect Why would an entrepreneur want to take on a partner when starting a business?

Review

Vocabulary
1. Explain the significance of: sole proprietorship, proprietor, unlimited liability, assets, partnership, limited partnership, limited liability company, joint venture.

Main Ideas
2. Synthesizing In a pyramid like the one below, rank the following four types of businesses in order of risk to you, with the highest risk at the top: partnership, limited partnership, limited liability company, sole proprietorship.

3. Comparing What is one advantage of a joint venture?

Critical Thinking
4. The BIG Idea Explain the advantages and disadvantages of being a sole proprietor.

5. Comparing Why do sole proprietorships and partnerships pay relatively lower taxes than other types of business organizations?

Applying Economics
6. Local Business Using the Internet or your own knowledge or research, list one sole proprietorship and one partnership that is owned and operated in your community or city.
Indra K. Nooyi

- President and Chief Financial Officer of PepsiCo, Inc.
- Board member of Motorola, the International Rescue Committee, the Lincoln Center for the Performing Arts, and the Asia Society
- Serves on the Advisory Boards of the Yale School of Management and the Greenwich Breast Cancer Alliance

At one time the lead guitarist in an all-female rock band in India, Indra Nooyi is now president and chief financial officer of PepsiCo, Inc. How does a young woman from Chennai, India, become a top executive at the giant corporation that owns Pepsi-Cola, Frito-Lay, Gatorade, Tropicana, Quaker Oats, and hundreds of other brands around the globe?

“To the extent that I have succeeded in finding happiness as a sister, a wife, a mom, an Indian daughter and daughter-in-law (both have their own challenges!), and as a business leader, I found that five simple principles have guided me over the years.

The 1st Principle that helped guide my life, is: Whatever you choose to do, aim high . . . and put your heart into it.

The 2nd Principle . . . is: Never stop learning. Some people think learning ends when you leave school. They are terribly misguided.

The 3rd Principle . . . is: Keep an open mind. Treat others with the same respect and dignity that you want others to treat you.

The 4th Principle . . . is: It’s important to remember that we’re all individuals. . . . [N]ever hide what makes you, you. Always be yourself.

The 5th Principle that helped guide my life is the most important of all: Remember the three things that are most important in life . . . family . . . friends . . . and faith.

Nooyi remains true to her Indian identity. She often wears a sari, and in her home in Connecticut there is a puja, or Hindu prayer room. And she still plays her electric guitar.

Checking for Understanding

1. Discussing Of the many roles Nooyi plays, which seem to be the most important to her? How can you tell?
2. Defending Which of Nooyi’s five principles is the most important to you? Why?
The Corporate World and Franchises

GUIDE TO READING

Section Preview
In this section, you will learn about the characteristics and structure of corporations and franchises.

Content Vocabulary
- corporation (p. 219)
- stock (p. 219)
- limited liability (p. 220)
- articles of incorporation (p. 220)
- corporate charter (p. 220)
- common stock (p. 221)
- dividend (p. 221)
- preferred stock (p. 221)
- bylaws (p. 221)
- franchise (p. 222)

Academic Vocabulary
- visible (p. 219)
- distinct (p. 219)
- annual (p. 221)

Reading Strategy
Sequencing As you read, complete a flowchart like the one below by filling in the steps necessary to form a corporation.

Decide to form a corporation → → →

PeOPLE In ThE NeWS

—from Entrepreneur.com

YOUNG FRANCHISORS While practically everyone has heard of Subway, not many people know that its founder, Fred DeLuca, started the sandwich juggernaut as a 17-year-old college student in 1965. Nearly 40 years later, he’s inspiring other young people to choose their own destinies. Working at the local Subway has become almost a rite of passage for teenagers, as it was for Devin Smith back in 1994. He, like DeLuca, was 17 when he began his relationship with Subway—Smith worked there part time during high school and college before graduating to the next level at Subway: ownership. Smith isn’t the only early achiever looking beyond the corporate path. Brandon Gough, president of Juice It Up! Franchise Corporation, notes a recent increase in younger applicants interested in the smoothie franchise.

Profits are a good thing. As a sole proprietor, you keep all the profits. In a partnership, you share the profits with one or several partners. In a corporation, however, the profits are dispersed among thousands of shareholders. So why do entrepreneurs incorporate, or form corporations? In this section, read to learn why and how corporations are formed.
Corporations and Their Structure

Main Idea  Stock represents ownership rights to a certain portion of a corporation’s profits and assets.

Economics & You  What do you think of when you picture a corporation? Profit? A complicated structure? Read on to learn about the characteristics of corporations.

Suppose your electronics repair business that we discussed at the beginning of this chapter has grown. You now have several partners and have turned your garage into a shop. You would like to expand and rent a store so that your business is more visible. You would also like to buy the latest equipment, charge a little less than your competitors, and capture a larger share of the market. You need financial capital, however.

You have decided that you do not want any more partners. You no longer want to consult with them about every detail of the business. What you want are financial backers who will let you use their funds while letting you run the business. You are proposing a corporation.

What Is a Corporation?  A corporation is an organization owned by many people but treated by law as though it were a person. A corporation can own property, pay taxes, make contracts, sue and be sued, and so on. It has a separate and distinct existence from the stockholders who own the corporation’s stock. Stock represents ownership rights to a certain portion of the future profits and assets of the company that issues the stock.

Skills Handbook  See page R48 to learn about Problems and Solutions.

corporation:  type of business organization owned by many people but treated by law as though it were a person; it can own property, pay taxes, make contracts, and so on

stock:  share of ownership in a corporation that entitles the buyer to a certain part of the future profits and assets of the corporation

The Biggest of Them All

In the early 2000s, Wal-Mart became the biggest corporation in the United States. In 2005, $8.90 out of every $100 spent in U.S. retail stores was spent at Wal-Mart. Although Wal-Mart offers low prices to consumers and employs a large number of people, some critics maintain that small businesses suffer from the intense competition.
In terms of the amount of business done (measured in dollars), the corporation is the most significant type of business organization in the United States today. See Figure 8.4 below to compare corporations with other forms of businesses.

One of the major advantages of a corporation is limited liability. If a corporation goes bankrupt or is sued, the stockholders’ losses are limited to their investment in the firm. A major disadvantage of corporations is that they are taxed more heavily than other forms of business organizations. In order to form a corporation, its founders must do three things. First, they must register their company with the government of the state in which it will be headquartered. Second, they must sell stock. Third, along with the other shareholders, they must elect a board of directors.

**Registering the Corporation** Every state has laws governing the formation of corporations, but most state laws are similar. Suppose that you and your partners decide to form a corporation. You will have to file the **articles of incorporation** with the state in which you will run your corporation. In general, these articles include four items:

1. Name, address, and purpose of the corporation;
2. Names and addresses of the initial board of directors;
3. Number of shares of stock to be issued;
4. Amount of money capital to be raised through issuing stock.

If the articles are in agreement with state law, the state will grant you a **corporate charter**—a license to operate from that state.

---

**Figure 8.4** Comparing Corporations, Partnerships, and Proprietorships

As you can see, although corporations make up only about 20 percent of all businesses in the United States, they earn about 85 percent of all business revenues.

![Graph](image)

**Revenues Generated by Business Organizations**

- **Propportion of Businesses**
  - Proprietorships: 71.6%
  - Partnerships: 8.2%
  - Corporations: 20.2%

- **Propportion of Total Business Revenue**
  - Proprietorships: 4.5%
  - Partnerships: 10.1%
  - Corporations: 85.4%

Members of a corporation’s board of directors are elected by the stockholders. The board will often meet to discuss corporate strategy, but it does not get involved in the day-to-day operations of a business.

Selling Stock  To raise funds for the expansion of your electronics repair business, you could sell shares of stock in your new corporation. **Common stock** gives the investor part ownership in the corporation, a right to a percentage of the company’s future profits, and voting rights at the annual stockholders’ meeting. It does not, however, guarantee a **dividend**—a money return on the money invested in a company’s stock. Holders of **preferred stock** do not have voting rights in the corporation, but they are guaranteed a certain amount of dividend each year. Plus, if the corporation goes out of business, holders of preferred stock have first claim on whatever value is left after creditors have been paid.

Naming a Board of Directors  To become incorporated, a company must have a board of directors. You and your partners, as founders of your corporation, would select the first board. After that, stockholders would elect the board. The bylaws of the corporation govern this election. **Bylaws** are a set of rules describing how stock will be sold and dividends paid, with a list of the duties of the company’s officers. They are written after the corporate charter has been granted.

The board is responsible for supervising and controlling the corporation. It does not run business operations on a day-to-day basis. Instead, it hires officers for the company—president, vice president(s), secretary, and treasurer—to run the business and hire other employees.

**Reading Check**  What are a major advantage and a major disadvantage of incorporating?
Franchises

Main Idea A franchise is an arrangement in which a person or group obtains the right to use the name and sell the products of another business.

Economics & You Can you find your favorite fast-food restaurant when you travel? If so, then the restaurant is probably a franchise. Read on to learn about franchising a business.

Many hotel, motel, gas station, and fast-food chains are franchises. A franchise is a contract in which a firm—usually a corporation—sells to a person or group of people the right to use its name and sell its products. In return, the person or group makes certain payments and meets certain requirements. The corporation, or parent company, is called the franchisor, and the person or group buying these rights is called the franchisee.

The franchisee pays a fee to the franchisor that may include a percentage of all revenues taken in. If a person buys a motel franchise, for example, that person agrees to pay the motel chain a certain initial fee plus a portion of the profits for as long as his or her motel stays in business. In return, the chain will help the franchisee set up the motel. Often, the chain will have a training program to teach the franchisee about the business and set the standards of business operations.

Wave of the Future?

Franchises exploded onto the retail scene in the 1950s with the development of fast-food chains. Their numbers have continued to increase over the years. Today, Subway sandwich shops are one of the most common and popular franchises in the United States.

Franchise Rules

Franchise agreements usually require the franchisee to meet certain quality standards decided on by the franchisor. For example, all Subway franchises are required to use freshly baked bread and fresh ingredients, and employees must assemble sandwiches in front of the customers.
Advantages of Franchising  The main reasons people choose to open franchises rather than start their own businesses are name recognition and a proven way of doing business. If the parent company is already successful, it has figured out a way to market its products or services effectively. The franchisee can follow this method rather than coming up with an original plan that may or may not work. In addition, parent companies generally spend a great deal on advertising. Think of how often you see ads for popular franchises like McDonald’s, Burger King, Wendy’s, and Pizza Hut. The franchisee benefits from this advertising without having to pay for it. Because of these advantages, the success rate of franchises is much higher than that of independently owned businesses.

Disadvantages of Franchising  For franchisees, the main disadvantage is a loss of control. While they gain the use of a business plan, training, and marketing, they give up the freedom to run their business as they’d like. Also, franchise arrangements sometimes run into legal trouble if one of the parties fails to hold up its side of the agreement.

Analyzing  Why might someone purchase a franchise rather than start his or her own business?

Vocabulary
1. Explain the significance of: corporation, stock, limited liability, articles of incorporation, corporate charter, common stock, dividend, preferred stock, bylaws, franchise.

Main Ideas
2. Comparing and Contrasting  Copy the diagram below, and list the advantages and disadvantages of incorporating a business.

<table>
<thead>
<tr>
<th>Incorporating</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantages</td>
<td>Disadvantages</td>
</tr>
</tbody>
</table>

3. The BIG Idea  The goal of business is to make a profit. Who gets the profits in a proprietorship? A partnership? A corporation?

Critical Thinking
4. Evaluating  Imagine you have $1,000 to invest. Would you buy preferred stock or common stock? Why?

Applying Economics
5. Franchising  Successful entrepreneurship can be profitable but carries risk. Write a paragraph explaining why franchising is less risky than being a sole proprietor. Use at least four examples from the text.
PANERA BREAD

Giving Fast Food a Run for Its Money

Check It Out! In this chapter you learned about franchises and corporations. In the following article, read to learn how one franchise is “rolling in the dough.”

Back in the 1980s, fast-food chains had turned into “self-serve gasoline stations for the body,” says Ronald M. Shaich, CEO of Panera Bread Co. In 1993, he acquired Panera and began preaching its virtues as he opened branches across the country. “It’s food you crave, food you trust.” Actually, people are gobbling it up.

Panera attracts its crowds by focusing on freshness. Breads and pastries are baked at each site from dough that contains no unhealthy trans fats. Shaich revitalizes Panera’s menu every two months with a new sandwich or salad. To cover the increased cost, it had to hike sandwich prices by 7%, to $4.99-plus. But the customers who frequent the chain didn’t balk. Fans don’t mind paying a premium for its healthy alternatives. The average Panera patron spends $8.51 on lunch, vs. an industry average of $4.55. Panera has trounced many fast-food competitors in average sales per store.

Panera’s expansion—and Shaich’s eye for spotting trends early—has helped the chain withstand lean times. In 2003, Americans went on a low-carbohydrate kick. With “bread” in its name, Panera suddenly landed on the do-not-eat list of many Atkins Diet followers. So Shaich acted fast to boost the salad lineup and low-carb, whole-grain breads. High marks from customers are projected to push Panera’s revenues to $1 billion in 2007.

—Reprinted from BusinessWeek

<table>
<thead>
<tr>
<th>Annual Per-Store Sales of Some Major U.S. Chain Restaurants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panera Bread</td>
</tr>
<tr>
<td>McDonald’s</td>
</tr>
<tr>
<td>Denny’s</td>
</tr>
<tr>
<td>Boston Market</td>
</tr>
<tr>
<td>Dunkin’ Donuts</td>
</tr>
<tr>
<td>Sales (in millions)</td>
</tr>
<tr>
<td>$1</td>
</tr>
<tr>
<td>$1.5</td>
</tr>
<tr>
<td>$2</td>
</tr>
</tbody>
</table>

Source: Nation’s Restaurant News.

Think About It

1. **Contrasting** How does Panera Bread differ from other fast-food franchises?

2. **Explaining** Owning a business means constantly tracking trends. How did Shaich avert disaster when low-carb diets emerged?
There are four main elements of business operation: expenses, advertising, record keeping, and risk.

Sole proprietorships and partnerships are two common ways that businesses are organized.

The majority of business revenues in the United States are brought in by corporations, which are owned by many people but treated by law as if they were individuals.

Proportion of Total Business Revenue

- Corporations: 85.4%
- Proprietorships: 4.5%
- Partnerships: 10.1%
Review Content Vocabulary

1. Imagine that you are starting a business, such as a pet grooming business or a clothing store. Write a paragraph or two explaining the choices you will have to make about how your new business will be structured and run. Use all of the following terms.

entrepreneur  
corporation  
startup  
sole proprietorship  
unlimited liability  
partnership  
limited partnership  
joint venture

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. relevant  e. temporary
b. generate  f. visible
c. document  g. distinct
d. potential  h. annual

2. Some partnerships are _______ because they are meant to end after a specific goal is met.

3. Retailers try to make their stores as _______ as possible so that more customers will see them.

4. Business owners strive to increase _______ revenue.

5. It is important for business owners to _______ their expenses for their tax records.

6. Stockholders must be informed about _______ and important business decisions.

7. Stockholders can attend a(n) _______ meeting each year to vote on company business.

8. A company’s profits will _______ dividends for its stockholders.

9. It is helpful for a new business to be _______, or different in some way, from its competitors.

Review the Main Ideas

Section 1 (pp. 207–212)

10. Every business involves expenses, receipts, and record keeping. What are two other elements? Why are they important?

11. When you calculate your profits, it is especially important for you to include the value of your time. What is this called?

12. If you start a small business, you have to consider many things. Where can you look for help?

Section 2 (pp. 213–216)

13. What is the most common form of business organization?

14. Describe the characteristics of sole proprietorships, partnerships, limited partnerships, and joint ventures by filling in a diagram like the one below.

![Diagram of Business Forms]

Section 3 (pp. 218–223)

15. What makes a corporation different from other forms of businesses such as sole proprietorships and partnerships?

16. Who grants corporate charters?

17. Which group within a corporation chooses the board of directors? What does the board of directors do?

18. How does a franchise operate?
Thinking Like an Economist

19. Use a chart like the one below to help you analyze and classify five or more businesses in your community. Write down a variety of businesses—retailers, service providers, “mom-and-pop” operations, businesses that serve other businesses, franchises, manufacturers, and so on. Conduct research or make educated guesses about each company’s business form (sole proprietorship, partnership, corporation, franchise, etc.) and explain why you think the owner or owners chose each form.

<table>
<thead>
<tr>
<th>Community Businesses</th>
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<tbody>
<tr>
<td>Business name</td>
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<tr>
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</table>

Critical Thinking

20. The BIG Idea What is the main reason entrepreneurs are willing to take huge financial risks to start new businesses?

21. Analyzing Why might a person decide in favor of a partnership rather than a sole proprietorship?

22. Determining Cause and Effect Create a diagram like the one below, and identify three problems in a corporation that might be caused by its complex organizational structure.

Analyzing Visuals

23. Study the cartoon below, and then answer the following questions.
   a. What type of business organization does Globo Tort represent?
   b. What kind of business is the Mom and Pop tortilla shop?
   c. What is the double meaning of the word dough in this cartoon?
**Demand for Oil**  Americans demand oil for many purposes, but mostly as a fuel for their automobiles. According to the Department of Energy, the average American drives a vehicle more than 12,000 miles and uses around 500 gallons of gasoline every year. The United States provides about 35 percent of its own oil. The remaining amount comes from various international sources, as shown in the map below.

- **Canada supplies 16 percent**
- **Mexico supplies 16 percent**
- **Caribbean Nations supply 2 percent**  
  *(Leading Sources: Virgin Islands, Trinidad and Tobago, Netherlands Antilles)*
- **South America supplies 17 percent**  
  *(Leading Sources: Venezuela, Colombia, Ecuador)*

On average, a barrel holding 42 gallons of crude oil produces 21 gallons of gasoline.
Europe supplies 4 percent
(Leading Sources: Great Britain, Norway, Belgium)

Persian Gulf Region supplies 24 percent
(Leading Sources: Saudi Arabia, Iraq, Kuwait)

Africa supplies 16 percent
(Leading Sources: Nigeria, Angola, Algeria)

Other World Sources supply 5 percent

Thinking Globally

1. **Identifying** Which two regions of the world supply the most oil to the United States?

2. **Analyzing** How do you think the amount of oil supplied by a region affects the political situation between that region and the U.S.?

3. **Applying** Choose one country listed in the chart, and then use the Internet to research how much oil that country supplies to the United States. Then research the political relationship between that country and the U.S. How are the two related?
The BIG Idea
The profit motive acts as an incentive for people to produce and sell goods and services.

Why It Matters
Think about the products that you buy most frequently. Are they produced by just one company, or do you have choices about where to buy the items? In this chapter, read to learn how competition—or the lack of it—determines the prices you pay.

Economics ONLINE
Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 9—Chapter Overviews to preview chapter information.
Competition happens when two or more companies strive against each other to convince consumers to buy their products or services. Competition is advantageous to consumers for several reasons. First, it provides us with choices. Competition is advantageous for another reason as well. Having many competing suppliers of a product, like coffee drinks, leads to lower prices. As you can imagine, for this reason each supplier would like to have as little competition as possible.
Market Structure and Perfect Competition

**Main Idea** Market structure refers to the extent of competition within particular markets.

**Economics & You** What if you could go to only one university, one doctor, or one grocery store? This situation is known as a monopoly. Read on to learn about this and other types of market structures.

In Chapter 8 you learned that businesses are often set up based on the number of owners—sole proprietorship, partnership, corporation. In this chapter, you’ll learn that businesses are also categorized by market structure—or the amount of competition they face. Figure 9.1 below shows the four basic market structures in the American economy: perfect competition, monopolistic competition, oligopoly, and monopoly. In this section you’ll learn about the ideal market structure of perfect competition.

All businesses must engage in some form of competition as long as other businesses produce similar goods or services. When a market includes so many sellers of a particular good or service that each seller accounts for a small part of the total market, a special situation exists. Economists term it perfect competition. For perfect competition, also known as pure competition, to take place, five conditions must be met:

**Figure 9.1 Comparing Market Structures**

- Markets that are either perfectly competitive or pure monopolies are rare. Most industries in the United States fit one of the other two forms.

**Perfect Competition**

**Monopolistic Competition**

**Oligopoly**

**Monopoly**

Most competition

Least competition

**Economic Analysis** Deducing What determines the price of goods and services in a perfectly competitive market?
(1) **A Large Market** Numerous buyers and sellers must exist for the product.

(2) **A Nearly Identical Product** The goods or services being sold must be nearly the same.

(3) **Easy Entry and Exit** Sellers already in the market cannot prevent competition, or entrance into the market. In addition, the initial costs of investment are small, and the good or service is easy to learn to produce.

(4) **Easily Obtainable Information** Information about prices, quality, and sources of supply is easy for both buyers and sellers to obtain.

(5) **Independence** The possibility of sellers or buyers working together to control the price is almost nonexistent.

**No Control Over Price** When the above five conditions are met, the workings of supply and demand, rather than a single seller or buyer, control the price. On the supply side, perfect competition requires a large number of suppliers of a nearly identical product. On the demand side, perfect competition requires a large number of buyers who know exactly what the market price is for the good or service.

In a perfectly competitive market, the market price is the equilibrium price. Total supply and total demand are allowed to interact to reach the equilibrium price—the only price at which quantity demanded equals quantity supplied. In a world of perfect competition, each individual seller would accept that price. Because so many buyers and sellers exist, one person attempting to charge a higher or lower price would not affect the market price.

**Information Is Key** True perfect competition is rarely seen in the real world. Nonetheless, fierce competition does exist in many sectors of the economy. The ability of consumers to obtain information is key to sustaining competition. Today, virtually anyone with access to the Internet can find out the lowest prices of just about anything.

**Analyzing** How is the Internet important to maintaining a competitive market structure?
Agriculture as an Example

Main Idea  Agricultural markets come close to a perfectly competitive market structure.

Economics & You  How much does a loaf of bread cost? Does the price ever change much? Read on to learn about how the prices of many agricultural products are determined by the market.

Few perfectly competitive industries exist in the United States. One that comes close is the agricultural market. It is often used as an example of perfect competition because farmers have almost no control over the market price of their goods. (See Figure 9.2.)

No Control Over Wheat Prices  No single wheat farmer has any great influence on wheat prices. The market price for wheat is determined by the interaction of supply and demand, and individual wheat farmers have to accept the market price. If the price is $3 per bushel, that is the price every farmer receives. Farmers who attempt to raise their price above $3 will find that no one will buy their wheat. Farmers will not be willing to sell their wheat for less than $3 per bushel.

Unique Situation  The total demand for wheat and other agricultural products is somewhat different from the demand for many other products. People’s demand for wheat is relatively inelastic—even if the price of wheat were to increase or drop, quantity demanded would not change significantly. The supply side of most agricultural markets is also unique. It is highly dependent on conditions over which farmers have little or no control, such as weather and crop disease.

Figure 9.2  A Classic Example

Because the wheat market meets all of the conditions needed for perfect competition, as shown in this table, it is often used as an example of a perfectly competitive industry. True perfect competition, though, is rarely seen in the real world.

Economic Analysis

Analyzing  Do you agree that the wheat market meets all five of the conditions listed here? Why or why not?

The Wheat Market as a Perfect Competitor

1. A Large Market  Thousands of wheat farmers grow wheat, and thousands of wholesalers buy wheat.
2. A Nearly Identical Product  All wheat is fairly similar.
3. Easy Entry and Exit  The costs of renting farmland are relatively low, and farming methods can be learned.
4. Easily Obtainable Information  Information about wheat prices is fairly easy to obtain. Indeed, it can be obtained on the Internet in a few seconds.
5. Independence  The possibility of thousands of wheat farmers banding together to control prices is very small.
Benefits to Society  The intense competition in a perfectly competitive industry forces the price down to one that just covers the costs of production plus a small profit. This price is beneficial to consumers because it means that they are paying only for what has been put in to make those products—the opportunity cost of the use of land, labor, capital, and entrepreneurship. The price that consumers pay for products under perfect competition is a correct signal about the value of those products in society.

Perfectly competitive industries yield economic efficiency. All inputs are used in the most advantageous way possible, and society therefore enjoys an efficient allocation of productive resources.

Explaining  What makes the demand for agricultural products unique?

Vocabulary
1. Explain the significance of: market structure, perfect competition.

Main Ideas
2. Summarizing  In a table like the one below, list the conditions that must be met for perfect competition to exist.

<table>
<thead>
<tr>
<th>Perfect Competition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
</tr>
<tr>
<td>4.</td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea  Explain how perfect competition tends to drive down profits.

4. Analyzing  Is there any way for a seller in a perfectly competitive market to raise prices?

5. Deducing  Why is perfect competition such a rare market structure?

Applying Economics
6. Perfect Competition  Explain how a local fast-food restaurant manager faces almost perfect competition in the demand for high-school employee labor.

Effects on Supply
Variations in weather, including natural disasters like floods, can wipe out entire harvests. So can crop diseases and crop-destroying insects. This means that farmers may have a good harvest one year and a poor harvest the next. As a result, there are widely fluctuating supplies of goods in the agricultural market.
GUIDE TO READING

Section Preview
In this section, you will learn about three types of imperfect market structures: monopoly, oligopoly, and monopolistic competition.

Content Vocabulary
- monopoly (p. 237)
- barriers to entry (p. 237)
- economies of scale (p. 238)
- patent (p. 238)
- copyright (p. 238)
- oligopoly (p. 240)
- product differentiation (p. 241)
- cartel (p. 241)
- monopolistic competition (p. 242)

Academic Vocabulary
- revolution (p. 239)
- dominate (p. 240)

Reading Strategy
Comparing and Contrasting  Use a table like the one below to describe how much competition the seller faces and how much control over price he or she has in each type of market structure listed.

<table>
<thead>
<tr>
<th></th>
<th>Competition</th>
<th>Control Over Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monopoly</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oligopoly</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monopolistic Competition</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

ISSues In The NeWS
—from BusinessWeek

TAMING THE GIANT  For 14 years, one regulator or another has chased after Microsoft—mostly unsuccessfully. In 1990, the Federal Trade Commission launched an investigation into a long list of allegedly predatory practices. The probe was dropped. In 1998, the Justice Dept. tried to prevent Microsoft from using its Windows monopoly to corner the emerging web browser market. Microsoft fought back and got only a slap on the wrist. Now European regulators are taking their shot at restraining the software giant.

In its March 24 ruling, the European Union labeled Microsoft an abusive monopolist and issued a sweeping set of penalties. . . . The EU ruled that Microsoft must share their technical information with rivals that will help their server software work better with Windows.

As mentioned in Section 1, perfect competition is an idealized type of market structure. Most industries in the United States, in contrast, represent some form of imperfect competition. Economists classify these three types of imperfect market structures as monopoly, oligopoly, or monopolistic competition. In this section, you’ll learn how they differ from one another.
Monopoly

Main Idea A monopoly exists when a single seller controls the supply of a good or service and largely determines its price.

Economics & You Have you ever played the board game Monopoly? What is the object of the game? Read on to learn the characteristics and objectives of monopolies.

The most extreme form of imperfect competition is a pure monopoly, in which a single seller controls the supply of the good or service and thus determines its price. A few such markets do exist in the real world. For example, some local electric utility companies are the sole providers for a community. See Figure 9.3 below for a description of the four characteristics of a monopoly.

In a pure monopoly, the supplier can raise prices without fear of losing business, because buyers have nowhere else to go to buy the good or service. A monopolist, however, cannot charge outrageous prices, as the law of demand is still operating. As the price of a good or service rises, consumers buy less.

If a monopoly is collecting all the profits in a particular industry, why don’t other businesses rush in to get a share of those profits? A monopoly is protected by barriers to entry—obstacles that prevent others from entering the market. State laws that prevent competing utility companies from entering the market are one example of a barrier to entry.

Another barrier to entry is the cost of getting started. Called “excessive money capital costs,” this barrier is found in industries such as automobiles and steel.

Figure 9.3 A Monopoly Market Structure

- A monopoly exists when a single seller controls the supply of a good or service and largely determines its price. Four major characteristics define a monopoly.

### Characteristics of a Monopoly

1. **A Single Seller** Only one seller exists for a good or service.
2. **No Substitutes** There are no close substitutes for the good or service that the monopolist sells.
3. **Barriers to Entry** The monopolist is protected by obstacles to competition that prevent others from entering the market.
4. **Almost Complete Control of Market Price** By controlling the available supply, the monopolist can control the market price.

**Economic Analysis**

**Listing** What are some examples of barriers to entry?
Types of Monopolies  Pure monopolies can be separated into four categories depending on why the monopoly exists. The four types of monopolies are natural, geographic, technological, and government, as shown in Figure 9.4 below.

First, we have natural monopolies, where the government grants exclusive rights to companies that provide things like utilities, bus service, and cable TV. The justification for natural monopolies is that a larger firm can often use its factors of production more efficiently. The large size, or scale, of most natural monopolies gives them economies of scale—by which they can produce large amounts of their good or service at a relatively low cost.

A geographic monopoly is another kind of monopoly. A country store in a lightly populated area is an example of this. Because the setting of the business is isolated and the potential for profits is so small, other businesses choose not to enter the market.

If you invent something, you are capable of having a technological monopoly over your invention. A government patent gives you the exclusive right to manufacture, rent, or sell your invention for a specified number of years—usually 20. Similarly, a United States copyright protects art, literature, song lyrics, and other creative works for the life of the author plus 70 years.

**Figure 9.4  Types of Monopolies**

- Pure monopolies can be separated into four categories depending on why the monopoly exists.

**A. Natural Monopoly**  In many major U.S. cities, bus service is a natural monopoly, granted exclusive rights by local governments to provide this service.

**B. Geographic Monopoly**  A country store in a lightly populated area is an example of a geographic monopoly. Other businesses choose not to enter the market because there is a small customer base and little potential for profits.
Finally, we have government monopolies. A government monopoly is similar to a natural monopoly, except the monopoly is held by the government itself. The construction and maintenance of roads and bridges, for example, are the responsibility of local, state, and national governments, who contract this work out to companies. In the United States, the postal service is a common example of a government monopoly.

Monopolies today are far less important than they once were. Geographic monopolies, for example, have much less effect now than they did in the past because of potential competition from mail-order businesses and electronic commerce on the Internet. More and more natural monopolies are being broken up by the introduction of new technologies and government deregulation.

Technological monopolies rarely last longer than the life of the patent—if even that long. Why? Competitors can make and patent slight variations in new products quickly. The microcomputer revolution in the early 1980s followed such a pattern. One company copied another’s product, making changes and adding features to obtain a patent of its own.

**Summarizing** What are the four types of monopolies, and what are their major characteristics?

**C. Technological Monopoly**
The Microsoft Windows operating system is an example of a technological monopoly.

**D. Government Monopoly**
In a government monopoly, local, state, and national governments themselves hold exclusive rights to contract out work like highway and bridge construction.

**Economic Analysis**
**Determining Cause and Effect** What factors have led to the decline of the power of monopolies in recent years?
An oligopoly exists when an industry is dominated by a few suppliers that exercise some control over price.

Economics & You  How many domestic car companies can you name? How many soft drink companies? Read on to learn more about this type of industry, in which a few sellers dominate the market.

Unlike a monopoly with just one supplier, an oligopoly is an industry dominated by several suppliers who exercise some control over price. See Figure 9.5 below for a description of the five characteristics of an oligopoly.

Oligopolies are not considered as harmful to consumers as monopolies. Consumers may pay more than if they were buying in a perfectly competitive market, but oligopolistic markets tend to have generally stable prices. They also offer consumers a wider variety of products than would a perfectly competitive industry. (See Figure 9.6.)

Product Differentiation  Oligopolists engage in nonprice competition. What does this mean? Let’s use automobiles as an example. Several large auto manufacturers have an oligopoly on the domestic car market. They all make cars, trucks, and sport utility vehicles. They spend millions, if not billions, of advertising dollars per year to differentiate their products in your mind—and to win your consumer dollars.

Skills Handbook
See page R44 to learn about Detecting Bias.
The price you pay for brand names is not just based on supply and demand. Rather, it is based on product differentiation—the real or perceived differences in the good or service that make it more valuable in consumers’ eyes.

**Interdependent Behavior** With so few firms in an oligopoly, whatever one does, the others are sure to follow. When one domestic airline cuts its airfares to gain market share, for example, the other major domestic airlines lower theirs even more. Although this type of price war is initially good for consumers in the form of lower prices, it may force an airline out of business if prices drop too much. Fewer airlines leads to less competition, which may raise prices in the long run.

In contrast, if competing firms in an oligopoly secretly agree to raise prices or to divide the market, they are performing an illegal act called collusion. Heavy penalties, such as fines and even prison terms, are levied against companies found guilty of collusion in the United States. One significant form of collusion is the cartel. A cartel is an arrangement among groups of industrial businesses, often in different countries, to reduce international competition by controlling price, production, and the distribution of goods. Such firms seek monopolistic power.

**Predicting Consequences** What is a price war? What are its effects on the consumer?
Monopolistic Competition

Main Idea  Monopolistic competition exists when a large number of sellers offer similar but slightly different products, and each firm has some control over price.

Economics & You  What makes you buy one brand of toothpaste over another brand that costs the same? Read on to learn about the role that advertising plays in monopolistic competition.

The most common form of market structure in the United States is monopolistic competition, in which a relatively large number of sellers offer similar but slightly different products or services. Obvious examples are brand-name items such as toothpaste, cosmetics, and designer clothes. See Figure 9.7 below for a description of the five characteristics of monopolistic competition.

Many of the characteristics of monopolistic competition are the same as those of an oligopoly. The major difference is in the number of sellers of a product. As you recall, in an oligopoly a few companies dominate an industry, and control over price is interdependent. In contrast, monopolistic competition has many firms, no real interdependence, and some slight difference among products. In this market structure, if a company succeeds in building brand loyalty for a product, the company gains a certain amount of influence over the market. It can raise the price of the product slightly without losing a great many customers.

---

**Figure 9.7  Market Structure of Monopolistic Competition**

- Monopolistic competition exists when a large number of sellers offer similar but slightly different products, and each firm has some control over price. Five major characteristics define monopolistic competition.

**Economic Analysis**

**Identifying**  What is the main way companies achieve product differentiation?

---

**Characteristics of Monopolistic Competition**

1. **Numerous Sellers**  No single seller or small group dominates the market.
2. **Relatively Easy Entry**  Entry into the market is easier than in a monopoly or oligopoly. One drawback is the high cost of advertising.
3. **Differentiated Products**  Each supplier sells a slightly different product to attract customers.
4. **Nonprice Competition**  Businesses compete by using product differentiation and by advertising.
5. **Some Control Over Price**  By building a loyal customer base through product differentiation, each firm has some control over the price it charges.
Because of the need to build brand loyalty, competitive advertising is even more important in monopolistic competition than it is in oligopolies. Advertising attempts to persuade consumers that the product being advertised is different from, and superior to, any other. When successful, advertising enables companies to charge more for their products. That’s why companies like Nike, The Gap, and Procter & Gamble pour millions of dollars into their advertising budgets every year.

The heavy advertising required by monopolistic competition has both critics and defenders. Critics claim that it induces consumers to spend more on products than they normally would just because of the name associated with them. Defenders argue that brand names can represent a guarantee of quality, and that advertising helps reduce the cost to consumers of weighing the trade-offs of numerous competing brands.

**Contrasting** How is monopolistic competition different from an oligopoly?

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### Vocabulary

1. **Explain** the significance of: monopoly, barriers to entry, economies of scale, patent, copyright, oligopoly, product differentiation, cartel, monopolistic competition.

### Main Ideas

2. **Describing** Copy the diagram below, and under each box, write a characteristic that fits the type of monopoly listed.

   - Geographic
   - Natural
   - Gov’t
   - Tech

### Critical Thinking

3. **The BIG Idea** Profits are determined by price. Explain how product differentiation is used to try to increase profits.

4. **Identifying** Name two barriers to entry that keep potential competitors out of a market.

### Applying Economics

5. **Product Differentiation** Give three examples of products you bought recently because advertising convinced you to buy them. What was it about these products that convinced you to buy them rather than other, similar products?
Bill Gates dropped out of Harvard in his junior year. He did so in order to devote all his time to the company he’d recently founded with his old school pal, Paul Allen. That company was Microsoft Corporation.

Gates and Allen became friends at Lakeside School in Seattle, Washington. Bill wasn’t sure he wanted to attend that particular school:

“In those days, Lakeside was an all-boys school where you wore a jacket and tie, called your teachers ‘master,’ and went to chapel every morning. For a while, I even thought about failing the entrance exam [on purpose].”

But he decided to do his best and was admitted into the seventh grade. This was in the late 1960s, and there was no such thing as a personal computer. Nevertheless, Gates and Allen became early computer enthusiasts. Not only did the two learn more than anyone about the fundamentals of computing programming, but they invented it as they went along.

Even back then they were certain there was a future in personal computers, and together they wrote the first ever microcomputer BASIC program. They had guessed right, and 30 years after its founding, their once-tiny company had annual revenues of nearly $40 billion. Does Gates see an end in sight? Not at all.

“[S]oftware has moved to the center . . . for communications, for creativity, and for visualization, and it’s amazing to see how far software has come and yet how much more we need to do.”

Checking for Understanding
1. **Explaining** What does Gates mean when he talks about “visualization” in the software industry?

2. **Speculating** Do you believe there is still a place for innovators in the software industry?
Government Policies Toward Competition

**GUIDE TO READING**

**Section Preview**
In this section, you will learn about steps the government has taken to regulate business practices.

**Content Vocabulary**
- interlocking directorate (p. 246)
- antitrust legislation (p. 246)
- merger (p. 247)
- conglomerate (p. 247)
- deregulation (p. 248)

**Academic Vocabulary**
- prohibit (p. 246)
- promote (p. 248)

**Reading Strategy**
**Organizing** As you read the section, complete a diagram like the one below by listing examples of federal regulatory agencies.

---

**ISSues In ThE NeWS**
---from the *Columbus Dispatch*

**AIRLINE BAILOUTS** In most industries, it works this way: The successful thrive, and the sick don’t survive. But in the airline business, it isn’t as simple. The sick take refuge in bankruptcy court—sometimes more than once—and survive in a smaller, usually weaker form, to fly another day.

That’s the potential scenario behind a coincidence in which Delta Airlines and Northwest Airlines filed for Chapter 11 [bankruptcy] protection, becoming the third and fourth major carriers to file for bankruptcy even as the overall economy is healthy.

There are some economists and restructuring experts who look at the phenomenon of airline bankruptcies and argue that the U.S. court system isn’t doing the industry any favors by intervening in what should be a Darwinian process. . . . The cash grants and loan guarantees simply [allow] struggling carriers to postpone the day of reckoning.

---

**Historically,** one of the goals of government in the United States has been to encourage competition in the economy. Does the federal government’s bailout of various airlines work toward that goal? Should the government intervene in such cases? In this section, you’ll learn about the federal laws and regulatory agencies that attempt to force monopolies to act more competitively.
The goal of antitrust legislation is to encourage competition in the economy and to prevent unfair trade practices.  

**Economics & You** How do you think people in your community would react to an oil monopoly today? Why? Read on to learn about how public pressure caused the government to take the first steps to regulating business over a hundred years ago.

The industrial expansion after the Civil War fueled the rise of big businesses. John D. Rockefeller’s Standard Oil Company at the end of the nineteenth century was the most notorious for driving competitors out of business and pressuring customers not to deal with rival oil companies. He also placed members of Standard Oil’s board of directors onto the board of a competing corporation. Because the same group of people, in effect, controlled both companies, it was less tempting for them to compete with one another. This practice of creating *interlocking directorates* was perfected by Rockefeller.

Public pressure against Rockefeller’s monopoly, or trust, over the oil business led Congress to pass the *Sherman Antitrust Act* in 1890. The law sought to protect trade and commerce against unlawful restraint and monopoly. This act was important *antitrust legislation*, or laws to prevent new monopolies or trusts from forming and to break up those that already exist.

Because the language of the Sherman Act was so vague, a new law was passed in 1914 to sharpen its antitrust provisions. The *Clayton Act* prohibited or limited a number of very specific business practices that lessened competition substantially. The Clayton Act, however, does not state what the term *substantially* means. As a result, it is up to the federal courts and agencies to make a subjective decision as to whether the merging of two corporations would substantially lessen competition.

**A Former Monopoly**

American Telephone & Telegraph (AT&T) was once the nation’s largest corporation and held a natural monopoly on telephone service. In 1984, “Ma Bell,” as the company was called, was broken up after the settlement of a lawsuit filed by the federal government. Today, the telephone service industry is highly competitive, especially since cell and digital phones have entered the market.
Most antitrust legislation deals with restricting the harmful effects of mergers. A **merger** occurs when two or more companies combine into one corporation. As shown in Figure 9.8 above, three kinds of mergers exist: horizontal, vertical, and conglomerate.

When the corporations that merge are in the same business, a **horizontal merger** has occurred. An example of a horizontal merger occurs when DVD Store A buys DVD Store B. When corporations involved in a “chain” of supply merge, this is called a **vertical merger**. An example would be a paper company buying the lumber mill that supplies it with pulp or buying the office supply business that sells its paper. Another type of merger is the conglomerate merger. A **conglomerate** is a huge corporation involved in at least four or more unrelated businesses. Procter & Gamble, for example, is a multinational conglomerate, with operations in more than 160 countries.

**Contrasting** Explain the difference between horizontal and vertical mergers.

**merger**: the legal combination of two or more companies that become one corporation

**conglomerate**: large corporation made up of smaller corporations dealing in unrelated businesses
Government Regulation

Main Idea The aim of government regulatory agencies is to promote efficiency, competition, fairness, and safety.

Economics & You When you apply for a job, can an employer turn you down because of your race, gender, or ethnicity? Why or why not? Read on to learn about the government’s regulatory agencies.

Besides using antitrust laws to foster a competitive atmosphere, the government uses direct regulation of business pricing and product quality. The chart below lists several regulatory agencies that oversee various industries and services. These agencies exist at the federal, state, and even local levels.

Although the aim of government regulations is to promote efficiency and competition, recent evidence indicates that something quite different has occurred. In the 1980s and 1990s, many industries were deregulated—the government reduced regulations and control over business activity. It was found that in trying to protect consumers from unfair practices, government regulations had actually decreased the amount of competition in the economy.

As an example, the Federal Communications Commission (FCC) had for years regulated the basic channels in the television market. With deregulation came the entry of competitive pay-TV, cable, and satellite systems.

deregulation: reduction of government regulation and control over business activity

<table>
<thead>
<tr>
<th>Agency</th>
<th>Function</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Trade Commission (FTC) (1914)</td>
<td>Regulates product warranties, unfair methods of competition in interstate commerce, and fraud in advertising.</td>
</tr>
<tr>
<td>Food and Drug Administration (FDA) (1927)</td>
<td>Regulates purity and safety of foods, drugs, and cosmetics.</td>
</tr>
<tr>
<td>Federal Communications Commission (FCC) (1934)</td>
<td>Regulates television, radio, telegraph, and telephone; grants licenses, creates and enforces rules of behavior for broadcasting; most recently, partly regulates satellite transmissions and cable TV.</td>
</tr>
<tr>
<td>Securities and Exchange Commission (SEC) (1934)</td>
<td>Regulates the sale of stocks, bonds, and other investments.</td>
</tr>
<tr>
<td>Equal Employment Opportunity Commission (EEOC) (1964)</td>
<td>Responsible for working to reduce workplace discrimination based on religion, gender, race, national origin, or age.</td>
</tr>
<tr>
<td>Occupational Safety and Health Administration (OSHA) (1970)</td>
<td>Regulates workplace environment; makes sure that businesses provide workers with safe and healthful working conditions.</td>
</tr>
<tr>
<td>Environmental Protection Agency (EPA) (1970)</td>
<td>Develops and enforces environmental standards for air, water, and toxic waste.</td>
</tr>
<tr>
<td>Nuclear Regulatory Commission (NRC) (1974)</td>
<td>Regulates the nuclear power industry; licenses and oversees the design, construction, and operation of nuclear power plants.</td>
</tr>
</tbody>
</table>
Many economists speculate about what would happen if the government removed its watchdog responsibility toward mergers in general. Economists assume prices would rise. If, however, the price increases caused profits to be excessive, other sellers would find ways to enter the market. Consumers would benefit eventually from a competitive supply of goods and services. Also, with increased global competition, domestic firms cannot raise prices without attracting foreign rivals. Indeed, global competition has become the biggest competitive threat to many American companies. The few domestic car producers have been battered by foreign competitors. Toyota, Honda, and others have created financial problems for General Motors and Ford.

Determining Cause and Effect What is one potentially negative result of government regulations?

Government deregulation of the airline industry was designed to lower the price of air travel, but the cartoonist believes this deregulation also had negative consequences.

Bruce Plante, The Chattanooga Times

section 3

Review

Vocabulary
1. Explain the significance of: interlocking directorate, antitrust legislation, merger, conglomerate, deregulation.

Main Ideas
2. Comparing and Contrasting Complete the chart below by listing some advantages and disadvantages of government control of business.

<table>
<thead>
<tr>
<th></th>
<th>Regulation</th>
<th>Deregulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantages</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Disadvantages</td>
<td></td>
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</tbody>
</table>

Critical Thinking
3. The BIG Idea Explain how the Sherman Antitrust Act and the Clayton Act limited profits for some businesses.

4. Determining Cause and Effect How might a merger help a business be more efficient and increase profits?

Applying Economics
5. Conglomerates Type “conglomerate” into an Internet search engine. Research one of the conglomerates that you find, and list all of the businesses or products owned by that conglomerate.
Antitrust rulings aim to open Microsoft’s Windows to competitors’ products.

Check It Out! In this chapter you learned about monopolies. This article discusses the technological monopoly that Microsoft holds and the antitrust cases trying to change that.

The long-running antitrust battle between Microsoft and the European Commission (EC) revolves around two separate issues: Microsoft’s bundling of its Media Player into Windows, and whether the company must disclose secret software protocols to rivals.

Microsoft’s argument is analogous to shoes and shoelaces. While consumers can and do buy shoelaces separately, they also expect at least one pair to be included when they buy new shoes. The company will argue that modern consumers similarly now demand a media player built into the operating system.

The arguments over server interoperability are more complex. Microsoft claims it shouldn’t be forced to disclose its server interface information because the software makers who want to use it aim to enhance their existing products to compete against Microsoft.

Microsoft’s rivals, naturally, take a different view. While courts largely lean towards protecting the intellectual property rights of inventors, things change when the holder of the copyright or patent is a monopolist with the ability to shape markets.

—Reprinted from BusinessWeek

Think About It
1. **Discussing** What arguments does Microsoft use to justify its technological monopoly?
2. **Assessing** According to the article, why might the intellectual property of Microsoft not be protected?
Of the **four basic market structures**, perfect competition and monopolies are rare, while monopolistic competition and oligopolies are much more common.

The **level of competitiveness** in a particular market is determined by several factors.

**Government regulatory agencies** seek to promote efficiency, competition, fairness, and safety.
Review Content Vocabulary

1. Write a paragraph or two explaining market structures and their characteristics. Use all of the following terms.

- market structure
- perfect competition
- monopoly
- oligopoly
- monopolistic competition
- cartel
- barriers to entry
- economies of scale

2. Now write a paragraph summarizing how the government tries to regulate unfair business practices. Use all of the following terms.

- antitrust legislation
- merger
- conglomerate
- deregulation

Review the Main Ideas

**Section 1** (pp. 231–235)

10. What five conditions are necessary for perfect competition to exist?

11. In a perfectly competitive market structure, how much control does a single seller have over market price?

12. What is one example of an almost perfectly competitive market?

**Section 2** (pp. 236–243)

13. What are the three types of market structures with imperfect competition?

14. Fill in a graphic organizer like the one below to list and describe the four categories of pure monopolies.

![Types of Monopolies Diagram]

15. How much control does an oligopoly have over price? Why?

16. What are the differences between an oligopoly and monopolistic competition?

**Section 3** (pp. 245–249)

17. What is the difference between a horizontal merger and a vertical merger?

18. What two methods does the federal government use to keep businesses competitive?
Thinking Like an Economist

List some industries that are regulated by government (common examples include electricity providers, broadcast television, airlines). Choose one, and then fill in a chart like the one below to help you analyze the advantages and disadvantages of government regulation of this industry. Then answer the questions that follow.

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td></td>
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</tbody>
</table>

19. In your opinion, should this industry be regulated by the government? Why or why not?

20. What would happen if this industry were to be completely deregulated? Justify your opinion with logical arguments and examples.

Critical Thinking

21. The BIG Idea Why is more competition generally good for consumers? What effect does competition have on suppliers?

22. Explaining Why are oligopolies typically interdependent?

23. Contrasting What are the basic differences between the goals of antitrust legislation and the goals of federal government regulatory agencies?

24. Predicting In a situation of perfect competition, what would happen if barriers to entry in the market suddenly sprang up?

Analyzing Visuals

25. Study the cartoon on the right, and then answer the following questions.

   a. Who do the two men pictured in this cartoon represent?
   
   b. What has happened to the speaker’s competition?
   
   c. With what crime does the cartoon imply the man has been charged?
Debating Economic Issues

Should price gougers be punished?

“Price gouging” is what happens when businesses sharply raise the prices of essential goods such as food, clothing, shelter, medicine, gasoline, and equipment needed to preserve lives and property during emergencies. After Hurricane Katrina in 2005, oil companies hiked the average price of gasoline by one-third or more, blaming damage to refineries in the Gulf of Mexico and increases in the price they paid for crude oil. Consumers complained that the price increases amounted to unjustifiable profits for the oil companies. In some states, price gouging is a felony, but few companies are actually penalized. Should laws against price gouging be toughened and enforced?

NO!
All prices should be determined by supply and demand

Prices are not just arbitrary numbers plucked out of the air. Nor are the price levels that you happen to be used to any more special or “fair” than other prices that are higher or lower. . . . The new prices make as much economic sense under the new conditions as the old prices made under the old conditions.

What do prices do? They not only allow sellers to recover their costs, they force buyers to restrict how much they demand. . . . What if [hotel] prices were frozen where they were before [Katrina] happened? . . . At higher prices, a family that might have rented one room for the parents and another for the children will now double up in just one room because of the “exorbitant” prices. That leaves another room for someone else. It is essentially the same story when stores are selling ice, plywood, gasoline, or other things for prices that reflect today’s supply and demand, rather than yesterday’s supply and demand. Price controls will not cause new supplies to be rushed in nearly as fast as higher prices will.

—Thomas Sowell, economist
The health of the nation’s economy depends on regulating gas prices

At best, 10 percent of production was shut down [after Hurricane Katrina hit]. . . . That’s 10 percent of one-fourth of U.S. demand—a tiny amount . . . while gas prices rose 25–35 percent and even more in some areas. Not often mentioned . . . was the fact that the world price of oil actually fell by almost 10 percent over the same period.

. . . When the per barrel price of crude falls, the price at the pump hangs at its high level, sometimes for weeks, but if crude goes up, so does the pump price. Consumers can’t shop for bargains, because all gas stations behave the same way. For the most part, though, it’s not the stations that are doing this gouging . . . but rather the oil companies themselves.

. . . If Congress and the White House were serious about combating price rigging, coordinated production slowdowns, and artificial scarcities, they would be changing the anti-trust laws so that the objective existence of anti-competitive pricing and production alone would be illegal, not just [the current requirement of] deliberate conspiring to fix prices.

—Dave Lindorff, author, This Can’t Be Happening: Resisting the Disintegration of American Democracy

Debating the Issue

1. Explaining  How do high gasoline prices affect American families?

2. Choosing Sides  Do you believe oil companies should be allowed to charge whatever people will pay for gasoline? Why or why not?

Find Out More!

3. Analyzing  Using the Internet or other resources, learn more about alternatives to paying high prices for gasoline. Which solution or solutions do you think would best solve the problem?
Microeconomics: American Business In Action

Chapter 10
Financing and Producing Goods

Chapter 11
Marketing and Distribution

Chapter 12
The American Labor Force

In this unit, read to find out...

- how businesses obtain financing and produce goods.
- how those goods are marketed and distributed to you as a consumer.
- who makes up the American labor force.
Ch 10 Financing and Producing Goods

The BIG Idea
The profit motive acts as an incentive for people to produce and sell goods and services.

Why It Matters
Imagine that you want to start your own business. What type of good or service would you produce? In this chapter, read to learn how companies obtain the financing needed to open for business, and how they try to work efficiently to make profits.

Economics ONLINE
Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 10—Chapter Overviews to preview chapter information.
If you were an entrepreneur, you would face many hurdles on your road to success. One hurdle would be finding sufficient financing to pay for your company’s current needs, such as parts and tools, and its long-term needs, such as growth. As you read this section, you’ll learn that both the short-term and long-term needs of businesses can be financed in a variety of ways.
Before You Pursue Financing

Main Idea Businesses should expand if the benefits of doing so exceed the costs.

Economics & You Have you ever taken a risk? Did you weigh the cost of the action against the potential benefits? Read on to learn about the factors businesses must consider before deciding to risk expansion.

Financing refers to the obtaining of funds, or money capital. Financing business operations and growth is an integral part of our free-enterprise system. It all begins with people who save by depositing their funds in one of several types of financial institutions, which you learned about in Chapter 6. The financial institutions, in turn, make these deposits available to businesses to finance growth and expansion.

Let’s assume that you own an electronics repair company that you have incorporated. You now have the opportunity to open additional repair shops in other locations, but you do not have enough extra funds to invest in the expansion. You can obtain this financing in many ways. These include digging into your own personal savings, asking your friends and family to loan funds to the company, borrowing from a financial institution, or selling more shares of stock. Even if you are able to finance the expansion, however, one important question remains. Should you expand?

financing: obtaining funds or money capital for business expansion

Staying in the Family

Many small businesses, such as neighborhood delis, receive financing from family and friends of the owner or owners.

Personal Finance Handbook
See pages R14–R15 for more information on taking out loans.
Businesses usually answer this question by making a standard **cost-benefit analysis**. (See **Figure 10.1** above.) You estimate the cost of any action and compare it with the benefits of that action. Developing a cost-benefit analysis involves five steps:

1. Estimate the costs of expansion.
2. Calculate expected revenues, or total income from sales.
3. Calculate expected profits, or revenues minus costs.
4. Calculate how much it will cost you to borrow funds to finance your proposed business expansion.
5. If expected profits more than cover the cost of financing the expansion, then the expansion may be warranted.

Here is a simple numerical example: Suppose that you can borrow $1 million to finance your business expansion. Your bank will charge 10 percent per year for the loan. That equals $100,000 per year. If your expansion generates profits of $200,000 per year, then borrowing $1 million would be worthwhile.

**Economic Analysis**

**Explaining** What is the difference between revenues and profits?

- **Costs Could Include:**
  - Renting new stores
  - Opportunity cost of more time spent working
  - Training new workers
  - New taxes
  - Additional bookkeeping
  - Additional inventory
  - Additional insurance
  - Meeting government regulations
  - Utilities

**Reading Check**

Identifying What are four methods businesses can use to obtain financing for expansion?
Why People Are Willing to Finance Investment

**Main Idea** Savings should be invested where they will get the highest expected rates of return in the form of interest or profits.

**Economics & You** Would you be willing to risk your savings gambling? Why or why not? Read on to learn about why people decide to risk financing business investments.

Businesses are interested in obtaining financing so that they can expand and make higher profits in the future. The people who finance such business investments—whether intentionally or unintentionally—are also seeking rewards. Such rewards can take several different forms.

Savers unintentionally finance business growth when they deposit funds in a savings account or certificate of deposit (CD). Their reward is the interest earned on the savings account or CD, as **Figure 10.2** below illustrates. For those who intentionally finance investment, the reward is the interest on a corporate bond that they purchase, or dividends from the stock that they buy in an expanding company.

**Pursuing Investment Financing** When one business succeeds at obtaining financing, it uses funds that might have helped another business. In a market economy, each business competes for scarce financial resources.

---

**Figure 10.2 Financing Business Expansion**

- Businesses are able to obtain financing because you (and other income earners) do not spend all that you earn during a year. Through saving, you and others who save make resources available to finance business expansion in the United States.

- People deposit savings to get interest.

- Financial Institutions loan savings funds to businesses.

- Businesses use savings funds to expand and improve.

- Interest is returned to saver/depositor.

**Economic Analysis**

**Synthesizing** On what specific things or activities might businesses spend financing funds?
If the cost to finance business expansion is relatively high, only those businesses that believe they have the most profitable expansion projects will be willing to pay the high cost of financing. If the cost of financing is relatively low, on the other hand, more companies will decide that they, too, can profitably engage in additional business investment. In either instance, the lending institution makes the final decision regarding lending the business the funds to expand.

**Methods of Financing** There are several methods of financing business expansion. As you learned in Chapter 6, corporations offer stock and may sell bonds to finance investment. Businesses, just like individuals, can also borrow from banks, finance companies, or other institutions. Today businesses can even use the Internet to obtain financing. In Section 2, you’ll learn more about the types of financing for business operations.

**Predicting Consequences** When savers unintentionally finance business growth, what reward do they receive? What is the reward for those who intentionally finance investment?

---

### Vocabulary Review

1. **Explain** the significance of: financing, cost-benefit analysis, revenues, profits.

### Main Ideas

2. **Identifying** Use a web diagram like the one below to list the steps involved in cost-benefit analysis.

3. **Contrasting** What is the difference between profit and revenue?

### Critical Thinking

4. **The BIG Idea** What is the profit rule used in cost-benefit analysis to decide whether or not to build or expand a business?

5. **Determining Cause and Effect** What are two ways people who finance a business can obtain profits?

### Applying Economics

6. **Financial Institutions** Use your own specific saving habits to create a chart similar to the one in Figure 10.2 on page 262. Include arrows showing in what type of financial institution your savings go or would go, and what your reward for saving is or would be.
GUIDE TO READING

Section Preview
In this section, you will learn about the three types of financing available to businesses: short-term, intermediate-term, and long-term.

Content Vocabulary
- debt financing (p. 265)
- short-term financing (p. 265)
- intermediate-term financing (p. 266)
- long-term financing (p. 267)

Academic Vocabulary
- undergo (p. 264)
- adequate (p. 266)

Reading Strategy
Organizing As you read, complete a table similar to the one below by filling in definitions and examples for the types of financing listed.

<table>
<thead>
<tr>
<th>Type of Financing</th>
<th>Definition</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term</td>
<td></td>
<td></td>
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<tr>
<td>Intermediate-term</td>
<td></td>
<td></td>
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<tr>
<td>Long-term</td>
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</tbody>
</table>

ISSues In ThE NeWS
—from Entrepreneur.com

MAXED OUT We asked our 2005 young millionaires how they financed their business, and what advice they could offer on getting financing. [Here’s what] Joel Boblit, 29, the founder of BigBadToyStore Inc., an online toy retailer specializing in collectible action figures, [had to say]:

“It was financed through credit cards and mortgaging everything we owned for the first two years. We financially went all in. I was actually in debt when I started the business, and my family had no extra assets, so we did it all completely on credit and high-interest loans. . . . We were probably up to $300,000 at the highest point in short-term loan and credit card debt, but we were also growing exponentially the first few years, so I didn’t feel too bad about it. But there is a definite risk involved.”

Businesses, like individuals, must undergo a certain process when borrowing funds. A business that wants to borrow must show creditworthiness by undergoing a credit check. Also, a business, like an individual, must pay interest on loans and repay them within a stated period of time. As you read this section, you’ll learn about the financing options from which businesses may choose.
Three Kinds of Financing

Main Idea When a business needs to borrow, it can use a variety of short-term, intermediate-term, or long-term financing.

Economics & You You may need to borrow to pay for college or other events. Is it better to borrow for the short term or long term? Read on to learn about the types of financing available to businesses.

Raising funds for a business through borrowing, or debt financing, can be divided into three categories: short-term, intermediate-term, and long-term financing.

Short-Term Financing When a business borrows funds for any period of time less than a year, it has obtained short-term financing. The chart below describes several types of short-term financing. A business may seek short-term financing for many reasons. A company may have excellent business during the month but not be paid until the beginning of the following month. In the meantime, the company needs funds to pay salaries and its bills. During a growing season, a farmer may have to borrow to buy seed, repair equipment, and pay workers.

---

<table>
<thead>
<tr>
<th>Short-Term Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trade Credit</strong></td>
</tr>
<tr>
<td>Trade credit is extended by one firm to another business buying the firm’s goods. It allows the buyer to take possession of goods immediately and pay for them at some future date, usually 30 to 90 days later.</td>
</tr>
<tr>
<td>Businesses often receive a discount—2 percent, for example—if they pay their bill within 10 days. If a business does not pay the bill in that amount of time, it is, in effect, paying 2 percent interest for the use of trade credit.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Unsecured Loans</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Most short-term bank credit for businesses is in the form of unsecured bank loans. These are loans not guaranteed by anything other than the promise to repay them. The borrower must sign a promissory note to repay the loan in full by a specified time and with a specified rate of interest. The usual repayment period is one year.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Secured Loans</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Secured loans are backed by collateral—something of value that the borrowers will lose if they do not repay a loan. Businesses offer as collateral property such as machinery, inventories, or accounts receivable—amounts owed to a business by its customers.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Line of Credit</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>A line of credit is a maximum amount a company can borrow from a bank during a period of time, usually one year. Rather than apply each time for a loan, a company may automatically borrow up to the amount of the line of credit—$100,000, for example.</td>
</tr>
</tbody>
</table>

---
Intermediate-Term Financing  Borrowing for 1 to 10 years is considered intermediate-term financing. When a company wants to expand its business by buying more land, buildings, or equipment, short-term financing generally is not adequate. For example, imagine you want to expand your electronics repair business, and you decide the best way to do this would be to open another shop. In this case, you would not apply for a 90-day loan. In 90 days, you would not be able to do enough repair jobs to earn the additional revenue to repay the loan. Instead, you would look for intermediate-term financing. Forms of this type of financing are described in the chart below.

**Intermediate- Term Financing**

**Loans**

Intermediate-term loans have repayment periods from 1 to 10 years and generally require collateral such as stocks, bonds, equipment, or machinery. The loan is considered a mortgage if it is secured by property such as the building in which the business is located. Sometimes large, financially sound companies may be able to get unsecured intermediate-term loans.

**Leasing**

Leasing means renting rather than buying—whether it is a building, machinery, or the like. One advantage of leasing is that the leasing company will often service the machinery at low cost. Another advantage is that the business may deduct a part of the funds spent on a lease before figuring income taxes. A disadvantage is that a lease often costs more than borrowing to buy the same equipment.
**Long-Term Financing**  Borrowing for longer than 10 years or issuing stock is called **long-term financing**. Long-term financing is used for major expansion, such as building a new plant or buying expensive, long-lasting machines to replace outdated ones. For financing investments like these lasting 10 to 15 years or more, corporations either issue stock or sell bonds. (See the chart below.) Usually only large corporations finance long-term debt by selling bonds. Unlike smaller companies, large corporations with huge assets appear to be better risks to investors who are interested in buying bonds.

---

**Determining Cause and Effect** In what cases might a business seek short-term financing?

---

### Long-Term Financing

**Bonds**

Bonds promise to pay a stated rate of interest over a stated period of time and to repay the full amount borrowed at the end of that time.

**Stocks**

Selling stock is called **equity financing** because part of the ownership, or equity, of the company is being sold. Corporations may sell either preferred or common stock. The differences between these types of stock are explained below.

<table>
<thead>
<tr>
<th>Common Stock</th>
<th>Preferred Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Common stock is issued by all public corporations; it is the stock most often bought and sold.</td>
<td>1. Many corporations do not issue preferred stock.</td>
</tr>
<tr>
<td>2. Holders of common stock have voting rights in a corporation. As a group they elect the board of directors.</td>
<td>2. Holders of preferred stock generally have no voting rights.</td>
</tr>
<tr>
<td>3. Common stock may pay dividends based on a corporation's performance. If the company does well, dividends may be high; if it does poorly, the dividends may be low or zero.</td>
<td>3. Preferred stock pays a fixed dividend. This amount must be paid before holders of common stock receive any dividends. If a company cannot pay a fixed dividend on time, it must usually make up the missed payment later.</td>
</tr>
<tr>
<td>4. The value of common stock rises and falls in relation to the corporation's performance and what investors expect it to do in the future.</td>
<td>4. The value of preferred stock changes in relation to how well the company is doing.</td>
</tr>
<tr>
<td>5. If a corporation fails, holders of common stock are the last to be paid with whatever funds are left after paying all creditors.</td>
<td>5. If a corporation fails, holders of preferred stock must be paid before any holders of common stock are paid, but bondholders are paid before any stockholders.</td>
</tr>
</tbody>
</table>
Choosing the Right Financing

Main Idea Decisions regarding financing depend on the level of interest rates, the financial condition of the company, the overall economic climate, and the opinions of the stockholders.

Economics & You When it comes time for you to borrow funds, how will you decide how much to borrow, or how long you will need to pay the loan back? Read on to learn how businesses make similar decisions.

Financial managers try to obtain capital at a minimum cost to the company. To do so, they try to choose the best mix of financing. The length of a loan that a company takes out or a corporation’s decision regarding whether to sell bonds or issue stock depends on four factors. These factors are the costs of interest, the financial condition of the company, the overall economic climate, and the opinions of the company’s owners.

Interest Rates When interest rates in general are high, a business may be reluctant to take out a loan. A company may delay its expansion until it can borrow at better interest rates, or it may take out a series of short-term loans at high rates, hoping that interest rates will drop. When that happens, the company will then take out a long-term loan.

Interest rates also affect the decision to issue bonds. When rates are high, corporations must offer high rates of interest on their bonds to attract investors. When interest rates drop overall, corporations can offer lower rates of return on their bonds.

Financial Condition of the Company A company or corporation whose sales and profits are stable or are expected to increase can safely take on more debt—if its current debt is not too large. Financial managers use cost-benefit analysis to determine if the potential profits will more than cover the cost of financing expansion.

Interest Rate Effects The cost of interest is one factor that determines what type of financing a business will choose. In general, when interest rates are high, businesses will put off borrowing or seek short-term loans. When interest rates drop, businesses are more likely to take out long-term loans.
**Market Climate**  Financial managers need to be aware of the market climate when determining whether to sell bonds or to issue stock to raise financing. If economic growth in the overall market appears to be slow, investors may prefer the fixed rate of return of bonds or preferred stock to the unknown return on common stock.

**Control of the Company**  Bonds do not have voting rights attached to them. Most preferred stocks also do not give voting rights to shareholders. The owners of common stocks, however, do have the right to vote in company elections. When debating issues of financing, financial managers may have to gain approval from the owners of common stock before taking action. Bondholders are not asked for their approval.

*Reading Check*  **Analyzing**  How does the overall economic climate affect a business’s decisions regarding financing?

---

**Review**

**Vocabulary**

1. **Explain** the significance of: debt financing, short-term financing, intermediate-term financing, long-term financing.

**Main Ideas**

2. **Comparing and Contrasting**  Use a Venn diagram like the one below to compare and contrast the three types of financing discussed in this section.

![Venn Diagram](image)

**Critical Thinking**

3. **The BIG Idea**  Explain three ways interest rates affect the profits of a company.

4. **Contrasting**  What are the major differences between common and preferred stock?

**Applying Economics**

5. **Financing Your Business**  Imagine you are opening a pizza shop in a popular and busy location. You need to borrow $100,000. Check today’s interest rates in a newspaper or on the Internet. Then list the four financing factors you should consider and describe how each would affect your business.
Thomas Sowell

Thomas Sowell spent his early years in Charlotte, North Carolina, where he grew up under very modest circumstances:

"Like most of the houses in the area ours had no such frills as electricity, central heating, or hot running water... For heat in the winter we had the stove, a fireplace in the living room, and a kerosene heater. For light at night we used kerosene lamps. It never occurred to me that we were living in poverty, and in fact those were the happiest times of my life."

Sowell was an exceptionally intelligent child, and he already knew how to read when he entered school. In time, his family moved to Harlem, and he was eventually drafted into the Marine Corps. With the G.I. Bill to help pay his way, he entered prestigious Howard University and later transferred to Harvard, where he graduated magna cum laude. There followed a long career as a scholar and writer, during which time he churned out over thirty books, dozens of essays, and hundreds of newspaper columns.

As a young man, Sowell was a self-described Marxist, but he eventually converted to free market capitalism. Today, if he must be labeled, he prefers the term libertarian. In describing his political change of heart, Sowell has the following to say: "Back in the days when I was a Marxist, my primary concern was that ordinary people deserved better and that elites were walking all over them." In time, however, Sowell’s view of the "elites" and their impact on others, both economically and politically, changed:

"The passing decades have taught me that political elites and cultural elites are doing far more damage than the market elites could ever get away with doing."

Checking for Understanding

1. **Synthesizing** Does Sowell believe that having lots of consumer goods is necessary for a child to be happy? How do you know?
2. **Interpreting** What do you think Sowell means by “political elites,” “cultural elites,” and “market elites”?
GUIDE TO READING

Section Preview
In this section, you will learn about the process that companies go through to produce goods and services that satisfy consumer needs and wants.

Content Vocabulary
- production (p. 272)
- consumer goods (p. 272)
- mechanization (p. 274)
- assembly line (p. 274)
- division of labor (p. 275)
- automation (p. 275)
- robotics (p. 275)

Academic Vocabulary
- process (p. 271)
- location (p. 272)

Reading Strategy
Organizing As you read, use a web diagram like the one below to list the production operations discussed in this section.

A PRODUCTION VISIONARY

At a dinner party in Tokyo in the summer of 1950, 21 of Japan’s most influential corporate leaders . . . [listened to] W. Edwards Deming, an obscure statistician who claimed he knew how to solve postwar Japan’s economic problems.

The pursuit of quality, Deming said, was the key to higher productivity, bigger profits, more jobs, and therefore a richer society. Quality, he lectured, did not begin by finding defects at the end of the production line. It had to be pursued along every link of the supply chain, with the active cooperation of everyone from suppliers to the humblest worker on the factory floor.

. . . It wasn’t until the ‘80s that U.S. manufacturers adopted his principles—largely to meet the competition from Japan. Deming’s 14 points are now standard operating procedure around the world.

After businesses obtain the necessary financing, they can get down to the work of producing goods or providing services. This may involve several steps of careful planning, including getting raw materials from suppliers on time. As you read this section, you’ll learn about all the steps in the process businesses go through to satisfy consumer needs and wants.
Steps in Production Operations

**Main Idea** The production process involves the coordination of many steps, such as planning, purchasing of inputs, quality control, and inventory control.

**Economics & You** Has a store ever run out of a product that you wanted to buy? If so, then that store did not maintain its inventory. Read on to learn about this and other production operations of businesses.

**Production** refers to the process of changing resources into goods. One category is **consumer goods**, or goods sold directly to individuals to be used as they are. As you learned in Chapter 1, businesses may also produce **capital goods**, which are products used to make other goods. Besides the actual manufacturing of a good, the production process also involves planning, purchasing, and quality and inventory control. (See Figure 10.3 below.) A fifth operation, product design, will be discussed in Chapter 11.

Planning includes choosing a location and scheduling production. Among the **location** factors to consider are nearness to markets, raw materials, labor supply, and transportation facilities. A business also needs to have access to a way to deliver its products—highways, railroads, airlines, and pipelines. Scheduling production operations involves setting start and end times for each step in the process. It includes monitoring labor, machinery, and materials so that production moves smoothly.

**Figure 10.3** Production Decisions

- **A. Planning** Where a business is located and how the business will get its products to consumers are directly related to how successful the business will be. Businesses that cater to teenagers, like music stores, often locate on college campuses.

- **B. Purchasing** A business's purchasing agent decides what to buy, from whom, and at what price.
The people who purchase goods for a business have to decide what to buy, from whom, and at what price. They are usually called purchasing agents. To get the best deal for the company, purchasing agents must consider the price and quality of raw materials, office supplies, machinery, and so on. They must also consider issues such as insurance and shipping rates and times.

Quality control involves overseeing the grade or freshness of goods, their strength or workability, their construction or design, safety, adherence to various standards, and other factors. Quality control systems can be as simple as testing one item per thousand produced or testing each product as it is finished.

Almost all manufacturers and many service businesses, such as dry cleaners, need inventories of the materials they use in making their products or offering their services. A production line can come to a complete halt if inventory runs out. Manufacturers and businesses, such as supermarkets, also keep stockpiles of finished goods on hand for sale.

 Inventories are costly, however. The more inventory a business has, the less capital it has for other activities. For example, it costs money to warehouse and insure goods against fire and theft. Some goods, such as film and medicines, spoil if kept beyond a certain period of time. Other goods may become obsolete, or out of date.

**Identifying** What must purchasing agents consider before buying goods for a business?

**C. Quality Control** Conducting quality control is an essential part of the production process, but there is a trade-off. The more time spent on quality control, the higher the production costs.

**D. Inventory Control** Businesses must manage their inventories carefully. Maintaining too large an inventory can be costly and possibly wasteful.

**Economic Analysis**

**Identifying** Besides choosing a location, what other major consideration goes into the planning stage of the production process?
Technology and Production

Main Idea: Productivity can be increased by utilizing technology and dividing labor.

Economics & You: Have you ever purchased anything online? Read on to learn about how technology such as the Internet has impacted business and production.

Technology is the use of science to develop new products and new methods for producing and distributing goods and services.

Mechanization: In the 1700s, the Industrial Revolution—the beginning of the factory system—came about through mechanization, which combines the labor of people and large power-driven machines. With the introduction of spinning and weaving machines in factories, entrepreneurs replaced skilled handiwork with machines run by unskilled workers. The rate of output per labor hour greatly increased as a result.

The Assembly Line: An outgrowth of mechanization was the assembly line. An assembly line is a production system in which the good being produced moves on a conveyor belt past workers who perform individual tasks in assembling it.

Figure 10.4: Continuing Advances

- The development of the assembly line was a major leap forward in the efficiency of the production process. Constantly advancing technology continues to improve the process today. Within the assembly line itself, for example, advances in robotics and automation make today’s assembly lines many times more efficient than those of Henry Ford’s time.

Ford assembly line in Dearborn, Michigan, 1928

Modern Ford assembly line in Flat Rock, Michigan

Economic Analysis: Comparing and Contrasting: What similarities can you see between the two assembly lines? What differences do you notice?
The Ford Motor Company developed the modern assembly-line process early in the twentieth century. Because the assembly line results in more efficient use of machines and labor, the costs of production drop. (See Figure 10.4.)

**Division of Labor** Assembly-line production is possible only with interchangeable parts made in standard sizes, and with the division of labor, or the breaking down of a job into small tasks. A different worker performs each task.

**Automation** Mechanization combines the labor of people and machines. In automation, machines do the work and people oversee them. Automation is so common in American society that most of us don’t even think about the efficiency of automated traffic signals, doors, or teller machines anymore.

**Robotics** Robotics refers to sophisticated, computer-controlled machinery that operates an assembly line. In some industries, robotics regulate every step of the manufacturing process—from the selection of raw materials to processing, packaging, and inventory control.

**Vocabulary**

1. Explain the significance of: production, consumer goods, mechanization, assembly line, division of labor, automation, robotics.

**Main Ideas**

2. **Determining Cause and Effect** What are the factors to consider when locating a business?

3. **Analyzing** Use a chart like the one below to explain how each adaptation helped increase business efficiency.

<table>
<thead>
<tr>
<th>Business Adaptation</th>
<th>How Efficiency Increased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mechanization</td>
<td></td>
</tr>
<tr>
<td>Assembly line</td>
<td></td>
</tr>
<tr>
<td>Division of labor</td>
<td></td>
</tr>
<tr>
<td>Automation</td>
<td></td>
</tr>
<tr>
<td>Robotics</td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

4. **The BIG Idea** How can poor inventory control affect profits?

5. **Contrasting** What is the difference between consumer goods and capital goods?

**Applying Economics**

6. **Purchasing** Imagine you are the purchasing agent for a pizza shop. List the items you would have to buy before opening, and research the cost of each item. Then make a list of additional items you would have to purchase on an ongoing basis. Finally, prepare a report you would submit to the owner of the business listing these costs.
FedEx is taking off like a ‘rocket ship.’

Check It Out! In this chapter you learned that businesses must make wise decisions when selecting a supplier to ship raw materials as well as finished goods. In this article, read to learn how FedEx is cutting costs for many small companies.

As soon as Motion Computing Inc. in Austin, Texas, receives an order for one of its $2,200 tablet PCs, workers at a supplier’s factory in Kunshan, China, begin assembling the product. When they’ve finished, they individually box each order and hand them to a driver from FedEx Corp., who trucks it 50 miles to Shanghai, where it’s loaded on a jet bound for Anchorage before a series of flights and truck rides finally puts the product into the customer’s hands. Elapsed time: as little as five days. Motion’s inventory costs? Nada. Zip. Zilch. “We have no inventory tied up in the process anywhere,” marvels Scott Eckert, Motion’s chief executive. “Frankly, our business is enabled by FedEx.”

There are thousands of other Motion Computings that, without FedEx, would be crippled by warehouse and inventory costs. That value proposition has made the Memphis shipping giant an indispensable partner for companies whose products are made in China. In the past two years, the volume of goods that FedEx has shipped over its vast international network has soared 40%, with much of the growth from Asia.

As far back as the 1980s, FedEx founder and CEO Frederick W. Smith predicted that Asia would become an economic powerhouse. These days, FedEx operates 120 flights weekly to and from Asia, including 26 out of China alone.

—Reprinted from BusinessWeek

Think About It

1. Determining Cause and Effect How does FedEx affect costs for Motion Computing, Inc.?
2. Synthesizing How has FedEx’s planning decisions affected its success over the past several years?
Before undertaking expansion, a business should conduct a **cost-benefit analysis** and expand only if the benefits of doing so outweigh the costs.

### Five Steps of Cost-Benefit Analysis

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Estimate the costs of expansion.</td>
</tr>
<tr>
<td>2</td>
<td>Calculate expected revenues.</td>
</tr>
<tr>
<td>3</td>
<td>Calculate expected profits.</td>
</tr>
<tr>
<td>4</td>
<td>Calculate cost of loan plus interest.</td>
</tr>
<tr>
<td>5</td>
<td>Expected profits should outweigh the costs of expansion.</td>
</tr>
</tbody>
</table>

When a business needs to borrow funds to expand, it can choose between **short-, intermediate-,**, and **long-term financing** depending upon the kind of expansion it wants to do.

<table>
<thead>
<tr>
<th>Type of Financing</th>
<th>Typical Repayment Term</th>
<th>Generally Used for:</th>
</tr>
</thead>
</table>
| Short-term        | 30–90 days             | • Paying bills  
                     |                        | • Buying supplies    
                     |                        | • Emergencies        |
| Intermediate-term | 1–10 years             | • Buying land, buildings, or equipment |
| Long-term         | 10–15 years or more    | • Major expansion projects, such as building a new plant or buying expensive, long-lasting equipment |

Once a business obtains funds to expand, it must consider the steps in **setting up the production process**.
Review Content Vocabulary

1. A manufacturing business needs advice on how to pay for an expansion. Write a paragraph or two explaining some of the company’s options for accomplishing this. Use all of the following terms.

- financing
- cost-benefit analysis
- revenues
- profits
- debt-financing

2. Now write a paragraph summarizing how companies go about producing goods and services. Use all of the following terms.

- production
- consumer goods
- mechanization
- assembly line
- division of labor
- automation
- robotics

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

3. An entrepreneur must find _______ financing, enough to pay for start-up costs.
   - a. sufficient
   - b. integral
   - c. instance
   - d. undergo
   - e. adequate
   - f. location
   - g. process

4. If a company’s process is no longer _______ for its production needs, the company might consider mechanization to speed things up.
   - a. sufficient
   - b. integral
   - c. instance
   - d. undergo
   - e. adequate
   - f. location
   - g. process

5. In one _______, an entrepreneur decides to use credit cards to finance his business.

6. The production _______ usually has many steps.

7. A business must _______ a thorough credit check to borrow money.

8. Getting funding is a(n) _______ part of starting or expanding a business.

9. Business owners should consider _______ factors, such as nearness to markets, raw materials, and transportation facilities.

Review the Main Ideas

Section 1 (pp. 259–263)

10. How do individuals unintentionally invest in businesses? What is their reward for their investment?

11. What are the steps in a cost-benefit analysis? Why do businesses use it when they think about expanding?

Section 2 (pp. 264–269)

12. Fill in a graphic organizer like the one below to describe a situation in which a business might use each type of financing.

<table>
<thead>
<tr>
<th>Examples of Business Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term</td>
</tr>
<tr>
<td>Intermediate-term</td>
</tr>
<tr>
<td>Long-term</td>
</tr>
</tbody>
</table>

13. Issuing stocks is a form of what type of financing?

14. What might cause a business to be reluctant to take out a loan?

Section 3 (pp. 271–275)

15. What steps are involved in the production process?

16. What does assembly-line production require?
Problem Solving

17. Imagine that you own a business. Think of at least five business expansions you would like to make to your company that would require financing. List after each type of business expansion, such as buying 10 desktop computers, what the appropriate type of financing would be. Finally, explain your choices. Use a table like the one below to organize your thoughts.

<table>
<thead>
<tr>
<th>Expansion</th>
<th>Type of Financing</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking

18. **The BIG Idea** What is the strongest motivation behind most entrepreneurs’ efforts to start or expand their businesses? Explain.

19. **Explaining** What factors should a business owner consider when deciding where his or her business should be located?

20. **Analyzing** Assume that you have to buy new inventory that you plan to sell off completely by the end of each month. What is the most appropriate type of financing to use to buy this inventory? Why?

21. **Synthesizing** Imagine that you represent a bank that gives loans to businesses for expansions. What qualities would you look for in a business before approving a loan? Why are these particular qualities important?

Analyzing Visuals

22. Study the cartoon below, and then answer the following questions.
   a. What does the woman want to buy?
   b. What reasons does the coffee shop’s owner give for not selling coffee by the pound?
   c. What does the shop owner’s reaction imply about his experience as an entrepreneur?
**Worldwide Advertising** Each year the United States spends approximately $500 billion on advertising. The map below shows advertising expenditures for five countries whose economies are at different levels of development.

### Russia

<table>
<thead>
<tr>
<th>Category</th>
<th>Spending (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Television</td>
<td>$718.4</td>
</tr>
<tr>
<td>Radio</td>
<td>123.0</td>
</tr>
<tr>
<td>Print*</td>
<td>1,130.5</td>
</tr>
<tr>
<td>Outdoor**</td>
<td>58.7</td>
</tr>
<tr>
<td>Point of Purchase</td>
<td>374.6</td>
</tr>
<tr>
<td>Promotions***</td>
<td>2,773.0</td>
</tr>
<tr>
<td>Direct Mail</td>
<td>314.5</td>
</tr>
<tr>
<td>Other</td>
<td>4,117.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$96.1 billion</strong></td>
</tr>
<tr>
<td><strong>% of World Total</strong></td>
<td>10.1%</td>
</tr>
</tbody>
</table>

### Egypt

<table>
<thead>
<tr>
<th>Category</th>
<th>Spending (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Television</td>
<td>$119.7</td>
</tr>
<tr>
<td>Radio</td>
<td>4.8</td>
</tr>
<tr>
<td>Print*</td>
<td>188.4</td>
</tr>
<tr>
<td>Outdoor**</td>
<td>9.8</td>
</tr>
<tr>
<td>Point of Purchase</td>
<td>46.8</td>
</tr>
<tr>
<td>Promotions***</td>
<td>727.9</td>
</tr>
<tr>
<td>Direct Mail</td>
<td>30.3</td>
</tr>
<tr>
<td>Other</td>
<td>128.4</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$12.6 billion</strong></td>
</tr>
<tr>
<td><strong>% of World Total</strong></td>
<td>1.3%</td>
</tr>
</tbody>
</table>

### Kenya

<table>
<thead>
<tr>
<th>Category</th>
<th>Spending (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Television</td>
<td>$15.2</td>
</tr>
<tr>
<td>Radio</td>
<td>0.2</td>
</tr>
<tr>
<td>Print*</td>
<td>24.0</td>
</tr>
<tr>
<td>Outdoor**</td>
<td>1.2</td>
</tr>
<tr>
<td>Point of Purchase</td>
<td>2.0</td>
</tr>
<tr>
<td>Promotions***</td>
<td>88.7</td>
</tr>
<tr>
<td>Direct Mail</td>
<td>5.5</td>
</tr>
<tr>
<td>Other</td>
<td>11.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1.5 billion</strong></td>
</tr>
<tr>
<td><strong>% of World Total</strong></td>
<td>0.16%</td>
</tr>
</tbody>
</table>
Thinking Globally

1. **Identifying** What is the largest category of advertising for each country?

2. **Defending** Which of the expenditures for specific countries surprised you the most? Explain your answer.

3. **Critical Thinking** Why do you think advertising expenditures for Kenya and Vietnam are so low compared to the other countries listed?
The **BIG Idea**
The profit motive acts as an incentive for people to produce and sell goods and services.

**Why It Matters**
Do you think advertisements influence your buying habits? In this chapter, read to learn how businesses market and distribute their goods and services.

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**Economics ONLINE**
**Chapter Overview** Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 11—Chapter Overviews to preview chapter information.
section 1

The Changing Role of Marketing

GUIDE TO READING

Section Preview
In this section, you will learn about the steps that companies take to figure out how to best meet consumer needs.

Content Vocabulary
- marketing (p. 284)
- consumer sovereignty (p. 284)
- utility (p. 284)
- market research (p. 285)
- market survey (p. 287)
- test-marketing (p. 287)

Academic Vocabulary
- estimate (p. 284)
- crucial (p. 285)
- individual (p. 287)

Reading Strategy
Organizing As you read the section, complete a web diagram similar to the one below by listing the four major types of utility (the ability of a good or service to satisfy consumer wants).

ISSues In ThE NeWS
— from the New York Times

TARGETING TEENS Marketers spend a lot of time figuring out what teenagers want. Teenagers are their most desirable and fickle demographic, the arbiters of cool who set trends, influence brand health, and part with their discretionary income most freely.

So as part of Advertising Week 2005, interactive advertising agencies tried to answer the question . . . of what teenagers want.

. . . So what do teenagers want? As one might expect, they want to have some fun. They want to customize products, they want to play games, and they want to socialize.

. . . Interactive advertising usually appeals to teenagers, the agency said, because it engages their desire to control what they buy. For marketers, it allows advertising to masquerade as a game and engage the customer.

In addition to financing and producing products, which you learned about in Chapter 10, businesses must promote and eventually sell their products and services. In doing so, they must conduct activities that provide information about their products or services to consumers. As you read this section, you’ll learn that these activities include market research, advertising and promotion, and distribution.
The Development of Marketing

Main Idea The focus of marketing is to maximize sales by satisfying consumer wants and needs.

Economics & You Have you ever tried to buy something late at night and found the stores to be closed? A 24-hour store would have met your demand. Read on to learn how companies work to satisfy consumer needs.

Marketing involves all of the activities needed to generate consumer demand and to move goods and services from the producer to the consumer. Some economists estimate that about 50 percent of the price people pay for an item today is for the cost of marketing. The idea and importance of marketing in the United States have changed considerably since 1900. The development of marketing can be traced by analyzing what it has focused on: production, sales, advertising, and consumer sovereignty—or consumer as ruler.

Today, marketing’s main purpose is to convince consumers that a certain product will add to their utility. Utility is the ability of any good or service to satisfy consumer wants. Utility can be divided into four major types: form utility, place utility, time utility, and ownership utility. (See Figure 11.1 below.)

Explaining What is the purpose of marketing?

Marketing: all the activities needed to generate consumer demand and to move goods and services from the producer to the consumer.

Consumer sovereignty: the role of the consumer as ruler of the market when determining the types of goods and services produced.

Utility: the amount of satisfaction one gets from a good or service.

Figure 11.1 Types of Utility

- Consumer utility can be divided into four major types.

A. Form Utility Form utility, created by production, is the conversion of raw materials to finished goods. Examples include transforming cotton cloth into clothing or refining crude oil into gasoline, as shown here.

B. Place Utility Place utility is created by having a good or service available where a consumer wants to buy it. Locating a gas station on a busy corner is an example of this type of utility.
Market Research

Main Idea Through market research, businesses can determine what products consumers are likely to buy and at what prices.

Economics & You Have you ever been asked to fill out a survey about a product or service? Read on to learn about this and other methods companies use to figure out what consumers want.

Finding out what consumers want can be difficult. It is crucial that businesses do so, however, because many markets today are national or even global. An increase in sales of a few percentage points can result in millions of dollars in increased profits. Therefore, before a product is produced or a service is offered, businesses research their market. Market in this sense means the people who are potential buyers of the good or service.

Through market research a company gathers, records, and analyzes data about the types of goods and services that people want. From automakers to producers of frozen foods, most companies producing consumer goods invest heavily in market research. They use this research to figure out how best to promote their product. Issues they consider include what their target audience should be and what advertising method will be most effective.

market research: gathering, recording, and analyzing data about the types of goods and services that people want

C. Time Utility Time utility is created by having a good or service available when a consumer wants to buy it. An all-night diner is an example of time utility.

D. Ownership Utility Ownership utility is the satisfaction one receives from simply owning the good or service. One might purchase a fine art painting or a piece of expensive jewelry just to have the satisfaction of owning the object. Luxury cars like the one shown here also provide ownership utility.

Economic Analysis

Contrasting What is the difference between time utility and place utility?
When Should Market Research Be Done? Market research may be done at several stages of product development. It can be done at the very beginning when the first ideas about a new product are being developed. It can be conducted again to test sample products and alternative packaging designs.

Early market research has several purposes. It helps producers determine whether there is a market for their good or service and what that market is. It can also indicate any changes in quality, features, or design that should be made before a product is offered for sale.

To investigate initial consumer response, market research is often done immediately after a product is released for sale. Some companies even test their advertising to make sure it is attracting the market segment for which the product was designed. Market researchers can also gather information about a product that has been on the market for a while. They then attempt to discover what should be done to maintain or increase sales.

Figure 11.2 Types of Market Surveys

A. Questionnaire Marketers often ask consumers to fill out questionnaires about a product. In such a questionnaire, the consumer provides information about how he or she learned about the product, when and where it was purchased, and how satisfied he or she is with the product.

B. Focus Groups Members of a focus group may test and discuss what they like and dislike about similar, and often competing, products. Generally, the people chosen to be part of the focus group do not know which company has hired them to test the products. The focus group is often observed through a one-way mirror by the marketers of one of the products.

Economic Analysis

Comparing and Contrasting What do you think the benefits and drawbacks of each of these types of market surveys might be?
Market Surveys  The first step in market research is performing a market survey, in which researchers gather information about who might be possible users of the product. Such characteristics as age, gender, income, education, and location—urban, suburban, rural—are important to a producer in deciding which market a product should target.

A market survey typically involves a series of carefully worded questions. The questions may be administered in the form of a written questionnaire, which is mailed to consumers. Manufacturers of small appliances such as hair dryers and microwave ovens often put a questionnaire on the back of the warranty card that purchasers are to return. Another way to survey the market is by conducting individual interviews or querying focus groups. (See Figure 11.2.) Some market surveys are also done online.

Testing New Products  As a final step before offering a product for national distribution, market researchers will often test-market a product such as a detergent or a toothpaste. Test-marketing means offering a product for sale in a small area, perhaps several cities, for two months to two years to see how well it sells before offering it nationally. (See Figure 11.3.) For example, before attempting to market a new energy drink, a company might sell it in several selected areas where the product is most likely to attract the target market segment.

market survey: information gathered by researchers about possible users of a product based on such characteristics as age, gender, income, education, and geographic location

test-marketing: offering a product for sale in a small area for a limited period of time to see how well it sells before offering it nationally
Review

Vocabulary
1. Explain the significance of: marketing, consumer sovereignty, utility, market research, market survey, test-marketing.

Main Ideas
2. Outlining Fill in the steps a new product goes through before reaching the market.

Critical Thinking
3. The BIG Idea Explain how test-marketing can increase profits.

4. Interpreting Why is marketing for consumer sovereignty successful?

5. Explaining What is meant by consumer utility?

Applying Economics
6. Market Surveys Imagine that you have the task of testing the market to see what people want in a new energy bar. What questions would you ask? Create a questionnaire for this product to distribute to consumers.

Researchers keep track of the units sold and test different prices and ad campaigns within the test markets. If the product is successful, the company will offer it nationally. If sales are disappointing, the company has two choices. It can make changes or, rather than spend more funds redesigning the product, the company can abandon the idea.

Of all the new products introduced every year in the United States, most are not profitable and do not survive in the marketplace. It is the constant lure of owning a high-profit item that motivates companies to continue developing new products.

Identifying What are two steps involved in market research?

The cost of marketing can significantly increase the price of a good or service.
In today’s highly competitive world, simply producing a product and offering it for sale is not enough. Through their marketing departments, companies plan a marketing strategy, which details how the company will sell the product effectively. As you read this section, you’ll learn that a marketing strategy, or plan, combines the “four Ps” of marketing: product, price, place, and promotion.
The “Four Ps” of Marketing

Main Idea The “four Ps” of marketing are product, price, place, and promotion.

Economics & You Have you ever noticed magazines and other “impulse” items displayed near the checkout lines in grocery stores? Read on to learn about methods companies use to promote their products.

Product Market research helps determine what good or service to produce. It also helps a company determine what services to offer with the product, how to package it, and what kind of product identification to use.

Additional services that accompany a product often help make a sale. Warranties are customary with many manufactured products, but some manufacturers offer special services free or for a small charge. For example, if you buy a digital camera, you may be able to purchase from the manufacturer a 2-year extended warranty in addition to the 1-year warranty given by the store in which you bought the camera.

Packaging is also an important factor in selling a product. The “right” packaging combines size, design, and color to attract potential consumers. DVDs, books, and food are especially dependent on packaging. Such words as New and Improved or Economy Size are used to attract customers. Sometimes manufacturers add coupons and rebate offers to their packages. Coupons are used to persuade consumers to make a repeat purchase and develop the habit of buying the product.

Once a product is offered for sale, product identification becomes important. Product identification is meant to attract consumers to look at, buy, and remember a particular product. It can involve the use of a logo or certain colors on a package. It can also involve a song or jingle, a certain type of packaging, or anything that can be associated with and identify the product.

Skills Handbook See page R44 to learn about Detecting Bias.
**Price** Supply and demand ultimately determine the price of a good or service. Because of the laws of supply and demand, the price at which a product sells may help determine whether it is successful in attracting buyers while still being profitable to its maker. In setting a price, a company has to consider the costs of producing, advertising, selling, and distributing the product, as well as the amount of profit it hopes to make. (See Figure 11.4 below.)

When companies first introduce a new product into the market, that product will often be priced low, initially, to lure customers away from better-known similar products. This strategy is called penetration pricing. Such pricing is an alternative to spending more on advertising.

Another strategy companies employ is to offer coupons attached right to the new products themselves in the store. The coupons act as incentives to attract consumers to the new products. If a consumer likes a new product, he or she will probably buy it again even without a coupon.

Often companies sell similar goods at similar prices. This practice is known as price leadership. For example, one major airline may lower its prices, which causes all of the other major airlines to follow by lowering their fares. Conversely, if a certain product becomes very popular with consumers, all the manufacturers of the product may raise their prices.

**penetration pricing:** selling a new product at a low price to attract customers away from an established product

**price leadership:** a practice in some industries in which the largest firm publishes its price list ahead of its competitors, who then match those announced prices

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### Economic Analysis

**Extending** What costs might be included in distributing a product?
**Place**  Where the product should be sold is another decision of the marketing department. Should it be sold through the mail, by telephone, in department stores, in specialty shops, in supermarkets, in discount stores, door-to-door, or on the Internet? Or should it be sold in a combination of many of these places? Often, the answer is **obvious** because of past experience with similar products. A cereal company, for example, would most likely market a new cereal in supermarkets.

The location of the product within the store itself is another consideration of both the manufacturer and the store owner. Cereals aimed at children, for example, are usually placed on lower shelves where children can see them. Also, more expensive items are placed on middle shelves at the eye level of adults of average height. This placement ensures that consumers will be more likely to notice the pricier products.

Sometimes a company will decide that its goods would appeal only to a limited market. Therefore, it may choose to sell the product or products only in specialty shops, through mail-order catalogs, or on the Internet.

Geographic location may also be a consideration when companies decide where to market products. Some products may be targeted specifically at large cities, while others may be more suitable for rural markets.

---

**Impulse Buying**

Product placement within a store is another factor marketers must consider. Often, companies will pay a high price to a store to have their products placed near the check-out counters, where people look at the products while they are waiting in line. Common products placed here include candy, gum, and magazines. People will often buy these products on impulse.
Promotion: Promotion is the use of advertising and other methods to inform consumers that a new or improved product or service is available. Promotion also seeks to convince consumers to purchase the new items. Businesses spend billions of dollars each year on promotional campaigns. Advertising methods may include ads in newspapers and magazines, radio spots, and television commercials. Increasingly, businesses are also advertising and promoting their products on the Internet.

The particular type of promotion that a producer uses depends on three factors: (1) the product, (2) the type of consumer that the company wants to attract, and (3) the amount the company plans to spend. If a product is going to be marketed to teenagers, for example, companies will often advertise in teen magazines and on teen Web sites.

Magazines and catalogs, credit card companies, and insurance companies also often use direct-mail advertising. The mailer usually includes a letter describing the product or service and an order blank.

Other promotional efforts include free samples, cents-off coupons, gifts, and rebates. Where and how products are displayed is important to promotion as well.

Summarizing: What determines the type of promotion that a producer uses?
Product Life Cycle

**Main Idea** Most products go through a four-stage life cycle consisting of introduction, growth, maturity, and decline.

**Economics & You** Can you think of a product that has been around since your childhood? What about a fad that passed quickly? Read on to learn about the life cycles of different products.

Most products go through what is known as a **product life cycle**. This cycle is a series of stages from first introduction to complete withdrawal from the market. The four stages of a typical product life cycle include introduction, growth, maturity, and decline.

People involved in marketing products need to understand the stages of each product’s life cycle because marketing programs are different for each stage. A product in its introductory stage has to be explained and promoted much differently than one in its maturity stage. Also, pricing can vary depending on the stage. Prices of products tend to be relatively high during the growth stage.

Many marketers attempt to extend the life of old products. They may redesign the packaging or find new uses for the product. Advertisements attempt to persuade consumers that they need the product for its new uses.

**Explaining** How do marketers extend the life of old products?

#### Section 2

**Vocabulary**

1. **Explain** the significance of: penetration pricing, price leadership, promotion, direct-mail advertising, product life cycle.

**Main Ideas**

2. **Examining** Copy the chart below and explain how each concept listed affects price.

<table>
<thead>
<tr>
<th>Concept</th>
<th>How It Affects Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply and demand</td>
<td></td>
</tr>
<tr>
<td>Penetration pricing</td>
<td></td>
</tr>
<tr>
<td>Price leadership</td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. **The BIG Idea** Besides profit desired, list the factors a company must consider before setting a price.

4. **Evaluating** Think of a product you like and use regularly. Which advertising method discussed in this section would you use to promote the product? Why?

**Applying Economics**

5. **Product Life Cycle** Research the product life cycle of videocassette tapes, and make a chart showing the *introduction, growth, maturity, and decline* of that product’s marketing.
Shop ‘Til You Feel It’s a Full-Blown Experience.

Check It Out! In this chapter you learned about marketing’s main purpose: to convince consumers that a certain product will add to their utility. The following article highlights how stores have taken this idea one step further.

Companies used to focus on making new, better, or cheaper products and services—and then selling them in the marketplace. Now, the game is to create wonderful and emotional experiences for consumers around whatever is being sold. It’s the experience that counts, not the product. While that business model has long been the preserve of cult-like brands such as Starbucks and Apple, it’s fast becoming the norm in all industries. . . .

Think of the emphasis on a consumer’s individual experience as a final blow to the notion of mass marketing. It’s the next step beyond customization of what you make—to shaping people’s emotions with what you make. And there’s good reason to take the leap. Profit margins are much higher on “experiences” than actual products or services. After all, customers aren’t just paying for a cup of coffee at Starbucks. . . . They’re paying admission to a club—one that delivers something to satisfy the soul.

—Reprinted from BusinessWeek

### The 10 Commandments of Emotional Branding

1. Consumers buy, people live.
2. Products fulfill needs, experiences fulfill desires.
3. Honesty is expected. Trust is engaging and needs to be earned.
4. Quality for the right price is a given. Preference creates the sale.
5. Notoriety gets you known. To be desired, you must meet the customer’s aspirations.
6. Identity is recognition. Personality is about character and charisma!
7. The functionality of a product is about practical qualities only. Design is about experiences.
8. Widespread presence is seen. Emotional presence is felt.
9. Communication is telling. Dialog is sharing.
10. Service is selling. Relationship is acknowledgment.

Source: www.allworth.com

### Think About It

1. **Recalling** According to the story above, how has the goal of marketing changed?
2. **Synthesizing** What is the marketing advantage for companies that focus on experiences rather than just products?
Decisions about distribution, or moving goods from where they are produced to the people who will buy them, is another function of marketing. As you read this section, you’ll learn about various options for distribution and how decisions are made regarding how goods will be moved and distributed. You’ll also learn about the increasing role of the Internet in this branch of marketing.

**PRODUCTS In ThE NeWs**

—from the *Arizona Daily Star*

**Cookie Craze** If you don’t think Girl Scout cookies have become a big business, the sight of 17,500 cases of cookies moving from a . . . warehouse last weekend would change your mind.

Troop leaders loaded the Thin Mints, Samoas, Do-Si-Dos, and other variations into a fleet of minivans, trucks, and U-Haul trailers for sale and delivery this week.

[A] growing percentage of those cookies are now sold from booths set up at shopping centers rather than through [door-to-door] cookie orders. . . .

“Some parents don’t want their children going door-to-door, and it’s also become a matter of convenience, . . . [said Dominick San Angelo, development manager for the Sahuaro Girl Scout Council]. “I’ve heard people say that they’d rather just buy the cookies on their way to the grocery store instead of ordering them and having them delivered later.”
Wholesalers, Retailers, Storage, and Transportation

**Main Idea** Goods are usually moved from producers to consumers through middlemen such as wholesalers and retailers.

**Economics & You** Do you buy goods such as clothing and food in the same place where they are produced? Read on to learn how consumer goods get from producers to you.

The routes by which goods are moved are known as **channels of distribution.** (See Figure 11.5 below.) Some consumer goods, such as clothing and farm products, are usually sold by a producer to a wholesaler and then to a retailer, who sells them to consumers. Other consumer goods, such as automobiles, are normally sold by the producer directly to a retailer and then to consumers. With each transaction, or business deal, the price increases. Few goods go directly from producer to consumer. An example of some that do would be vegetables sold at a farmer’s roadside stand.

**Wholesalers** Businesses that purchase large quantities of goods from producers for resale to other businesses (not to consumers) are called **wholesalers.** Various types of wholesalers exist. Some may buy goods from manufacturers and sell them to retail stores that then deal directly with consumers. Others may also buy and sell raw materials or capital goods to manufacturers.

**Figure 11.5 Distribution of Consumer Goods**

- In rare cases, consumer goods go directly from the manufacturer to the consumer. More often, goods first travel through other channels of distribution, such as wholesalers and retail stores.

**Economic Analysis**

**Synthesizing** If the same product moved through each of the three distribution channels shown, in which channel would consumers wind up paying the highest price? Why?

See StudentWorks™ Plus or go to glencoe.com.

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**channels of distribution:** routes by which goods are moved from producers to consumers

**wholesalers:** businesses that purchase large quantities of goods from producers for resale to other businesses
Retailers  Businesses that sell consumer goods directly to the public are retailers. You are probably familiar with many of them: department stores, discount stores, supermarkets, club warehouses, mail-order houses, specialty stores such as bookshops, and so on.

Traditional retailers have also “set up shop” on the Internet. More and more, there are e-commerce retailers that have no physical store anywhere. They are “virtual companies.”

Storage and Transportation  Part of the distribution process includes storing goods for future sales. The producer, wholesaler, or retailer may perform this function. Most retailers keep some inventory on hand for immediate sales. Many have a two- to three-month supply, depending on the type of merchandise.

Transportation involves the physical movement of goods from producers and/or sellers to buyers. In deciding the method of transportation, businesspeople must consider the type of good, such as perishable food. The size and weight of the good are also important. Airfreighting tons of wheat is impractical, but airfreighting small machine parts is not. Speed may be necessary to fulfill a sale or to get fresh fruit to a food plant. The cost of the different types of transportation helps determine how to ship items.

Predicting Consequences  How has the Internet affected the retail sector?
Other Distribution Channels

**Main Idea** Direct marketing is done mainly through catalogs and over the Internet.

**Economics & You** Have you ever been to a club warehouse store? What are the benefits and challenges of this type of shopping? Read on to learn about this and other expanding distribution channels.

In the last 15 to 20 years, distribution channels have expanded rapidly because of the growth of club warehouse stores and direct marketing. A typical club warehouse store requires a membership fee—about $55 a year for individuals and more for businesses. The club warehouse formula is to buy a limited number of brands and models of each product in such huge quantities that the warehouse gets very favorable prices from the manufacturers. Direct marketing is done mainly through catalogs and over the Internet. Catalog shopping became a popular distribution channel to avoid state sales taxes. The purchaser normally does not pay sales tax if the catalog company is located in another state. The same holds true for goods purchased through the Internet, although this may change in the future.

Shopping on the Internet has become increasingly popular because of the ease with which it can be done. Anybody with access to the Internet and a valid credit card can order just about anything on the Web.

**Reading Check** Evaluating What are three reasons to shop on the Internet?

---

**Vocabulary**

1. **Explain** the significance of: channels of distribution, wholesalers, retailers, e-commerce.

**Main Ideas**

2. **Identifying** In a web diagram like the one below, list three common distribution channels for products.

---

**Critical Thinking**

3. **The BIG Idea** Determine and list two ways an e-commerce company can boost profits, as compared to other distributors.

4. **Contrasting** What is the difference between a retailer and a wholesaler?

**Applying Economics**

5. **Catalog Marketing** Find four catalog displays, and then draw or describe specific changes you would implement to make the ad more appealing and convincing to yourself and other teenagers.
Margaret Whitman—or “Meg,” as everyone calls her—is considered one of the most powerful women on the planet. As a new MBA graduate in 1979, she took her first plunge into the corporate world with Procter & Gamble in Cincinnati. Following that she held important positions with several major corporations before making the most important career move of her life. Rather than continue holding top jobs with established companies, Whitman decided to hitch her wagon to a rising star.

While she was working at Hasbro in 1997, she was approached by a corporate recruiter and offered the CEO’s position at eBay. At first she wasn’t interested. In that year, eBay had only $5.7 million in revenues, a fairly small company by current standards. After conducting further research, however, Whitman became convinced that taking over leadership of eBay was the right move. Eventually, stockholders agreed. Under Whitman’s direction, eBay’s revenues grew from $5.7 million to over $4.5 billion in just eight years. During that same period, registered users on eBay rose from 2 million to 180 million.

In the process, Whitman has done quite well for herself. In 2005, she made the Forbes list of the 500 richest people in the world, coming in at slot 437 with an estimated net worth of $1.5 billion.

What does Meg Whitman think about her job?

“I have one of the best jobs in corporate America. It’s this unique blend of commerce and community. . . . [eBay] is one of the fastest-growing companies of any scale. Every week, there is a different set of issues, a different challenge, something new to think about.”

Perhaps the best part of Whitman’s job is the constant learning experience it provides:

“Probably at least a couple of times a week, I go, ‘Huh! I didn’t know that.’”

Checking for Understanding

1. Speculating Do you think an advanced degree is needed in order to be a corporate executive? Why or why not?

2. Defending If you were an executive, would you take a position with a small, not-yet-established company? Why or why not?
The main purpose of marketing is to convince consumers that a certain product or service will add to their utility. Product testing helps marketers predict whether or not a new good will sell well.

When introducing a new product, businesses need to keep the “Four Ps” of marketing in mind.

Goods are usually moved from manufacturers to consumers through various distribution channels like wholesalers and retailers.
Review Content Vocabulary
1. Write a paragraph or two explaining the process of marketing, promoting, and distributing a product. Use all of the following terms.
   - marketing
   - utility
   - market research
   - penetration pricing
   - promotion
   - product life cycle

Review the Main Ideas
Section 1 (pp. 283–288)
10. What is the relationship between marketing and utility?
11. What are the four types of utility?
12. When is market research done, and how is it conducted?

Section 2 (pp. 289–294)
13. List and describe the “four Ps” of planning a marketing strategy.
14. What are two examples of how goods and services can be promoted?
15. Fill in a graphic organizer like the one below to show the four stages of a product’s life cycle.

Section 3 (pp. 296–299)
16. What are distribution channels? Give two examples of common channels of distribution.
17. Who may perform the storage function of distribution?
18. What factors must a business consider in choosing a method of transporting the goods they sell?

Review Academic Vocabulary
Choose the letter of the term that best completes each sentence.
   a. estimate
   b. crucial
   c. individual
   d. strategy
   e. accompany
   f. obvious
   g. method
   h. valid

2. When a product becomes profitable, it proves that the company used a _______ marketing strategy.

3. One _______ of finding out what consumers want is sending out questionnaires.

4. Coupons that _______ advertisements are often very effective at bringing in new buyers.

5. After a product has been on the market for some time, stores can better _______ how many units of the product to order.

6. Knowing what customers want is _______ knowledge for marketers and producers.

7. Sometimes improvements that would help a product sell better are _______ and easy to do.

8. Marketers might try a new _______ for selling an older product.

9. Each _______ response to a market survey is important to help improve a product.
Thinking Like an Economist

19. Suppose that you are in charge of marketing a new product.

   a. First, come up with a product to market, such as a new sports drink or a cell phone targeted at young users.
   
   b. Create a short questionnaire to use as a market-research tool to find out what people who might buy the product would want.
   
   c. Have as many people as possible answer the questionnaire.
   
   d. Analyze the results and create a simple visual presentation to show what the product should be like and how best to market it.

20. Now describe the cycle your new product will go through while it is being tested in the market.

Critical Thinking

21. **The BIG Idea** How does the process of marketing (research, promotion, distribution, etc.) help producers? How does it help consumers?

22. **Evaluating** Think of a product that has been around for a very long time, such as a particular brand of candy or soft drink. Fill in a graphic organizer like the one below to evaluate various methods marketers might use (or have used) to try to extend the life of this older product.

<table>
<thead>
<tr>
<th>Marketing method</th>
<th>How effective would it be?</th>
<th>Why?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Redesign packaging</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New uses for product</td>
<td></td>
<td></td>
</tr>
<tr>
<td>New advertising</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Fill in another idea)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Analyzing Visuals

23. Study the cartoon on the right, and then answer the following questions.

   a. Who are the two men pictured in this cartoon?
   
   b. What process is the speaker describing?
   
   c. What flaw in this process does the man point out?
Debating Economic Issues

Should advertising to kids be banned?

Advertisers spend billions of dollars each year targeting children as young as two years old. Between television, games, movies, the Internet, magazines, and other sources, kids get an average of 8.5 hours of media exposure a day. That’s 40,000 ads per year. Childhood obesity has doubled in the past 20 years—as has the amount spent advertising junk food to kids. People who support banning ads directed at children say they create the desire for unhealthy foods and make socially inappropriate behavior seem cool. Opponents of a ban say parents should exert more control. Should advertising to children be against the law?

YES! Parents can’t fight $15 billion worth of advertising

We can no longer stand by as our children’s health is sacrificed for corporate profits. Children are especially vulnerable to the impact of advertising. . . . Children under eight aren’t able to understand that ads are created to convince people to buy products. . . . Teens are particularly vulnerable because they are being marketed to in a way that preys on their desire to be older and to act older. It’s harder and harder to find “unbranded” time for children, time that is not in their face selling them something.

. . . One family, alone, can’t combat a $15 billion industry.

. . . If Congress cared about the health and well-being of children, it would enact legislation that would support not the rights of . . . marketers, but the rights of children to grow up—and the rights of parents to raise them—without being undermined by greed.

—Susan Linn, author of Consuming Kids: The Hostile Takeover of Childhood, and Diane E. Levin, co-founders, Campaign for a Commercial-Free Childhood
NO! Parents and advertisers should be mutually responsible

Advertisers need to gain the trust of children and their parents through effective and honest advertising. In turn, parents must take responsibility for their children: monitor what they watch and read, determine how they spend their free time, and educate them to become responsible and informed consumers. Advertising to children will become less controversial only when advertisers and parents assume mutual responsibility for its content and exposure.

With respect to broadcast advertising, the industry believes that current guidelines—the careful review and approval process of commercials by the advertiser, its agency, and the station or network that will air the advertising—provide sufficient controls for children’s advertising. According to the American Association of Advertising Agencies, whose member agencies place more than 80 percent of all national advertising in the U.S., product commercials aired during children’s programming are designed to “show the product’s features and explain its benefits in terms understandable to children and sensitive to their special attitudes and perceptions.”

—Statement by the Advertising Educational Foundation, an organization of advertisers, advertising agencies, and media companies

### Debating the Issue

1. **Specifying** In what ways might advertising be linked to childhood obesity?

2. **Choosing Sides** Do you think advertising should be allowed in places like schools and on school buses, where they will be seen mainly by children? Why or why not?

### Find Out More!

3. **Analyzing** Bring to class two examples of ads—one targeting children under 8 and one targeting teenagers. How does the advertiser in each ad appeal to the target audience?

### Annual Advertising Spending by Food Manufacturers (in Millions)

<table>
<thead>
<tr>
<th>Category</th>
<th>Spending (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prepared convenience foods</td>
<td>$1,563</td>
</tr>
<tr>
<td>Candy and snacks</td>
<td>$1,095</td>
</tr>
<tr>
<td>Soft drinks</td>
<td>$702</td>
</tr>
<tr>
<td>Cooking products, seasonings</td>
<td>$675</td>
</tr>
<tr>
<td>Coffee, tea, juices</td>
<td>$625</td>
</tr>
<tr>
<td>Dairy products</td>
<td>$505</td>
</tr>
<tr>
<td>Bakery goods</td>
<td>$408</td>
</tr>
<tr>
<td>Meat, poultry, fish</td>
<td>$210</td>
</tr>
<tr>
<td>Fruits, vegetables, grains, beans</td>
<td>$159</td>
</tr>
<tr>
<td>General promotions</td>
<td>$50</td>
</tr>
</tbody>
</table>

*Source: Center for Science in the Public Interest*
The **BIG Idea**

The labor market, like other markets, is determined by supply and demand.

**Why It Matters**

In this chapter, read to learn about the major categories of the labor force, the role of unions in today’s work force, and the factors that affect wages.
Everyone—from a lumberjack to a biologist to the president of a corporation—belongs to the productive resource known as labor. As you read this section, you’ll learn how workers are categorized, how wages are determined, and why employers need to pay more to get (and keep) good workers.
The Civilian Labor Force

Main Idea

Workers can be categorized by the type of work they perform and by skill level.

Economics & You

Do you have a job? What kinds of skills does it require? Read on to learn about how American workers are categorized according to their skill level or the type of work that they do.

When discussing labor, economists use the term labor force in a specific way. The civilian labor force is the total number of people 16 years old or older who are either employed or actively seeking work. Individuals not able to work, such as disabled people or those in prisons or mental institutions, are not included in the civilian labor force. People in the armed forces or those not looking for a paying job, such as full-time students and homemakers, are excluded as well. Figure 12.1 below shows the civilian labor force in comparison to the total working-age population.

Workers in the United States are categorized in several ways. One way is to group them according to the type of work they perform. Another way is by the level of training or education their jobs require.

Skills Handbook

See page R50 to learn about Using Bar and Circle Graphs.

Figure 12.1

Employment Status of U.S. Population

As shown here, most people age 16 and older in the United States are part of the civilian labor force.

![Figure 12.1: Employment Status of U.S. Population](image)

### Employment Status of the United States Population

- **Homemakers**: 23,001,000 (10.1%)
- **Disabled**: 7,700,000 (3.4%)
- **Retired**: 24,111,000 (10.6%)
- **In school**: 10,752,000 (4.8%)
- **Other**: 9,607,000 (4.3%)
- **Armed forces**: 1,212,000 (0.5%)

#### Total

- **Employed**: 143,688,000 (63.2%)
- **Not in the labor force**: 75,171,000 (33.2%)
- **Unemployed**: 7,123,000 (3.1%)

Source: Standard & Poor’s.
Blue-Collar, White-Collar, and Service Workers

During the late 1800s and early 1900s, higher wages paid to workers in urban areas lured farmworkers there. Displaced farmers, and others who entered the workforce because of higher wages, often became blue-collar workers—craft and manufacturing workers and nonfarm laborers.

The largest sector of the labor force is white-collar workers. Office workers, salespeople, and highly trained individuals such as physicians and engineers are classified as white-collar workers. This sector experienced steady growth throughout the twentieth century.

In recent years, a shift away from farm work and blue-collar jobs to the service sector of the economy has occurred. Service workers are those who provide services directly to individuals. Cooks, piano tuners, health-care aides, computer repair specialists, and barbers are all service workers. See Figure 12.2 below.

**Figure 12.2 Worker Categories by Type of Job**

- Economists sometimes classify workers by their type of occupation, regardless of the skills necessary to perform the job.

**A. White-Collar Workers**
White-collar workers include office workers, salespeople, and highly trained individuals such as engineers.

**B. Blue-Collar Workers**
Blue-collar workers include craft workers, workers in manufacturing, and nonfarm laborers.

**C. Service Workers**
Service workers provide services—haircuts, food service, child care, and so on—directly to individuals.

**Economic Analysis**
**Extending** How do you think “white-collar” and “blue-collar” workers got their names?
Jobs Categorized by Skill Level

Another way to categorize workers is by the skills required to perform their occupation. **Unskilled workers** are those whose jobs require no specialized training. Jobs such as waiting on tables, assembly-line work, and custodial work are generally considered unskilled, although obviously these types of work require skills such as patience and the ability to pace oneself or to work according to a schedule. Such jobs may also demand the ability to work well with people.

**Semiskilled workers** are those whose jobs require some training, often using modern technology. The job of nurse’s aide, for example, is considered a semiskilled occupation. Someone who has learned a trade or craft, either through a vocational school or as an apprentice to an experienced worker, is considered a **skilled worker**. Police officers and electricians engage in skilled occupations.

**Professionals** are those with college degrees and usually additional education or training. Also classified as white-collar workers, people who hold professional jobs include teachers, architects, and accountants.

Although such terms as semiskilled, skilled, etc., are helpful in picturing different areas of the labor force, individual workers do not always fall into a single category. The definition of technician, for example, has become increasingly vague, as some technicians today require professional-level training. Also, workers may move from one skill level to another as they gain training and experience.

---

**Identifying Who is not included in the civilian labor force?**

**unskilled workers:** people whose jobs require no specialized training

**semiskilled workers:** people whose jobs require some training, often using modern technology

**skilled workers:** people who have learned a trade or craft either through a vocational school or as an apprentice to an experienced worker

**professionals:** highly educated individuals with college degrees and usually additional education or training

---

**In Training**

Often, people work in semiskilled occupations while they are training for a skilled profession. Nurses’ aides, for example, may move on to become nurses.
Supply and Demand in the Labor Market

Main Idea  In labor markets, wages are influenced by factors affecting supply and demand, such as variations in skill levels, job conditions, and work locations.

Economics & You  In your opinion, do you get paid enough for the work that you do? Read on to learn how supply and demand determine wages in the labor market.

The labor market, like other markets, is affected by supply and demand. Suppliers are the workers who offer their services to employers, while the demand comes from the employers who require workers.

Supply and Demand Factors That Affect Wages
Three major factors affect how supply and demand determine prices, or in this case wages, in the labor market. These factors include skill, type of job, and location. Figure 12.3 below discusses two of these factors.

Figure 12.3  Some Factors That Affect Wages

- The skill level a person brings to a job and the risk involved in performing a job are two major factors in determining how much a job will pay.

A. Skill  Alex Rodriguez, third baseman and power hitter for the New York Yankees, signed a $252 million 10-year contract. His wages are high because his types of skills are in high demand but short supply.

B. Type of Job  People with dangerous jobs, such as firefighters, receive higher wages than others who do not have life-threatening occupations.

Economic Analysis  Identifying What kind of labor market exists when there is high demand and short supply for a certain occupation?
The first factor, *skill*, may come from talent, initiative, education and/or training, or experience. Because the demand for talented individuals is usually high, whereas the supply of such employees is often scarce, a type of “tight” labor market occurs. The evidence of such a “tight” labor market is that it usually results in high prices—or high wages. Highly educated brain surgeons, for example, are paid large sums because their skills are in high demand relative to supply.

The type of job also affects the amount an employer is willing to pay and a potential employee is willing to accept. Jobs that are unpleasant or dangerous, such as coal mining, often pay higher wages compared to other jobs requiring equal levels of skill. Again, the demand for workers might be high, but the supply of laborers willing to do the work may be low.

In contrast, some jobs are enjoyable or prestigious or desirable enough that people are willing to take them even at low wages. Many people take lower-paying jobs in industries such as filmmaking and publishing for these reasons. In these cases, the demand for workers might be low, whereas the supply of individuals waiting for prestigious positions is high.

The *location* of both jobs and workers is the third factor in determining wages. (See Figure 12.4 above.) If workers are relatively scarce in an area, companies may have to pay high wages to attract workers to move there. In contrast, a company in a heavily populated area often can hire people at relatively low wages. Even professionals in such a location may not receive high wages.
Restrictions on Wages  If the labor market were perfectly competitive, the changing supply and demand for labor would result in constantly shifting wage rates.

Two factors restrict supply and demand in terms of their influence on wages. One is the federal minimum wage law, which sets the lowest legal hourly wage rate that may be paid to certain types of workers. Some states and cities have their own minimum wage laws, too.

Although the purpose of the minimum wage is to help workers, some studies have shown that the opposite often occurs. An increase in the minimum wage causes some firms to hire fewer low-skilled workers. This can delay the acquisition of job skills by low-paid workers who may not have had much formal education. When this happens, these low-skilled workers are even less sought after in the labor market.

Another factor that restricts the influence of supply and demand on wages is the process of wage negotiations between organized labor (unions) and management. Supply and demand have less influence on wage negotiations than do such things as the company’s ability to pay higher wages, the length of the negotiated contract, and seniority—length of time on the job. You’ll learn more about organized labor in Sections 2 and 3.

Summarizing  List at least three factors, other than supply and demand, that influence wages.
IPOD’ING AT WORK?

The boss is watching—so watch your iPod!

Check It Out! In this chapter you learned about job categories and their skill levels. In the following article, read to learn how some companies are using tech-toys to enhance the skills of their employees.

Trying to turn out productive workers as efficiently as possible, a few fast-food chains are using iPod video players to train new employees. Pal’s Sudden Service, a regional chain with Tennessee and Virginia outlets, started iPod video training in its 20 restaurants in February. “We’re looking to expedite the learning process through technology,” says Pal’s CEO Thom Crosby. Chuck E. Cheese, the pizza-and-games chain, is a few months into testing the video iPods in one of its Dallas outlets.

Both programs, developed by podTraining, a Flower Mound (Texas) startup, use short video clips to show new hires how to do their jobs. Unlike video or DVD-based training systems, the iPods can be updated quickly and cheaply by downloading new content. And the portability of the iPod allows training to be done on the job. New Pal’s employees practice making the chain’s trademark Big Pal burger while watching a video of the process. Other videos address customer service, ethics, and cashier operations.

TJ Schier, president and founder of podTraining, says he is developing more fast-food training videos for the iPod, including troubleshooting segments produced with Coca-Cola to teach workers what to do when a soda machine breaks. . . . At Pal’s, the iPod program has shaved a week and a half from new-employee training times, Crosby says, and has created a cool factor that has given a boost to recruitment.

—Reprinted from BusinessWeek

Think About It

1. Explaining What is the advantage of using iPods versus other training systems?
2. Extending What other benefits to using iPods besides the ones listed in the article can you think of?
In the late 1800s, some American workers began taking steps to try to improve their wages and working conditions. They believed that if they united in groups, they would have more influence on management than they would as individual workers acting alone. As you read this section, you’ll learn about the steps that workers took to gain a voice in their working environments.
Development of Labor Unions

Main Idea Labor unions developed to attempt to improve working conditions and wages for their members.

Economics & You If you work, do you feel that working conditions in your job are fair? Read on to learn about how workers who wanted to change working conditions formed the first labor unions.

Working conditions in the 1800s were very different from those of today. Buildings were often poorly lighted and ventilated, and the machinery was sometimes dangerous to operate. The workweek was long, and wages were low. Healthcare benefits, unemployment insurance, sick leave, and paid vacations and holidays did not exist. In an attempt to gain some control over their wages and working conditions, many American workers started forming labor unions. A labor union is an association of workers organized to improve wages and working conditions for its members. Unionism, however, met with strong resistance. In the 1800s, state legislatures passed laws against unions, and courts upheld them.

Figure 12.5 Labor’s Early Struggle for Recognition

The major weapon for workers to use against management was the strike. More often than not, however, striking unions were viewed as dangerous by the public, who turned against them.

**Maps In Motion** See StudentWorks™ Plus or go to glencoe.com.

[Map showing various labor unrest events]

- **1892 Silver Mines Unrest** Miners strike to protest wage cut; the state jails more than 1,000 workers.
- **1896 Haymarket Affair** A bomb explodes in labor rally, killing 7 police officers. Police fire into crowd, killing 10.
- **1892 Homestead Massacre** Steel workers strike to protest a wage cut; 13 people are killed.
- **1892 Pullman Strike** About 14,000 troops attack striking railroad workers, killing 30.
- **1897 Sugarcane Worker Strike** State militia breaks strike, killing 30 people, mostly African Americans.
- **1912 Textile Strike** Police beat 40 strikers’ hungry children.
- **1902 Anthracite Coal Strike** About 140,000 miners strike to win union recognition.

**Labor Unrest**

**Economic Analysis** Why did American workers form labor unions?
Many businesses refused to hire union members or deal with unions. Workers who tried to unionize were fired and blacklisted—kept from being employed. **Strikes**, or deliberate work stoppages by workers to force an employer to give in to their demands, often resulted in violence between strikers and police, as described in Figure 12.5. Not until the mid-1930s did Congress begin to pass laws to regulate labor-management relations.

### The American Labor Movement

For much of its history, organized labor in the United States has been split into two groups: craft unions and industrial unions. A **craft union** is made up of skilled workers in a specific trade or industry, such as carpentry or printing. The first permanent federation, or organization of national labor unions, was the American Federation of Labor (AFL), composed of craft unions and led by Samuel Gompers. An **industrial union** is made up of all the workers in an industry regardless of job or skill level. Attempts to organize industrial unions date to the late 1800s and the leadership of Eugene V. Debs, founder of the American Railway Union. The first significant effort to unionize unskilled and semiskilled workers did not begin, however, until the formation of the Congress of Industrial Organizations (CIO) in 1938.

### The AFL-CIO

During the late 1930s and early 1940s, both the AFL and the CIO launched organizing campaigns that made the lines between industrial and craft unions less clear. AFL unions began recruiting semiskilled and unskilled workers, while the CIO began organizing workers in the skilled trades. The resulting rivalry cost both union federations time and effort. By the mid-1950s, union leaders realized that the labor movement would make greater gains if craft and industrial unions worked together. As a result, the two federations merged in 1955 to form the present AFL-CIO.

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**Reading Check**

**Determining Cause and Effect** What were some complaints of workers in the 1800s?
How Unions Are Organized

Main Idea  Labor unions can exist as local unions, as national or international unions, or as federations.

Economics & You  Do you think that today’s workers should be required to join a local union? Why or why not? Read on to learn about both sides of this debate.

Organized labor operates at three levels: the local union, the national or international union, and the federation.

Local Unions  A local union consists of the members of a union in a particular factory, company, or geographic area. The local deals with a company by negotiating a contract and making sure the terms of the contract are kept. The influence that a local has often depends on the type of membership policy it has negotiated with management.

Not all local unions are alike. Membership requirements and the ways in which management relates to union members vary from one kind of shop to another. In a closed shop, companies could hire only union members. The Taft-Hartley Act of 1947 outlawed closed shops, however. In a union shop, a new employee must join the union after a specific period of time, usually three months. In an agency shop, employees are not required to join the union, but they must pay union dues.

Supporters of union and agency shops argue that employees in companies that are unionized should be required to pay union dues because they benefit from contracts the union negotiates. Opponents believe that a person should not be required to join a union. Since 1947 a number of states have passed right-to-work laws that forbid union shops. These laws allow workers to continue working in a particular job without joining a union. The benefits negotiated by the union must be made available to workers who do not join the union. Unions have less power in states with right-to-work laws than in other states.

The Big Three  Three of the largest unions in the United States are the Teamsters, the United Automobile Workers, and the United Steelworkers of America.

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**local union**: members of a union in a particular factory, company, or geographic area

**closed shop**: company in which only union members could be hired

**union shop**: company that requires new employees to join a union after a specific period of time

**agency shop**: company in which employees are not required to join the union, but must pay union dues

**right-to-work laws**: state laws forbidding unions from forcing workers to join and pay union dues
**National Unions** Above the locals are the national unions. These are the individual craft or industrial unions that represent locals nationwide. Those unions that also have members in Canada or Mexico are often called international unions.

National unions send in organizers to help employees set up locals. To help in negotiating a contract between a local and a particular company, the nationals provide lawyers and other staff members. In certain industries such as steel and mining, the national union negotiates the contract for the entire industry. After the majority of union members accept the contract, all the locals within the industry must work under the contract. Some of the largest unions are the International Brotherhood of Teamsters, the United Automobile Workers (UAW), and the United Steelworkers of America (USW).

**Federation Level** At the federation level is the AFL-CIO, which is made up of more than 50 national and international unions with about 9 million members.

Since 2005, the AFL-CIO has had to face competition from a new union organization. That organization is called the Change to Win Federation. It is composed of members of seven unions, including the Service Employees International and the International Brotherhood of Teamsters. Change to Win seeks to promote and increase U.S. union membership.

**Evaluating** How do right-to-work laws affect unions?

**Review**

**Vocabulary**

1. **Explain** the significance of: labor union, strike, craft union, industrial union, local union, closed shop, union shop, agency shop, right-to-work laws.

**Main Ideas**

2. **Summarizing** In a diagram like the one below, list the types of unionized shops described in this section, along with one characteristic of each shop.

**Critical Thinking**

3. **The Big Idea** How do the laws of supply and demand relate to unionization?

4. **Contrasting** What is the difference between a craft union and an industrial union?

**Applying Economics**

5. **Professional Unions** Interview a teacher about the teacher’s union in your school. Is it an agency shop? How much are the dues? What services does the union offer? Is the teacher satisfied with this union? If there is no union, how do teachers negotiate a contract?
GUIDE TO READING

Section Preview
In this section, you will learn how unions and employers determine the conditions of employment, and about the role of unions today.

Content Vocabulary
- collective bargaining (p. 321)
- cost-of-living adjustment (COLA) (p. 321)
- mediation (p. 321)
- arbitration (p. 321)
- picketing (p. 322)
- boycott (p. 322)
- lockout (p. 323)
- injunction (p. 323)

Academic Vocabulary
- neutral (p. 321)
- resolve (p. 321)

Reading Strategy
Organizing As you read the section, complete a chart like the one below by listing the steps of the collective bargaining process that can occur if labor and management are unable to reach a compromise.

ISSues In ThE NeWS
—from CNN.com

Hockey Season Cut Short [In February 2005], the NHL canceled the remainder of the season... after a series of last-minute offers were rejected on the final day of negotiations.

The players had been locked out over a salary cap dispute since the season was scheduled to start in October. The NHL now becomes the first major professional sports league in North America to lose an entire season to a labor dispute. ... The league and players’ union traded a flurry of proposals and letters ... but could never agree on a cap. The players proposed $49 million per team; the owners said $42.5 million.

... Over the 10-year term of the last collective bargaining agreement, players’ salaries went from just over $500,000 a season to $1.83 million. An economic study commissioned by the NHL determined that players got 75 percent of team revenues, the most of any of the four North American professional teams.

At the core of negotiations between management and unions is compromise. Companies want to keep wages and benefits low to hold labor costs down and remain competitive in the market. Unions want to increase wages and benefits for their members as much as possible. As you read this section, you’ll learn that both sides must be prepared to give and take a little.
Negotiations

Main Idea  Union contracts are negotiated to determine a wide range of contract issues.

Economics & You  Have you ever had to compromise to get something you wanted? Read on to learn about how workers and management attempt to reach compromises on important labor issues.

Collective bargaining is the process by which unions and employers negotiate the conditions of employment. In collective bargaining, labor and management meet to discuss a wide range of contract issues, including working hours, fringe benefits, and a cost-of-living adjustment (COLA). In most cases, negotiations are friendly and result in an agreement that satisfies all parties.

If negotiations become hostile or compromise breaks down, labor and management may try mediation. Mediation occurs when a neutral person steps in and tries to get both sides to reach an agreement. The mediator suggests possible solutions and works to keep the two sides talking with each other. The federal government, through the Federal Mediation and Conciliation Service (FMCS), provides a mediator free of charge upon request of either side. In a typical year, FMCS mediators are involved in thousands of negotiations. A number of state and private mediators also help resolve disputes.

If mediation fails, the negotiation process may go to arbitration, in which the two sides submit the issues they cannot agree on to a third party for a final decision. Both sides agree in advance to accept the arbitrator’s decision, although one or both sides may not be completely happy with the outcome. The FMCS often helps in these cases by providing labor and management with a list of private arbitrators in their area.

Reading Check  What is mediation? What role does the federal government play in this process?

Seeking Compromise  In most cases, issues that arise between management and workers are settled to the satisfaction of all parties through collective bargaining.
Strikes and Management

Main Idea If labor negotiations break down, unions may resort to strikes or boycotts, and management may resort to lockouts or injunctions.

Economics & You Have you ever witnessed, or participated in, a strike? What did you experience? Read on to learn about what happens when negotiations between labor and management break down.

Most contracts are settled at the bargaining table. Sometimes, however, negotiations break down and a strike results. The number of strikes in the United States has declined sharply since the 1970s, as shown in Figure 12.6.

Strikers usually walk up and down in front of their workplace carrying picket signs that state their disagreement with the company. Picketing is meant to discourage workers from crossing the picket line to work for the employer. It is also aimed at embarrassing the company and building public support for the strike.

Striking unions may also use a boycott to exert more economic pressure. In a boycott, unions urge the public not to purchase goods or services produced by a company. In addition, unions may ask politicians to push management for a settlement or to support publicly the union’s demands.

When Negotiations Fail

One of the biggest strikes in recent history involved the Transport Workers Union Local 100 (TWU) in New York City. In December 2005, negotiations between the union and the Metropolitan Transportation Authority broke down over retirement, pension, and wage issues. Most New York City transit authority personnel observed the strike, effectively ending all bus and subway service and affecting millions of commuters. The strike lasted for three days.

picketing: action of strikers who walk in front of a workplace carrying signs that state their disagreement with the company

boycott: economic pressure exerted by unions urging the public not to purchase the goods or services produced by a company
Strikes can drag on for months and even years. After a long period of time, strikers sometimes become discouraged. Some may decide to go back to work without gaining what they wanted. In most cases, however, strikes are settled as management and labor return to the negotiating table and work out an agreement.

**Lockouts** When faced with a strike, management has methods of its own to use against strikers. One is the lockout, which occurs when management prevents workers from returning to work until they agree to a new contract. Another tactic is to bring in strikebreakers, called “scabs” by strikers. These are people willing to cross a picket line to work for the terms the company offers.

**Injunctions** Management sometimes requests a court injunction to limit picketing or to prevent a strike from continuing or even occurring. An injunction is a legal order of a court preventing some activity. Under the Taft-Hartley Act of 1947, the president of the United States can obtain an injunction to delay or halt a strike for up to 80 days if the strike will endanger the nation’s safety or health. During this cooling-off period, the two sides must try to reach a settlement. Although settlements usually are reached in these cases, presidents have invoked the Taft-Hartley Act numerous times over the years.

**Describing** What is a scab?
Decline of Unions

Main Idea Union membership has declined steadily over the past several decades.

Economics & You If you had the option of joining a union for your job, would you? Why or why not? Read on to learn about why fewer workers than ever before are willing to become union members.

The establishment of the AFL in 1886 is considered the beginning of the modern union era. Since that time, unions have achieved many of their goals. Union supporters list among their accomplishments better wages and working conditions for all employees—union and nonunion. They point out that many workers now enjoy a sense of security that helps to maintain some control over their jobs and lives.

Union supporters also note that the collective bargaining process has brought more order and fairness to the workplace. It has made clear the rights and responsibilities of both management and labor.

Because working conditions have improved so dramatically over the years, many nonunion workers often see little to gain from joining a union. Figure 12.7 below shows how much union membership has declined since the 1940s. In addition, the nature of the economy itself is changing. More jobs are opening in the white-collar and service sectors, whereas blue-collar jobs are decreasing due to automation.

Skills Handbook See page R49 to learn about Using Line Graphs.

Figure 12.7 Declining Union Membership

The labor movement today faces many problems. The percentage of the labor force who belong to a union reached a high in the mid-1940s and has been declining since 1955.

Economic Analysis Comparing Compare the trend in strikes with what is happening in union membership. How are the two related?

* Author’s estimate
Unions’ demands must be reasonable for the union to be effective.

The labor movement also has its critics. Some opponents charge that unions have grown so large and bureaucratic that they are out of touch with their members’ needs. Others claim that increased wages are passed on to consumers in the form of higher prices.

Employers often argue that union rules decrease productivity. They point to rules that slow the introduction of new technology or require more employees than necessary to do a job. In addition, at times corruption among some labor leaders has damaged the reputation of organized labor.

Analyzing What are two reasons why workers are less willing to join unions today than in the 1940s?

Vocabulary
1. Explain the significance of: collective bargaining, cost-of-living adjustment (COLA), mediation, arbitration, picketing, boycott, lockout, injunction.

Main Ideas
2. Interpreting From a worker’s point of view, what are the advantages and disadvantages of each strategy listed in the table below?

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Picketing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Boycott</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lockout</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Injunction</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea How can collective bargaining overrule supply and demand for wages in a workplace?
4. Contrasting What is the difference between mediation and arbitration?

Applying Economics
5. Collective Bargaining Imagine that your student body is bargaining with your school administration about conditions for students. Using each term in this section’s vocabulary list, write a newspaper article about what is happening in negotiations.
By the time César Chávez reached the eighth grade and dropped out of school to help support his family, he had attended more than 30 elementary and middle schools as the child of migrant farm workers. After a stint in the U.S. Navy, Chávez married, started a family, and returned to the life of an agricultural worker. He caught the eye of a community organizer and was recruited to work for a Latino civil-rights group. His goal, however, was to create a union for underpaid farm workers.

Chávez spent 10 years learning how to be an organizer, and in 1962, he began the difficult work of forming what would become the United Farm Workers of America.

“The organizer has to work more than anyone else. . . . and in the initial part of the movement, there’s the fear that when the organizer leaves, the movement will collapse. So you have to be able to say, I’m not going to be here a year or six months, but an awful long time.”

He did stay a long time, and in 1966 he negotiated the first genuine union contract between a grower and farm workers. For the next 27 years, he led boycotts, went on hunger strikes, and continued his organizing activities until his death in 1993. Though given great credit for his dedication, he acknowledged his reliance on the workers themselves:

“I have always believed that, in order for any movement to be lasting, it must be built on the people. They must be the ones involved in forming it, and they must be the ones that ultimately control it.”

Checking for Understanding
1. **Assessing** Of what importance was César Chávez’s work as a civil-rights organizer?
2. **Drawing Conclusions** Why does an organizer need to be dedicated to his or her cause?
In labor markets, a variety of factors that affect supply and demand for jobs ultimately determine wages for those jobs.

- Skill level required
- Job conditions
- Work location

Labor unions formed in the United States to try to improve working conditions and wages for their members.

Because working conditions in general have improved so much since the mid-1950s, many nonunion workers see little to gain by joining a union, and union membership has declined.
Review Content Vocabulary

1. Write a paragraph or two describing the basic categories of workers. Use all of the following terms.
   - blue-collar workers
   - white-collar workers
   - service workers
   - semiskilled workers
   - skilled workers
   - professionals
   - unskilled workers

2. Write a paragraph or two explaining the role of organized labor in the United States, both past and present. Use all of the following terms.
   - minimum wage law
   - labor union
   - strike
   - local union
   - union shop
   - right-to-work laws
   - collective bargaining
   - mediation
   - picketing
   - lockout

Review the Main Ideas

Section 1 (pp. 307–313)

9. Which category of worker usually has a higher-education degree as well as additional training?

10. What is the difference between blue-collar and white-collar workers?

11. What factors determine how much a person is paid for his or her work?

12. What two main factors restrict the influence of supply and demand on wages?

Section 2 (pp. 315–319)

13. Why did workers start forming unions in the late 1800s?

14. What are the major kinds of labor unions, and what type(s) of workers belong to each?

15. What two union federations merged in 1955?

16. How do right-to-work laws affect workers who do not belong to unions?

Section 3 (pp. 320–325)

17. What kinds of issues are typically addressed in collective bargaining negotiations?

18. What is a strike, and what is it meant to accomplish?

19. How might management respond to strikes?

20. Create a diagram like the one below to explain the factors that have caused a decline in union membership in recent decades.

Declining Union Membership

- blue-collar workers
- white-collar workers
- service workers
- unskilled workers
- semiskilled workers
- skilled workers
- professionals

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

- a. resource
- b. displaced
- c. regulate
- d. significant
- e. neutral
- f. resolve

3. Labor unions have had a ______ impact on improving working conditions and wages.

4. Human labor is a valuable productive ______.

5. Sometimes a ______ third party must mediate between workers and management.

6. When a person loses his job, he becomes ______.

7. Congress has passed laws to ______ labor-management relations.

8. Unions and management often ______ their disputes through negotiations.
Math Practice
Study this table about union membership in different occupations in the United States. Then answer the questions that follow.

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Percentage of workers who belong to unions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>13.3%</td>
</tr>
<tr>
<td>Financial (bankers, accountants, brokers, etc.)</td>
<td>2.3%</td>
</tr>
<tr>
<td>Local government (teachers, police, firefighters, etc.)</td>
<td>41.9%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>13.0%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>21.4%</td>
</tr>
<tr>
<td>Transportation and utilities</td>
<td>24.0%</td>
</tr>
</tbody>
</table>

21. Which group in the table is the most heavily unionized? Why do you think so many in this group belong to unions?

22. Which occupation had the lowest percentage of union members? Why do you think this is so?

23. If 100,000 people are working in manufacturing jobs in one state, about how many of them belong to unions?

Critical Thinking
24. The BIG Idea How do supply and demand affect the labor market? Give an example.

25. Determining Cause and Effect Why do workers with more education and training generally get paid higher wages?

26. Synthesizing How might things be different for workers today if labor unions had never existed?

27. Predicting Consequences Do you think union membership will continue to decline in the future? Why or why not?

Analyzing Visuals
28. Study the cartoon below, and then answer the following questions.
   a. What is a CEO?
   b. What economic factors contribute to a CEO having a higher salary than the young women shown in the cartoon?
   c. Do you think it is fair that CEOs make more than fast-food workers? Why or why not?
How can young people run successful businesses?

THE ISSUE
In a recent survey, 90 percent of teachers and guidance counselors reported that students have expressed interest in starting their own businesses. Many say that they would prefer being their own boss to working for an employer, but there are other reasons to become an entrepreneur. First, there is the potential to earn more income than you would working for someone else. There’s also the possibility of earning passive money—money you make even when you’re not working, which could include royalties from books or income from sales made by employees you hire. Also, many people like the idea of being able to set their own hours and work in an environment of their own choosing. But how can young people without business experience operate successful businesses?

THE FACTS
Many successful companies were started by young people with a good idea. When Michael S. Dell was an 18-year-old freshman at the University of Texas, he thought buying computers and parts from retail stores was too expensive and that the service was generally poor.

Like all successful entrepreneurs, Michael saw a need in the market and met it: he began selling computer parts out of his dorm room. Without the expense of operating retail stores, he could offer lower prices. He borrowed $1,000 and founded Dell Computer Corporation (now Dell, Inc.) to sell computers directly to consumers. By 2006 Dell had become the world’s top vendor of personal computers, with sales of almost $56 billion.

The Dell business model did not come from Michael Dell’s experience in business but from his personal experience as a consumer. Other young entrepreneurs have taken similar paths. At age 16, for example, Richard Branson published a magazine in London called Student. It evolved into the Virgin Group, a conglomerate that now operates dozens
of companies in industries from entertainment and fitness to financial services and travel, including space tourism.

THE ECONOMIC CONNECTION: ENTREPRENEURSHIP

Almost three-fourths of American businesses—19.5 million—consist of one self-employed person. More than 6 million new businesses are started each year; after five years, almost 44 percent have survived. The rest usually fail because of poor management or inadequate financing.

Once you decide to start a business, the first step is to identify a good or service the public either wants or needs, or can be convinced it wants or needs—discovering or creating demand. Then, write a business plan detailing how you’ll produce the product (production), who will buy it (market research), and how you’ll reach them (marketing). Other key considerations include taxes, insurance, legal issues, and cash flow—the money coming into and going out of a business.

Learning to handle these functions as you go is called on-the-job training. That’s how Michael Dell, Richard Branson, Mary Kay, Bill Gates, and many other entrepreneurs did it. Of course, the risk of learning as you go is that you may not learn the skills you need as quickly as you need them. But several organizations are available to help. Many universities offer entrepreneurship programs. Junior Achievement and the Young Entrepreneur Foundation provide advice, ideas, and annual awards. The Small Business Administration provides advice and tools to help young entrepreneurs get started.

CONCLUSION

Entrepreneurs are a large segment of the American labor force. They are people willing to take risks and rely on their own initiative—rather than an employer—for their livelihoods. While having the right skills and experience are valuable in any job, the essential qualities of successful entrepreneurs are determination, perseverance, the ability to hire good people, and the ability to learn from mistakes.

Analyzing the Impact

1. Synthesizing In what ways might it be easier for young people to start businesses than older people who have already been in the workforce?

2. Critical Thinking Think of a product you could make or a service you could sell. If you decided to start a business, who would buy the product/service? What would you need to start?
In this unit, read to find out...
- what statistics measure the economy's health.
- how the American banking system works.
- the role government plays in the nation's economy.

Macroeconomics: The Nation’s Economy

Chapter 13
Measuring the Economy’s Performance

Chapter 14
Money and Banking

Chapter 15
The Federal Reserve System and Monetary Policy

Chapter 16
Government Spends, Collects, and Owes

Chapter 17
Stabilizing the National Economy
The BIG Idea
Economists look at a variety of factors to assess the growth and performance of a nation’s economy.

Why It Matters
Economists use an array of tools to evaluate the performance of the American economy. In this chapter, read to learn about GDP, the consumer price index, and other economic indicators.

Chapter Overview
Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 13—Chapter Overviews to preview chapter information.
People can measure how economically successful they are by how much income they make and by their standard of living. These calculations include figuring out how much their disposable personal income will buy. In this section, you’ll learn that the state of the nation’s overall economy is measured in a similar way.
National Income Accounting, GDP, and NDP

Main Idea Gross domestic product is an estimate of the total dollar value of all final goods and services produced annually within a country.

Economics & You What tools and measurements does a physician use to decide whether you are healthy? Read on to learn about the factors economists use to determine the health of the American economy.

The way we usually measure the national economy’s performance is by using national income accounting. This area of economics deals with the overall economy’s output, or production, and its income.

Five major statistics measure the national economy. These are gross domestic product, net domestic product, national income, personal income, and disposable personal income. Each will be examined separately, starting with the largest overall measurement—gross domestic product. Figure 13.1 below shows gross domestic product and how it is related to the other four measurements.

Figure 13.1 Measuring the National Economy

- Economists start with GDP and subtract various items until they reach the figure measuring disposable personal income—the amount people have left to spend after they pay taxes. This graph shows how five important measures of the national economy are calculated.

Graphs In Motion See StudentWorks™ Plus or go to glencoe.com.

Using Graphs According to the graph, what is the difference in dollars between gross domestic product and disposable personal income?
Measuring GDP  The broadest measure of the economy’s size is **gross domestic product (GDP)**. This is the total dollar value of all *final* goods and services produced in the nation during a single year. This figure tells the amount of goods and services produced within the country’s borders and made available for purchase in that year.

Measuring Value  Note the word *value* in the definition of GDP. Simply adding up the quantities of different items produced would not mean much. Can we really measure the strength of the economy, for example, if we know that 3 billion safety pins and 2 space shuttles were produced?

What we need to know is the total value of the items, using some common measure. Economists use the dollar as this common measure of value. As a result, GDP is always expressed in dollar terms. For example, in 2006, GDP for the United States totaled more than $13 trillion.

Measuring Final Goods and Services  The word *final* in the definition of GDP is also important. Measuring the economy’s performance accurately requires that economists add up only the value of final goods and services to avoid *double counting*. For example, consider all the parts that go into computers. When calculating GDP, we do not take into account the price of memory chips and motherboards if those chips and motherboards are installed in computers for sale. The final price of the computer to the buyer already includes the price of these parts. When memory chips and motherboards are sold separately, however, they are included in GDP.

Also, only new goods are counted in GDP. The sale price of a used car or a secondhand refrigerator is not counted as part of GDP. Such a sale is not due to the production of the nation, but only transfers an existing product from one owner to another. If a new battery is put in an old car, however, that new battery is counted as part of GDP.

**Avoiding Double Counting**

When calculating GDP, economists count only the value of the final product. The intermediate products that go into making a flat-screen television, for example, are not counted in GDP. Only the price of the television itself is counted.

gross domestic product (GDP): total dollar value of all final goods and services produced in a nation in a single year

**Economics ONLINE**

**Student Web Activity**

Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on Chapter 13—*Student Web Activities* to learn about your gross state product.
Computing GDP

To derive GDP, economists add the expenditures made in four economic categories. The first is the consumer sector (C), or those goods and services bought directly by consumers. The second category is the investment sector (I), or business purchases of items used to produce other goods. Goods and services bought by the government sector (G) make up the third category. The final category is net exports (X), or the difference between what the nation sells to other countries and what it buys from other countries. This figure may be a plus or minus depending on economic activity in a given year. (See Figure 13.2.) GDP measurements have weaknesses, though. Statistics about easily measurable things, such as government purchases, are reliable. Some workers, however, are given food, fuel, or housing as part of their wages, and GDP can include only an estimate of their value. Also, GDP omits certain areas of economic activity, such as unpaid work.

**Net Domestic Product (NDP)**

The loss of value because of wear and tear to durable or capital goods is called depreciation. GDP disregards depreciation. It does not take into account that some production merely keeps machines and equipment in working order and replaces them when they wear out. Net domestic product (NDP)—another way of measuring the economy—accounts for the fact that some production is lost to depreciation. NDP takes GDP and subtracts the total loss in value of capital goods caused by depreciation.

**Reading Check**

Why are only new and final goods counted in GDP?
Measurements of Income

Main Idea Disposable personal income is the total income that people have left after taxes are paid.

Economics & You If you have a job, how much do you earn there? Read on to learn about how personal income is a factor in determining the nation’s economic health.

So far, you’ve learned about GDP and NDP—two major measurements of the value of the nation’s output. Economists also look at three additional measurements dealing with income—national income, personal income, and disposable personal income.

National Income The total amount of income earned by everyone in the economy is called national income (NI). NI includes the income of those who use their own labor as well as those who earn income through the ownership of the other factors of production. NI is equal to the sum of all income resulting from five different sources. These sources include wages and salaries, income of self-employed individuals, rental income, corporate profits, and interest on savings and other investments.

Personal Income The total income that individuals receive before personal taxes are paid is called personal income (PI). PI can be derived from NI through a two-step process. First, several items are subtracted: corporate income taxes, profits that businesses reinvest in business to expand, and Social Security contributions employers make. These items are subtracted because they represent income that is not available for individuals to spend.

Elements of National Income

- Wages and salaries paid to employees
- Income of self-employed individuals, including farmers and owners of sole proprietorships and partnerships
- Rental incomes of property owners
- Corporate profits
- Interest on savings and investments individuals receive
Then government transfer payments are added to NI. **Transfer payments** are welfare payments and other assistance payments—unemployment compensation, Social Security, and food stamps—that a state or the federal government makes to individuals. These transfer payments add to an individual’s income even though they are not exchanged for any current productive activity.

**Disposable Personal Income** The income that people have left after taxes, including Social Security contributions, is called **disposable personal income (DPI)**. DPI equals PI minus personal taxes. DPI is an important indicator of the economy’s health because it measures the actual amount of money income people have available to save and spend.

**Identifying** What five sources of income make up the national income?
In Section 1, you learned how GDP statistics measure the size of the national economy. You also learned that GDP figures can be misleading or incomplete because they do not measure unpaid work or depreciation. In this section, you’ll learn about another factor that influences the current dollar value of GDP as well as your ability to purchase goods and services.
The Purchasing Power of Money

Main Idea The nominal value of GDP must be adjusted for changes in the purchasing power of money to determine changes in real output.

Economics & You Will one dollar buy you more or less food than it would have a year ago? Read on to learn about the changing purchasing power of money.

When thinking about GDP, economists need to take inflation into account. Inflation is a prolonged rise in the general price level of goods and services. When this situation occurs, the purchasing power of the dollar goes down. A dollar’s purchasing power is the real goods and services that it can buy. In other words, if there is inflation, a dollar cannot buy the same amount as it did before the inflation occurred.

How does a drop in the dollar’s purchasing power skew GDP? The higher GDP figures that result from inflation do not represent any increase in output. For example, last year an ice-cream cone may have cost $1.50. This year it may cost $2.00. The physical output has not changed; only its money value has. To get a true measure of the nation’s output in a given year, inflation must be taken into account. Deflation, a prolonged decline in the general price level of goods and services, also affects the dollar value of GDP, but deflation has rarely happened in modern times.

Reading Check How is the value of a dollar determined?

Figure 13.3 Selected Consumer Prices

Price indexes allow you to compare price levels from year to year. When the CPI rises, there is inflation.

A. Selected Categories This table shows the CPI broken down into four major categories.

<table>
<thead>
<tr>
<th>Consumer Price Index of Selected Categories</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>180.5</td>
<td>186.6</td>
<td>191.2</td>
</tr>
<tr>
<td>Clothing</td>
<td>120.9</td>
<td>120.4</td>
<td>119.5</td>
</tr>
<tr>
<td>Housing</td>
<td>184.8</td>
<td>189.5</td>
<td>195.7</td>
</tr>
<tr>
<td>Medical</td>
<td>297.1</td>
<td>310.1</td>
<td>323.2</td>
</tr>
</tbody>
</table>


B. Overall CPI This table shows the overall CPI for selected years.

<table>
<thead>
<tr>
<th>The CPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
</tr>
<tr>
<td>1996</td>
</tr>
<tr>
<td>1997</td>
</tr>
<tr>
<td>1998</td>
</tr>
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<td>2002</td>
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<tr>
<td>2003</td>
</tr>
<tr>
<td>2004</td>
</tr>
<tr>
<td>2005</td>
</tr>
</tbody>
</table>


Economic Analysis Drawing Conclusions

What general trend do you notice in the overall CPI?
Measures of Inflation

Main Idea Inflation can be measured in several ways by calculating changes in different price indexes.

Economics & You Think of an item that costs more today than it did when your parents were your age. This is an example of inflation. Read on to learn how inflation is calculated.

The government measures inflation in several ways. The three most commonly used measurements are the consumer price index, the producer price index, and the implicit GDP price deflator.

Consumer Price Index (CPI) Every month, the government measures the prices of a specific group of goods and services that the average household uses. This measurement is the consumer price index (CPI). The group of items that are priced, called a market basket, includes about 80,000 specific goods and services under general categories such as food, housing, transportation, clothing, education, recreation, medical care, and personal care. About every 10 years, the market basket is updated to include new products and services and to reflect more current spending patterns. (See Figure 13.3.)

Employees at the federal Bureau of Labor Statistics (BLS) compile the CPI monthly. They start with prices from a base year so that they have a point of comparison for current-day prices. For example, if you paid $2.00 for an ice-cream cone in 2006, and the price of the cone increased to $2.50 in 2007, the cost of an ice-cream cone has risen 50 cents since the base year 2006 ($2.50 – 2.00 = .50).

In compiling the CPI, the BLS’s base year is really the average of prices that existed for the three years 1982 to 1984. This base is given a value of 100. CPI numbers for later years indicate the percentage that the market basket price has risen since the base year. For example, the 2004 CPI of 188.9 means that the average price of goods and services in the market basket has risen 88.9 percent since the period 1982–1984 (188.9 – 100 = 88.9). The price level, therefore, rose 88.9 percent since 1982–1984. The CPI can also be used to calculate inflation for any period.
Producer Price Index Another important measure of inflation is the **producer price index (PPI)**. The PPI is actually a group of indexes that measures the average change in prices that United States producers charge their customers—whether these customers are other producers buying crude materials for further processing or wholesalers who will sell the products to retailers or directly to consumers. Most of the producer prices included in the PPIs are in mining, manufacturing, and agriculture.

The PPIs usually increase before the CPI. Apple producers, for example, may experience a weak harvest. Because of the reduced supply of apples, the price of apples rises. A bakery that buys apples will eventually increase the price of its apple pies to cover the higher price of apples. Eventually the CPI will increase because consumers will have to pay more for the final products—in this case, apple pies. Therefore, changes in the PPIs often are watched as a hint that inflation and the CPI are going to increase.

**GDP Price Deflator** Government economists account for inflation by issuing another measure of price changes in GDP, called the **GDP price deflator**. This index removes the effects of inflation from GDP so that the overall economy in one year can be compared to another year. When the price deflator is applied to GDP in any year, the new figure is called **real GDP**.

**Figure 13.4** Nominal and Real GDP Over Time

- Nominal GDP is also called current GDP. Real GDP has been adjusted for inflation using 2000 as a base year.

**Economic Analysis**

**Using Graphs** By how much did nominal GDP rise between 1980 and 2005?

Source: U.S. Department of Commerce.
The federal government uses 2000 as its base year to measure real GDP. Each year the price deflator is used to change current, or nominal, GDP into real GDP. For example, GDP in current dollars for 2004 was $11,734.3 billion. To find real GDP for 2004, the government divides 2004 GDP by the 2004 price deflator (109.099) and multiplies the result by 100:

\[
\frac{11,734.3 \text{ billion}}{109.099} \times 100 = 10,755.7 \text{ billion}. 
\]

Real GDP for 2004 was $10,755.7 billion. This figure may now be compared to other years’ real GDP figures. Such comparisons are more meaningful than those made by simply comparing nominal values. Figure 13.4 on page 344 shows both nominal GDP and real GDP over time.

Purchasing power is determined by more than just wages—inflation is also a factor.

## Vocabulary

1. Explain the significance of: inflation, purchasing power, deflation, consumer price index, market basket, base year, producer price index, GDP price deflator, real GDP.

## Main Ideas

2. Contrasting In a chart like the one below, describe the difference between what the CPI and the PPI measure.

<table>
<thead>
<tr>
<th>Index</th>
<th>What It Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPI</td>
<td></td>
</tr>
<tr>
<td>PPI</td>
<td></td>
</tr>
</tbody>
</table>

## Critical Thinking

3. The BIG Idea Why would real GDP be more accurate than nominal GDP when comparing one year’s growth to another?

4. Predicting Consequences Producer prices are monitored to predict how the CPI might change. Explain how this works.

## Applying Economics

5. Market Basket Choose six items you buy regularly, and list the price of each. Ask an adult what this item cost ten years ago. Write a paragraph to describe how inflation or deflation affects the price of each of your items today.
GDP: WHAT’S COUNTED, WHAT’S NOT

Figuring out the size of the U.S. economy is a tricky task.

Check It Out! In this chapter you learned about GDP. In this article, read to learn why economists debate this measurement’s accuracy.

You might think that calculating the size of the U.S. economy is easy: Add up the value of all the goods and services that American workers produce, and you’re done. Unfortunately, this simple procedure has a basic flaw: It leads to a lot of double-counting. For example, if [a person] sets up a factory making ceramic frogs and sells them to The Ceramic Frog Store, there’s a real danger the frogs will be counted twice: when they leave the factory and again when they’re sold to some frog-crazed consumer.

So here’s what the government’s statistical experts do. Everything that’s bought is assigned to one of three bins. The “consumption bin” includes goods and services intended for use by households or the government today or in the near future. Food, haircuts, cell-phone service, and computer games all go into the consumption bin.

The “investment bin” includes all long-lived assets expected to contribute to production in the future. For example, shopping malls, airplanes, and business computers all go into the investment bin. Business software was put into the investment bin in 1999. Homes go there, too.

Finally, the “intermediate output” bin includes all purchases by a business that are used up today in the production of whatever it is the business produces. The classic case is the purchase of ingredients by a restaurant.

Here’s the problem: There are all sorts of anomalies where purchases are put into the wrong bin, either for historical reasons or because it’s too hard to put them somewhere else. Education—human capital—is surely a long-lived asset, but government and personal spending on education is mostly put into the consumption bin. A big portion of the long-term output of American companies isn’t being counted as part of GDP at all. And that, in a nutshell, is the problem.

—Adapted from BusinessWeek

Think About It
1. Recalling Into what three categories does the government organize purchases?
2. Analyzing According to the article, what part of the American economy is not being counted in GDP? What impact might this have on measuring the economy’s output?
As we shall see, the laws of supply and demand can be applied to the economy as a whole, as well as to individual consumer decisions. Economists are interested in the demand by all consumers for all goods and services, and the supply by all producers of all goods and services. In this section, we’ll learn about how economists study the economy as a whole in terms of supply and demand.
Aggregate Demand and Supply

Main Idea Aggregate demand and aggregate supply curves plot the price level versus total output.

Economics & You On any given day, you probably see people buying things. Read on to learn about aggregate demand and supply, which sums up all of the individual supply and demand in the economy.

In Chapter 7, you learned about demand and supply for individual goods and services. Here we look at demand and supply again, but in a different way. When we look at the economy as a whole, we are looking at aggregates—the summing up of all the individual parts in the economy. As you’ll learn in this section, we call these sums aggregate demand and aggregate supply.

Aggregate Demand Aggregate demand can be defined as the total of all planned expenditures in the entire economy. To determine how much people, businesses, and governments plan to spend, we have to relate this planned spending to something. Because there are millions of different prices for all products, aggregate demand cannot be related to individual prices. Instead, aggregate demand is related to the price level—the average of all prices as measured by a price index. If we use the implicit GDP price deflator as our index, our measure of aggregate demand will be based on real (adjusted for inflation) domestic output. You can see this relationship in Figure 13.5 below. It is called the aggregate demand curve.

Figure 13.5 Aggregate Demand and Supply

A. The Aggregate Demand Curve Although the curve for aggregate demand resembles that for simple demand, it is for the entire economy, not just one good or service. Aggregate demand may increase (curve shifts to the right) if consumers collectively spend more and save less or if better economic conditions are forecast. Aggregate demand may decrease (curve shifts to the left) if higher taxes are imposed on the overall economy or if bleak economic conditions are forecast.
Notice the similarity between the aggregate demand curve and the individual demand curve you studied in Chapter 7 (page 179). Both of them slope downward, showing an inverse relationship. As the price level in the economy goes down, a larger quantity of real domestic output is demanded per year. This change in quantity demanded is shown as a movement along the AD curve.

There are two main reasons for this inverse relationship. First, inflation causes the purchasing power of cash to go down, and deflation causes it to go up. Therefore, when the price level goes down, the purchasing power of all cash will go up. You and everyone else will feel slightly richer because you are able to buy more goods and services. Secondly, when the price level goes down in the United States, our goods become relatively better deals for foreigners who want to buy them. Foreigners then demand more of our goods as exports.

**Aggregate Supply** Aggregate demand is only one side of the story. Let us look at aggregate supply. As the price of a specific product goes up, and if all other prices stay the same, producers of that product find it profitable to produce more. The same is true for all producers in the economy over a short period of time. If the price level goes up and wages and other costs of production do not, overall profits will rise. Producers will want to supply more to the marketplace—they offer more real domestic output as the price level increases. The reverse is true as the price level falls. This is called **aggregate supply**. You can see this positive relationship in the graph in Figure 13.5 below—the aggregate supply curve.

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**B. The Aggregate Supply Curve** The aggregate supply curve shows the amount of real GDP that will be produced at various price levels. Aggregate supply increases (curve shifts to the right) when all firms experience lower costs of production due to lower taxes or interest rates or lower prices for foreign oil, for example. Aggregate supply decreases (curve shifts to the left) for the opposite reasons: higher taxes, higher interest rates, higher prices for foreign oil.

**Economic Analysis**

Extending What other examples of lower production costs, besides the ones listed here, might occur and cause the aggregate supply curve to shift?
Putting Aggregate Demand and Aggregate Supply Together  Just as we are able to compare demand and supply for a given product to find an equilibrium price and quantity, we can compare aggregate demand and aggregate supply.

The equilibrium price level in our example is determined where the aggregate demand curve crosses the aggregate supply curve, or at a GDP price deflator of 140. The equilibrium quantity of real GDP demanded and supplied is $14 trillion. As long as nothing changes in this situation, the economy will produce $14 trillion of real domestic output, and the price level will remain at 140—there will be neither inflation nor deflation.

Now, if something pushes out the aggregate demand curve faster than the aggregate supply curve, the equilibrium price level will rise. If the aggregate supply curve shifts out faster than the aggregate demand curve, the equilibrium price level will drop.

Predicting Consequences  What will happen to the equilibrium price level if there is an increase in aggregate demand?

Vocabulary
1. Explain the significance of: aggregates, aggregate demand, aggregate demand curve, aggregate supply, aggregate supply curve.

Main Ideas
2. Synthesizing Create a diagram like the one below to show why there is an inverse relationship between aggregate quantity demanded and the price level.

Critical Thinking
3. The BIG Idea  Explain how a bad economic forecast can affect aggregate demand.
4. Determining Cause and Effect Explain how high taxes and interest rates hurt aggregate supply.

Applying Economics
5. Today's Economy  Use a newspaper, the Internet, or a business magazine to make a list of all of the clues you see that show aggregate demand, aggregate supply, or prices rising or falling. Then write a paragraph explaining whether you think the current economy is inflationary, stable, or deflationary.
Some years inflation in the United States is high; other years it is not. The same holds true for unemployment and world trade. In any given year as well as over time, we have fluctuations in virtually all aspects of our economy. In this section, you’ll learn about these ups and downs in the economy and how they relate to GDP.
Model of the Business Cycle

Main Idea Business cycles are characterized by periods of expansion and contraction in economic activity.

Economics & You Think about a time when you felt ill. Probably your symptoms worsened for a while, then leveled off and began to improve until you felt normal again. Read on to learn about similar fluctuations in the health of the economy.

The ups and downs in an economy are called **business fluctuations**. Some people associate them with what has been called the **business cycle**—irregular changes in the level of total output measured by real GDP. In a model of an idealized business cycle, growth leads to an economic **peak** or **boom**—a period of prosperity. Eventually, however, real GDP levels off and begins to decline. During this part of the cycle, a **contraction** of the economy occurs. If the contraction lasts long enough and is deep enough, the economy can continue downward until it slips into a recession.

A **recession** generally is defined as any period of at least six consecutive months in which real GDP declines. Business activity starts to fall rapidly. Factories scale back production, consumers cut back on purchases, and few new businesses open. If a recession becomes extremely bad, it deepens into a **depression**. Then millions of people are out of work, and the economy operates far below **capacity**.

At some point, the economy hits a **trough**, or the lowest point in the business cycle. This occurs when real GDP stops going down and slowly begins to increase. The increase in economic activity that follows the trough is called an **expansion** or **recovery**. Consumer spending picks up, signaling factories to increase production to meet demand. The recovery continues until the economy hits another peak, and a new cycle begins.

Determining Cause and Effect What factors might cause a recession to deepen into a depression?
Ups and Downs of Business

Throughout its history, the United States has experienced business expansions and recessions of varying severity and frequency.

Economics & You What changes do you think occurred in the nation's economy after the September 11, 2001, terrorist attacks? Read on to learn about this and other business cycles in American history.

In the real world, as you can see from Figure 13.6 above, business cycles occur irregularly. The periods of expansion and contraction are clear, however.

The largest drop that eventually resulted in a depression followed the stock market crash in October 1929. The preceding years had been a time of widespread prosperity. By September 1929, heavy speculation had driven stock prices to an all-time peak. Then stock prices started to fall in early October and continued to fall. Suddenly, on October 29, there was a stampede to unload stocks. In one day the total value of all stocks fell by $14 billion.
Not long after the stock market crash, the nation fell into a recession. Factories shut down, laying off millions of workers. Businesses and banks failed by the thousands. Real GDP fell sharply over the next few years, pushing the nation into the depths of the Great Depression. (See Figure 13.7 below.) A gradual upward rise climaxed in the boom period after World War II.

Quite naturally, the economic expansion during World War II has caused many to believe that war is “good” for the economy. It is true that the total national output of goods and services increased during the war. At the same time, though, much of this output went to the war effort—bombs, planes, and guns—rather than consumer goods. So, the average American’s true standard of living didn’t rise by much until the late 1940s.

---

Figure 13.7 Prosperity, Depression, and Boom

A. Prosperity Before the Crash
The 1920s had been a decade in which Americans began buying increasing numbers of radios, stoves, and automobiles. During these years, prices remained stable, and the standard of living rose about 3 percent per year.

B. Depression Conditions
The Great Depression of the 1930s forced millions of Americans out of work. Used to the prosperity of the 1920s, Americans during the bust era of the Depression often relied on handouts.

C. War Boom
The United States economy grew rapidly during World War II. There were 17 million new jobs created, and farmers shared in the prosperity as crop prices doubled between 1940 and 1945.

---

Economic Analysis
Summarizing What happens in an economy during a recession?
Until the 1980s, small ups and downs occurred. The 1980s started off with a small recession that developed into the most serious economic downturn by some measurements since World War II. This downturn ended in 1982 and was followed by relative prosperity, except for a severe stock market crash in October 1987. The economy boomed during the last half of the 1990s, but started to falter in March 2001, when the so-called dot-com meltdown occurred. Many Internet businesses failed then. The terrorist attacks in September caused further weakness in the economy. But the recession lasted a total of only eight months. Then, through the middle of the first decade of the 2000s, economic growth was the norm.

**Identifying** What was the worst economic downturn in American history? What major event led to the nation’s greatest economic boom?

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### Section 4 Review

**Vocabulary**

1. Explain the significance of: business fluctuations, business cycle, peak, boom, contraction, recession, depression, trough, expansion, recovery.

**Main Ideas**

2. Determining Cause and Effect In a chart like the one below, explain how each event listed affected the nation’s economy.

<table>
<thead>
<tr>
<th>Event</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>Depression</td>
<td></td>
</tr>
<tr>
<td>WWII</td>
<td></td>
</tr>
<tr>
<td>Tech boom</td>
<td></td>
</tr>
<tr>
<td>9/11</td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. The BIG Idea What happens during an economic expansion? During a contraction?

4. Analyzing Why does the economy expand during war times?

**Applying Economics**

5. Government Assistance Research and compile a list of the ways that government helped people during the Great Depression. Then write a paragraph telling why you believe tax dollars should or should not be used to assist people in this way.
Section Preview
In this section, you will learn how economists explain and predict changes or fluctuations in the economy.

Content Vocabulary
- innovation (p. 357)
- economic indicators (p. 358)
- leading indicators (p. 358)
- coincident indicators (p. 359)
- lagging indicators (p. 359)

Academic Vocabulary
- anticipate (p. 357)
- compile (p. 358)
- duration (p. 359)

Reading Strategy
Sequencing  As you read the section, complete a time line similar to the one below by listing the three broad categories of economic indicators and when they occur relative to an economic change.

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ISSues In ThE NeWS
—from Britannica Student Encyclopedia

TRYING TO EXPLAIN BUSINESS FLUCTUATIONS
Economists, politicians, and others have been puzzled by business cycles since at least the early 19th century. One of the more unusual explanations was proposed by English economist William Stanley Jevons in the 19th century. He believed the ups and downs of an economy were caused by sunspot cycles, which affected agriculture and caused cycles of bad and good harvests. This hypothesis is not taken seriously today.

Shifts, changes, and temporary fluctuations do not constitute business cycles. They are adjustments that economies have always endured. The question that must be answered is, what causes a widespread buildup of prosperity followed by a sudden decline? Since money is the connecting link between all economic activities, the answer must be sought there.

For as long as booms and recessions have existed, economists have tried to explain why business fluctuations occur. No single theory, however, seems to explain past cycles or to serve as an adequate measure to predict future ones. The difficulty arises because at any given time, several factors are working together to create business fluctuations.
Causes of Business Fluctuations

Main Idea  Business cycles can be caused by changes in business investment, government policies, and the availability of key commodities, or by psychological factors.

Economics & You  How has the Internet affected the economy in your lifetime? Read on to learn about how innovations such as the Internet, along with several other factors, contribute to business fluctuations.

For many years economists believed that business fluctuations occurred in regular cycles. Later, they thought changes in the rate of saving and investing caused the fluctuations. Today economists tend to link fluctuations to four main forces: business investment, government activity, external factors, and psychological factors.

Some economists believe that business decisions are the key to fluctuations. Suppose a firm believes that prospects for future sales are good and increases its capital investment. This expansion will create new jobs and more income for consumer spending. Innovations—usable inventions and new production techniques—can have a similar effect on the economy. When businesses anticipate an economic downturn, they cut back on capital investment, which could lead to a recession.

A number of economists believe that the changing policies of the federal government are a major reason for business cycles. The government affects business activity in two ways: through its policies on taxing and spending, and through its control over the supply of money available in the economy.

Factors outside a nation’s economy also influence the business cycle. Wars in particular have an important impact, because of increased government spending during wartime. Another external factor—the availability of raw materials such as oil—may also have an effect.

Finally, it is possible that people’s psychological reactions to events—such as the terrorist attacks of September 11, 2001—also cause business fluctuations.

Reading Check  Analyzing What are two major ways that the government influences business activity?

innovation: transforming an invention into something useful to humans

External Factors

War, natural and environmental disasters, and crime waves are some external factors that affect business cycles.
Economic Indicators

Main Idea Some economists use leading, coincident, and lagging indicators to assess the current state of the economy and to predict its future course.

Economics & You Have you ever made a prediction about something, such as the weather or the outcome of a sports match? How accurate were your predictions? Read on to learn about the tools economists use to predict changes in the economy.

Every day, business leaders are faced with trying to predict what will happen to the economy in the coming months and years. To aid decision makers, government and private economists study a number of economic indicators to learn about the state of the economy. Economic indicators are statistics that measure variables in the economy, such as stock prices or the dollar amount of loans to be repaid. Each month, the U.S. Department of Commerce, along with a private company called the Conference Board, compiles statistics for economic indicators covering all aspects of the U.S. economy.

Leading Indicators
Statistics that point to what will happen in the economy are called leading indicators. They seem to lead to a change in overall business activity—whether it is an upward or a downward trend. The Conference Board keeps track of numerous leading indicators, but the ten listed in the chart are the ones that most concern American economists.

<table>
<thead>
<tr>
<th>Major Economic Indicators</th>
<th>Leading Indicators</th>
<th>Coincident Indicators</th>
<th>Lagging Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1 Average weekly hours for production workers in manufacturing</td>
<td>1 Number of nonagricultural workers who are employed</td>
<td>1 Average length of unemployment</td>
</tr>
<tr>
<td></td>
<td>2 Weekly initial claims for unemployment insurance</td>
<td>2 Personal income minus transfer payments</td>
<td>2 Size of manufacturing and trade inventories</td>
</tr>
<tr>
<td></td>
<td>3 New orders for consumer goods</td>
<td>3 Rate of industrial production</td>
<td>3 Labor cost per unit of output in manufacturing</td>
</tr>
<tr>
<td></td>
<td>4 Speed with which companies make deliveries (the busier a company, the longer it will take to fill orders)</td>
<td>4 Sales of manufacturers, wholesalers, and retailers</td>
<td>4 Average interest rate charged by banks to their best business customers</td>
</tr>
<tr>
<td></td>
<td>5 Number of contracts and orders for plants and equipment</td>
<td></td>
<td>5 Number of commercial and industrial loans to be repaid</td>
</tr>
<tr>
<td></td>
<td>6 Number of building permits issued for private housing units</td>
<td></td>
<td>6 Ratio of consumer installment debt to personal income</td>
</tr>
<tr>
<td></td>
<td>7 Stock prices</td>
<td></td>
<td>7 Change in consumer price index for services</td>
</tr>
<tr>
<td></td>
<td>8 Changes in money supply in circulation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9 Changes in interest rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10 Changes in consumer expectations</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Coincident Indicators

Other economic indicators, which usually change at the same time as changes in overall business activity, also help economists. When these **coincident indicators** begin a downswing, they indicate that a contraction in the business cycle has begun. If they begin an upswing, they indicate that the economy is picking up and a recovery is under way.

Lagging Indicators

A third set of indicators seems to lag behind changes in overall business activity. For example, it may be six months after the start of a downturn before businesses reduce their borrowing. The amount of change in these **lagging indicators**, whether up or down, gives economists clues as to the duration of the phases of the business cycle.

**Contrasting**

What is the difference between leading and lagging economic indicators?

---

**Vocabulary**

1. Explain the significance of: innovation, economic indicators, leading indicators, coincident indicators, lagging indicators.

**Main Ideas**

2. Summarizing Copy the chart below, and in each box, explain how the term listed affects the business cycle.

<table>
<thead>
<tr>
<th>Investment</th>
<th>Policy</th>
<th>Products</th>
<th>Psychology</th>
</tr>
</thead>
</table>

**Critical Thinking**

3. The **BIG IDEA** In what two ways does government affect business activity?

4. **Contrasting** Explain the difference between leading indicators, coincident indicators, and lagging indicators.

**Applying Economics**

5. **Innovations** Choose two innovations that you believe had the most influence on the American economy in your lifetime, and explain why.
Recalling her appointment to the Board of Governors of the Federal Reserve System, Janet Yellen remarked, “I didn't even own a suit. I never felt I had to have a suit at Berkeley. . . . The minute after I got the call, I walked across the street and bought [one].”

But it wasn't just a new suit she took to Washington. Yellen is well known as someone who can understand and explain complicated economic issues. Until this point in her professional career, she had taught in universities, lectured at the London School of Economics, and held various positions advising the government. This was the first time when, as she put it, she had “the opportunity to apply ivory tower ideas to the real world[,] . . . a chance many scholars only dream of.” But she didn't let her lofty position disrupt her normal life. “I made up my mind early on that my family would remain a priority.”

Her goal, as head of one of the nation's 12 Federal Reserve Banks, is to help achieve and maintain “maximum employment and price stability.”

Unlike some economists, Yellen does not believe that a free-market economy is best left to itself. In 1985 she and her Nobel Prize-winning husband, George Akerlof, coauthored a paper in which they demonstrated that the government could, in fact, smooth out business cycles, an idea that, at the time, was out of favor.

“Capitalism is a terrific system for organizing economic activity. But the market system has some failures that necessitate or are helped by government intervention.”

Checking for Understanding

1. **Paraphrasing** What did Yellen mean when she said she had “the opportunity to apply ivory tower ideas to the real world”?

2. **Speculating** What does it mean to “smooth out business cycles”?
A nation’s **gross domestic product (GDP)** is the total dollar value of all final goods and services produced annually.

GDP figures must be adjusted for **inflation**, which can be measured in several ways.

- **Consumer Price Index (CPI)**: A statistical measure of the average prices of a specified set of goods and services purchased by typical consumers in urban areas.
- **Producer Price Index (PPI)**: Measure of the change in price over time that U.S. producers charge for their goods and services.
- **GDP Price Deflator**: Price index that removes the effect of inflation from GDP so that the overall economy in one year can be compared to another year.

The **price level of the overall economy** is determined by the interaction of aggregate demand and aggregate supply.
Review Content Vocabulary

1. Write a paragraph or two explaining how economists measure the U.S. economy. Use all of the following terms.

- national income accounting
- gross domestic product (GDP)
- net domestic product
- inflation
- real GDP
- consumer price index
- producer price index
- GDP price deflator
- aggregate demand
- aggregate supply

2. Write a paragraph or two explaining business fluctuations and how they can be predicted. Use all of the following terms.

- business fluctuations
- business cycle
- boom
- recession
- depression
- expansion
- recovery
- economic indicators
- leading indicators
- lagging indicators

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. statistics  b. category  c. indicate  d. output  e. capacity  f. precede  g. anticipate

3. What a factory produces is called its _______.
4. When a factory is producing all it can possibly produce, it has reached its _______.
5. Economists use _______ to measure the national economy.
6. The consumer sector is one _______ considered when computing GDP.
7. An increase in consumer spending might _________, or point to, an economic expansion.
8. A boom would _______ economic contraction.
9. Economists try to _______ coming changes in the economy by analyzing economic indicators.

Review the Main Ideas

Section 1  (pp. 335–340)

10. Net exports and government goods and services are two components of GDP. What are the other two components?

11. Fill in a chart like the one below to list the five categories that make up national income.

<table>
<thead>
<tr>
<th>National Income</th>
<th>a. wages and salaries</th>
<th>b.</th>
<th>c.</th>
<th>d.</th>
<th>e.</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;consumer price index&quot;</td>
<td>&quot;producer price index&quot;</td>
<td>&quot;GDP price deflator&quot;</td>
<td>&quot;aggregate demand&quot;</td>
<td>&quot;aggregate supply&quot;</td>
<td></td>
</tr>
</tbody>
</table>

Section 2  (pp. 341–345)

12. What is the difference between inflation and deflation?

13. How would you determine real GDP if you knew only GDP? Why would you do this?

Section 3  (pp. 347–350)

14. Why do the aggregate demand and supply curves slope the way they do?

15. What is the point where the aggregate demand and supply curves cross?

Section 4  (pp. 351–355)

16. What are the four main phases of a business cycle?

17. When the economy enters a recession, what normally happens?

Section 5  (pp. 356–359)

18. How might psychological factors affect the business cycle?

19. What two aspects of government activity affect business cycles?
Critical Thinking

20. The BIG Idea How might knowledge of nationwide economic statistics help you in your daily life?

21. Summarizing Create a diagram like the one below to summarize national income accounting. Start with the lowest statistic, disposable personal income, and work your way up to GDP—adding and subtracting the appropriate items.

Math Practice

22. To make comparisons between the prices of things in the past and those of today, you have to make the distinction between current prices (often called nominal values) and prices adjusted for inflation (real values). Use the following equation and statistics to find real 2000 GDP.

\[
\text{Nominal GDP} \times \frac{\text{Implicit GDP Price Deflator}}{100} = \text{Real GDP}
\]

- 2000 nominal GDP = $10.223 trillion
- 2000 price deflator = 107.7

Analyzing Visuals

23. Study the cartoon on the right, and then answer the following questions.

a. What economic problem is shown in this cartoon?

b. How does the employee think this problem could be solved?

c. The boss implies that if wages were to increase more rapidly, inflation would worsen. Is the boss right? Why or why not?
A Brief History of Money  Over the centuries such items as cattle, salt, large stones, seashells, metals, beads, tea, coffee, tobacco, fishhooks, and furs have served as money. Some of the more important developments in the history of money are described here.

Cowrie Shells
Cowrie shells have been used as money throughout Asia, Africa, and Oceania. The cowrie was still in use in some African countries as recently as the mid-1900s. The name for Ghana’s monetary unit, the cedi, comes from the Ghanaian word meaning “cowrie shell.”

Two Bits
Do you know why people sometimes call a quarter “two bits”? The origin of this term dates back to colonial times. The American colonists used Spanish silver dollar coins called “pieces of eight.” Each coin was divided into eight pieces—or bits—so that it could be broken to make change. Four bits was equal to half a dollar, while two bits equaled a quarter.
Rings and Ingots
Perhaps as early as 2500 B.C., the people of ancient Egypt and Mesopotamia—the land between the Tigris and Euphrates Rivers—were using gold and silver as money. The money took the form of rings, small ornaments, and ingots, or bars.

Thinking Globally

1. **Identifying** Where did the use of coins develop?
2. **Analyzing** How is the history of money in Africa reflected in the currency of Ghana?
3. **Applying** How did coins in the United States develop from “two bits” to the quarters, dimes, and nickels we use today? Use the Internet to research the history of coins in the United States, and create a timeline depicting when each of these coins was developed and put into use.
Money and Banking

The BIG Idea
Governments strive for a balance between the costs and benefits of their economic policies to promote economic stability and growth.

Why It Matters
When you think of the word money, what comes to mind? Besides coins and cash, what other types of money can you name? In this chapter, read to learn about the functions of money and the role of the banking system.

Economics ONLINE
Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 14—Chapter Overviews to preview chapter information.
For thousands of years, money has made it possible for businesses to obtain easily what they need from suppliers and for consumers to obtain goods and services. What, however, is money, and how does it function in an economic system? As you read this section, you’ll learn the answers to these questions.
The Functions of Money

Main Idea Money functions as a medium of exchange, a unit of accounting, and a store of value.

Economics & You What personal items do you value the most? Would you trade them in exchange for other goods? Read on to learn about how many items with a store of value can be used as money.

The basis of the market economy is voluntary exchange. Most Americans think of money as bills, coins, and checks. Historically, though, money has also been shells, gold, or sheep. Native Americans used wampum—beads made from shells. People in the Fiji Islands used whales’ teeth.

Economists identify money by certain functions. Anything that is used as a medium of exchange, a unit of accounting, and a store of value is considered money. (See Figure 14.1 below.)

Medium of Exchange To say that money is a medium of exchange simply means that a seller will accept it in exchange for a good or service. Without money, people would have to barter—exchange goods and services for other goods and services. Barter requires a double coincidence of wants. Each party to a transaction must want exactly what the other person has to offer. In the past, bartering was used extensively, both within and between societies. Today, however, bartering works only in small societies with fairly simple economic systems.

money: anything customarily used as a medium of exchange, a unit of accounting, and a store of value

medium of exchange: use of money for exchange for goods or services

barter: exchange of goods and services for other goods and services

Figure 14.1 Three Functions of Money

All money serves three functions.

A. Medium of Exchange The money this person is holding serves as a medium of exchange; the vendor will accept it in exchange for a meal.

B. Unit of Accounting Money is also a unit of accounting. The products in U.S. markets are all priced in dollars and cents, so people can easily compare values of different items.
Economic Analysis

Synthesizing

Why is cash a more efficient medium of exchange than other items, like shells and beads, that people used in the past?

Unit of Accounting

Money is the yardstick that allows people to compare the values of goods and services in relation to one another. In this way, money functions as a unit of accounting. Each nation uses a basic unit to measure the value of goods, as it uses the foot or meter to measure distance. In the United States, this base unit of value is the dollar. In Japan, it is the yen, and in much of Europe, the euro. An item for sale is marked with a price that indicates its value in terms of that unit.

By using money prices as a factor in comparing goods, people can determine whether one item is a better bargain than another. A single unit of accounting also allows people to keep accurate financial records—records of debts owed, income saved, and so on.

Store of Value

Money also serves as a store of value. You can sell something, such as your labor, and store the purchasing power that results from the sale in the form of money for later use. People usually receive their money income once a week, once every two weeks, or once a month. In contrast, they usually spend their income at different times during a pay period. To be able to buy things between paydays, a person can store some of his or her income in cash and some in a checking account. It is important to note that in periods of rapid and unpredictable inflation, money is less able to act as a store of value.

\[ \text{Reading Check} \]

Explaining What are the disadvantages of bartering?

C. Store of Value

Finally, money serves as a store of value—people can store their purchasing power in the form of dollars. Money income earned from a part-time job, like mowing lawns, for example, can be stored this way.

\[ \text{Economic Analysis} \]

Synthesizing Why is cash a more efficient medium of exchange than other items, like shells and beads, that people used in the past?
Any item to be used as money must first meet certain criteria.

**Economics & You** What do you think of when you hear the term “money”? Read on to learn about the characteristics that define money.

Anything that people are willing to accept in exchange for goods can serve as money. At various times in history, cattle, salt, animal hides, gems, and tobacco have been used as mediums of exchange. Each of these items has certain characteristics that make it better or worse than others for use as money. Cattle, for example, are difficult to transport, but they are durable. Gems are easy to carry, but they are not easy to split into small pieces to use.

**Figure 14.2** below lists the characteristics that to some degree all items used as money must have. Almost any item that meets most of these criteria can be and probably has been used as money. Precious metals like gold and silver work very well as mediums of exchange, and have often been used as such throughout history. It is only in more recent times that paper money has been widely used as a medium of exchange.

**Figure 14.2** Characteristics of Money

- This table lists the traits that items must possess to be able to be used as money, whether those items are bills, coins, or some other item.

### Characteristics of Money

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Durable</td>
<td>Money must be able to withstand the wear and tear of being passed from person to person. Paper money lasts one year on average, but old bills can easily be replaced. Coins, in contrast, last for many years.</td>
</tr>
<tr>
<td>Portable</td>
<td>Money must be easy to carry. Though paper money is not very durable, people can easily carry large sums of paper money.</td>
</tr>
<tr>
<td>Divisible</td>
<td>Money must be easily divided into small parts so that purchases of any price can be made. Carrying coins and small bills makes it possible to make purchases of any amount.</td>
</tr>
<tr>
<td>Stable in value</td>
<td>Money must be stable in value. Its value cannot change rapidly, or its usefulness as a store of value will decrease.</td>
</tr>
<tr>
<td>Scarce</td>
<td>Whatever is used as money must be scarce. That is what gives it value.</td>
</tr>
<tr>
<td>Accepted</td>
<td>Whatever is used as money must be accepted as a medium of exchange in payment for debts. In the United States, acceptance is based on the knowledge that others will continue to accept paper money, coins, and checks in exchange for desired goods and services.</td>
</tr>
</tbody>
</table>

**Economic Analysis**

**Analyzing** In which of the categories listed does paper money have an advantage over cattle as a medium of exchange? Why?

**Reading Check** Identifying Name five items—other than paper bills, coins, or checks—that have been used as money.
Types of Money

Today, all United States money is fiat money that is not backed by gold or any other commodity.

Economics & You What if your boss decided to pay you for a week’s worth of work in cattle or IOUs? Would you accept either of these as a fair exchange? Read on to learn more about mediums of exchange.

Mediums of exchange such as cattle and gems are considered commodity money. They have a value as a commodity, or good, aside from their value as money. Representative money is money backed by—or exchangeable for—a valuable item such as gold or silver.

At one time, the United States government issued representative money in the form of silver and gold certificates. In addition, private banks accepted deposits of gold bars or silver ingots (called bullion) in exchange for paper money called banknotes. The notes were a promise to convert the paper money back into coin or bullion on demand. These banks were supposed to keep enough gold or silver in reserve—on hand—to redeem their banknotes. That did not always happen, however.

Today all United States money is fiat money, meaning that its face value occurs through government fiat, or order. It is in this way declared legal tender.

Contrasting Explain the difference between commodity money and representative money.

---

Main Idea

Today, all United States money is fiat money that is not backed by gold or any other commodity.

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Contrasting Explain the difference between commodity money and representative money.

---

Vocabulary

commodity money: a medium of exchange such as cattle or gems that has value as a commodity or good aside from its value as money

representative money: money that is backed by an item of value, such as gold or silver

fiat money: money that has value because a government fiat, or order, has established it as acceptable for payment of debts

legal tender: money that by law must be accepted for payment of public and private debts

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Main Ideas

2. Recalling In a diagram like this one, list an example for each function of money.

---

Critical Thinking

3. The BIG Idea Government policy has a significant effect on fiat money and legal tender. Explain why this is true.

4. Determining Cause and Effect Describe how inflation affects money as a store of value.

---

Applying Economics

5. Bartering Imagine that you live in a barter society. List five items you use and value. What would you be willing to trade each item for? Write a paragraph to explain why using money might be more convenient than barter.
As a nine-year-old boy in Kansas City, Missouri, Hector Barreto’s first job was waiting tables in his family’s restaurant.

“I like to tell people that everything important that I learned about business I learned in a Mexican restaurant. And it’s true. My father was an immigrant to this country in the late 1950s. . . . The greatest thing for [him] was the opportunity to be your own boss, and my father and mother saved their money and they were able to open up a little Mexican restaurant. . . . [T]his is a dream that really has defined our country for centuries, . . . that dream that tells us that it really doesn’t matter where we start. It only matters where you end up. And if you work hard enough, and if you create an environment for yourself, you can accomplish anything that you want. . . . I learned that from my father.”

After earning a bachelor’s degree in business administration, Barreto went on to found, among other things, a small business institute providing technical assistance, education, and development opportunities to small businesses.

Eventually Barreto came to the attention of President George W. Bush, and in 2001 he was unanimously confirmed by the U.S. Senate as administrator of the U.S. Small Business Administration (SBA). This is a critical position, because small businesses are an important part of the economy and employ more than half of all workers in the United States. In interviews, Barreto has made it clear that he credits the spirit of American entrepreneurship for the success of small businesses:

“Small business people are resilient. The same stubbornness that drives an entrepreneur to start a business of their own and be their own boss . . . also steels their resolve to survive in tough times.”

Checking for Understanding

1. **Defending**  What is your opinion about a nine-year-old working in a family business? What do you think Barreto’s opinion is?

2. **Drawing Conclusions**  Do you believe it should be government’s role to help people run small businesses? Why or why not?
American banking has undergone many changes since our nation’s founding. Its mediums of exchange have included everything from wampum to “virtual” money—banking in cyberspace on the Internet. In this section, you’ll learn about the development of and changes in the United States banking industry.
History of American Banking

**Main Idea** Throughout history, instability in the banking system has contributed to business fluctuations.

**Economics & You** How has banking changed since your parents or guardians were in high school? Read on to learn about money and banking in the United States since the colonial period.

Because the history of money in the United States is so closely tied to the development of the nation’s banking system, the time line in Figure 14.3 below describes both. During the early colonial period of American history, England did not permit the new colonies to print money or mint coins. Therefore, bartering for goods was common. Colonists used various items in place of coins and paper money. In the Massachusetts Bay Colony, for a time, people used Native American wampum as a medium of exchange. In the Virginia Colony, tobacco became commodity money.

Though scarce, some European gold and silver coins also circulated in the colonies. The Spanish dolár, later called the “dollar” by colonists, was one of the more common coins.

Skills Handbook

See page R52 to learn about **Sequencing Events.**

---

**Figure 14.3 Time Line of Money and Banking**

When the United States was first established, it had no reliable medium of exchange or banking system. Over the years, the nation’s monetary standard and banking regulations have undergone many changes.

- **1780s–1792** Amid state versus national bank controversy, First Bank of the United States and U.S. mint are created. Dollar becomes national currency valued in relationship to gold and silver.

- **1830s–1860s** End of Second Bank’s charter sparks increase in state banks. Fluctuating money supply causes unstable prices and business activity.

- **Late 1860s–early 1900s** 1869: Monetary standard shifted to gold; greenbacks redeemed with gold coins. With no regulation of banknote supply, money shortages occur. 1873–1907: Four financial panics force closure of banks with low reserves.

- **1811–1816** Instability follows expiration of First Bank’s charter and rise of state-chartered banks. Second Bank of the United States pressures state banks to limit lending and maintain gold/silver reserves.

- **Civil War** Fiat money (“greenbacks”) issued to pay for war. 1863–64: Federally chartered, private national banks created. Safe, uniform currency established requiring backing of national banknotes by government bonds.
The Revolutionary War brought even more confusion to the already haphazard colonial money system. To help pay for the war, the Continental Congress issued bills of credit, called Continentals, that could be used to pay debts. So many of these notes were issued that they became worthless, and people often refused to accept them. The phrase “not worth a Continental” became a way of describing something of little value.

After the war, establishing a reliable medium of exchange became a major concern of the new nation. The Constitution, ratified in 1788, gave Congress the power to mint coins, although private banks were still allowed to print banknotes representing gold and silver on deposit. Then in 1792, Congress passed the Coinage Act, which established the dollar as the basic unit of currency for the nation.

The nation’s new leaders also had to decide on a banking system. Some supported a national banking system, while others argued for state-chartered banks. Today, we have both.

**Determining Cause and Effect** What effects did the Revolutionary War have on the colonial money system? Why?
Banking Services

Main Idea The efficiency of banking services has increased as computer technology has reduced the dependence on paper.

Economics & You Why do you choose to keep your money at one bank rather than another? What services or other benefits influence your decision? Read on to learn about many of the services offered by present-day banks.

Banks and savings institutions today offer a wide variety of services, including checking accounts, interest on certain types of checking accounts, automatic deposit and payment, storage of valuables, transfer of money from one person to another, and overdraft checking. **Overdraft checking** allows a customer to write a check for more money than exists in his or her account. The bank lends the needed amount and the customer pays the money back, usually at a relatively high rate of interest.

In general, the types of banking services are the same across the country. The exact terms and conditions of the services, however, **vary** from state to state according to each state’s banking laws. When choosing a bank or savings institution, you should obtain information on the bank’s service charges.

Electronic Banking One of the most important changes in banking began in the late 1970s with the introduction of the computer. With it came **electronic funds transfer (EFT)**, or a system of transferring funds from one bank account directly to another without any paper money changing hands. One of the most common features of EFT is **automated teller machines (ATMs)**. These units let consumers do their banking without the help of a teller.

Today you can even do your banking from home. You can see your account balances, transfer funds from a savings account to a checking account, pay bills, and often even apply for a loan—all on the Internet. There are even Internet-only banks.

**Banking Convenience**

Since automated teller machines were developed in the late 1970s, their usage and popularity have grown tremendously. Today, many people do their banking exclusively through ATMs and the Internet.
**EFT Concerns** Although EFT can save time, trouble, and costs in making transactions, it does have some drawbacks. The possibility of tampering and lack of privacy are increased because all records are stored in a computer. A person on a computer terminal could call up and read or even alter the account files of a bank customer in any city, if he or she knew how to get around the safeguards built into the system. In response to these and other concerns, the Electronic Funds Transfer Act of 1978 describes the rights and responsibilities of participants in EFT systems. For example, EFT customers are responsible for only $50 in losses when someone steals or illegally uses their ATM cards, if they report the cards missing within two days. If they wait more than two days, they could be responsible for as much as $500. Users are also protected against computer mistakes.

**Reading Check** Evaluating List at least one positive and one negative outcome of electronic banking.

**section 2 Review**

**Vocabulary**
1. Explain the significance of: overdraft checking, electronic funds transfer (EFT), automated teller machine (ATM).

**Main Ideas**
2. Comparing and Contrasting Electronic funds transfer is rapidly replacing paper or live transactions. In a chart like the one below, list two advantages and two disadvantages of EFT.

<table>
<thead>
<tr>
<th>Electronic Funds Transfer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantages</td>
</tr>
<tr>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
</tr>
<tr>
<td>Disadvantages</td>
</tr>
<tr>
<td>1.</td>
</tr>
<tr>
<td>2.</td>
</tr>
</tbody>
</table>

**Critical Thinking**
3. The BIG Idea What do you believe are the two most significant laws affecting banking since the 1920s? Why?
4. Analyzing What is the significance of service charges, and how are they determined?

**Applying Economics**
5. Service Charges Go to three local banks and pick up information pamphlets on credit cards, checking accounts, and savings accounts at each bank. Bring these to class and make a list of charges that you would have to pay. Which bank offers the best terms for you?
GUIDE TO READING

Section Preview
In this section, you will learn about what counts as money and near money in the United States.

Content Vocabulary
- checking account (p. 380)
- checkable deposits (p. 380)
- thrift institutions (p. 380)
- debit card (p. 381)
- near moneys (p. 382)
- M1 (p. 383)
- M2 (p. 383)

Academic Vocabulary
- consist (p. 379)
- create (p. 381)

Reading Strategy
Listing As you read, complete a web diagram like the one below by listing five different forms that money can take in the United States.

ISSUES IN THE NEWS
—from the Associated Press

NEW MONEY Hooray for the red, yellow and orange! Those are the colors featured on the newly redesigned $10 bill, the third currency denomination to add splashes of color to the traditional green of U.S. currency.

Some 800 million of the new bills will be put into circulation starting [in 2006] in the government’s latest effort to stay ahead of the tech-savvy counterfeiters.

… The makeover of the $10 bill follows similar colorization of the $20 bill in 2003 and the $50 bill [in 2004].

… Each bill denomination has different colors mixed in with the traditional green. For the $20, the additional colors are peach and blue, while the $50 bill has blue and red.

… The government plans to redesign the currency every seven to ten years to keep ahead of counterfeiters armed with ever more sophisticated devices.

When you think of money, you may think only of coins and paper bills. In fact, many people use the term “money” to refer only to cash. As you read this section, you’ll learn that money is more than just currency and coins. You will also learn how economists measure the amount of money in circulation in the U.S. economy.
Money and Near Moneys

Main Idea The money supply consists of not only bills and coins, but also checking and savings deposits and certain other liquid investments.

Economics & You Do you have a checking account or a savings account? Read on to learn about how these, in addition to the cash in your wallet, count as money.

Money in use today consists of more than just currency. It also includes deposits in checking and certain types of savings accounts, plus certain other investments.

Currency The Bureau of the Mint, which is part of the Treasury Department, makes all the coins in the United States. About 5 percent of the currency in circulation today is in the form of coins.

Most of the nation’s currency consists of Federal Reserve notes issued by Federal Reserve banks. The Bureau of Engraving and Printing, also part of the Treasury Department, prints all Federal Reserve notes. They are issued in denominations of $1, $5, $10, $20, $50, and $100. (Larger notes used to be printed, but the practice was stopped to make it harder for criminals to hide large amounts of cash.)

Fighting Funny Money Government printing officials employ several methods to try to make counterfeiting more difficult. Such methods include printing multicolored bills and using embedded devices such as strips, microprinting, and inks whose colors change depending on the angle of the light.
Checks A **checking account** consists of funds deposited in a bank that a person can withdraw at any time by writing a check. The bank must pay the amount of the check on demand, or when it is presented for payment. Such accounts used to be called **demand deposits**. Today we call these **checkable deposits**, and a variety of financial institutions offer them. Many banks provide checking accounts at no cost to the customer. The banks can still make a profit on such accounts, however, by charging very high fees when customers write checks for more than the balance of their accounts. These fees may be as high as $30 for a check that is only a few dollars more than the customer’s checking account balance.

Commercial banks used to be the only financial institutions that could offer checkable deposits. Today all **thrift institutions**—mutual savings banks, savings and loan associations (S&Ls), and credit unions—offer checkable deposits. In addition, many brokerage houses offer the equivalent of checking accounts. Merrill Lynch and Fidelity Investments are two examples.

The largest part of the money supply in the United States consists of checkable accounts. **Figure 14.4** below provides information about how to manage checks and checking accounts, including how to write a check and balance a checkbook.

**Figure 14.4 Managing a Checking Account**

- When you write a check, the funds will not come out of your account until the receiving party deposits the check and it is processed through the Federal Reserve system. It is very important to manage your account carefully and to make sure the funds are there when the check finally clears.

**A. Writing a Check** Always fill out your checks completely and clearly in ink. Make sure the numeric amount in the box matches the written amount on the line below it.

**B. Tracking Your Transactions** Whenever you write a check to someone or make a deposit into your checking account, record the check number, date, and amount in your check register. Keep an accurate running total in the right-hand column.

<table>
<thead>
<tr>
<th>Number</th>
<th>Date</th>
<th>Description</th>
<th>Payment of Debt</th>
<th>Fee</th>
<th>Deposit of Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>132</td>
<td>4/25</td>
<td>Fashion shop</td>
<td>$75.96</td>
<td>$</td>
<td>$</td>
<td>$754.75</td>
</tr>
<tr>
<td>133</td>
<td>5/7</td>
<td>Rent</td>
<td>462.50</td>
<td></td>
<td></td>
<td>292.25</td>
</tr>
<tr>
<td>134</td>
<td>5/7</td>
<td>Phone</td>
<td>83.00</td>
<td></td>
<td></td>
<td>209.25</td>
</tr>
<tr>
<td>135</td>
<td>5/14</td>
<td>Cash</td>
<td>50.00</td>
<td></td>
<td></td>
<td>159.25</td>
</tr>
<tr>
<td>136</td>
<td>5/15</td>
<td>J.W. Little</td>
<td>10.80</td>
<td></td>
<td></td>
<td>149.25</td>
</tr>
<tr>
<td></td>
<td>5/22</td>
<td>John’s check</td>
<td></td>
<td>4.00</td>
<td></td>
<td>153.25</td>
</tr>
<tr>
<td></td>
<td>5/23</td>
<td>Paycheck</td>
<td></td>
<td>500.61</td>
<td></td>
<td>653.86</td>
</tr>
<tr>
<td>137</td>
<td>6/1</td>
<td>Rent</td>
<td>462.50</td>
<td></td>
<td></td>
<td>191.36</td>
</tr>
</tbody>
</table>
**Credit Cards and Debit Cards**  Even though many people use their credit cards to purchase goods and services, the credit card itself is not money. It acts neither as a unit of accounting nor as a store of value. The use of your credit card is really a loan to you by the issuer of the card, whether it is a bank, retail store, gas company, or American Express. Basically, then, credit card “money” represents a future claim on funds that you will have later. Credit cards defer payments rather than complete transactions that ultimately involve the use of money.

A **debit card**, on the other hand, automatically withdraws funds from a checkable account. When you use your debit card to purchase something, you are in effect giving an instruction to your bank to transfer money directly from your bank account to the bank account of the grocery store, retail store, gas station, etc. (Debit cards can be used to make online purchases as well, and the process is the same.) The funds transfer usually happens within 72 hours of your purchase. The use of a debit card does not create a loan. Rather, debit card “money” is similar to checkable account money.

Debit cards have become increasingly popular in the United States. In some other countries, such as France, they are used almost exclusively in place of cash. An advantage to debit cards is that people who use them cannot spend more than they have in their checking accounts, and so they avoid overdraft fees.

**Economic Analysis**

**Synthesizing**  Why is the “Current Balance” shown on the bank statement different from the running balance shown on the check register?
Near Moneys Numerous other assets are almost, but not exactly, like money. These assets are called near moneys. Their values are stated in terms of money, and they have high liquidity in comparison to other investments, such as stocks. Near moneys can be turned into currency or into a means of payment, such as a checking deposit, relatively easily and without the risk of loss of value. For example, if you have a bank savings account, you cannot normally write a check on it. You can, however, go to the bank and withdraw some or all of your funds. You can then redeposit these funds in your checking account or spend it all as cash.

Time deposits and savings account balances are near moneys. Both pay interest, and neither can be withdrawn by check. Time deposits require that a depositor notify the financial institution within a certain period of time, often 10 days, before withdrawing money. Savings accounts do not usually require such notification.

Explaining What are near moneys? Name two examples of this type of asset.
The Money Supply

Economists use both narrow and broad definitions of the money supply to measure the amount of money in circulation.

Economics & You In your opinion, what should count as money? Read on to learn about the two basic definitions of the U.S. money supply.

How much money is there in the United States today? That question is not so easy to answer. First, the definition of money supply must be agreed upon. Currently, two basic definitions are used, although others exist. The first is called M1, and the second M2.

M1 includes all currency (bills and coins), all checkable deposits, and traveler’s checks. M2 includes everything in M1 plus savings deposits, small-denomination time deposits, money market deposit accounts, retail money market mutual fund balances, and other more specialized account balances.

Figure 14.5 on the previous page shows the growth of M1 and M2 from 1994 to 2006.

Comparing What does the M2 definition of the money supply include that the M1 does not?

M1: narrowest definition of the money supply; consists of moneys that can be spent immediately and against which checks can be written

M2: broader definition of the money supply; includes all of M1, plus such near moneys as savings deposits, small-denomination time deposits, money market deposit accounts, and retail money market mutual fund balances.

Vocabulary
1. Explain the significance of: checking account, checkable deposits, thrift institutions, debit card, near moneys, M1, M2.

Main Ideas
2. Comparing and Contrasting In a diagram like the one below, list the characteristics of each type of card in the outer circles and the traits they share in the inner circle.

Debit Cards
Both
Credit Cards

Critical Thinking
3. The BIG Idea What is the advantage of allowing thrift institutions to offer the same services as commercial banks?
4. Explaining Describe the difference between M1 and M2.

Applying Economics
5. Counterfeiting Contact the closest Secret Service office, and ask them for information about how money is coined and printed to prevent counterfeiting. Share the information you discover with your class.
BANKS: “PROTECTION” RACKET?

Overdraft and other fees become huge profit sources for banks.

Check It Out! In this chapter you learned about banking services. In this article, read to learn how consumers and critics are reacting to higher bank fees for those services.

Chris Keeley went on a shopping spree last Christmas Eve, buying $230 in gifts with his debit card. But his holiday mood soured a few days later when he received a notice from his bank that he had overdrawn the funds in his checking account. While the bank allowed each of his seven transactions to go through, it charged him $31 a pop—or a hefty $217 in fees for his $230 worth of purchases.

This fee frenzy may seem paradoxical with so many banks trying to lure new customers with offers of “free” checking. Sure, most don’t carry monthly maintenance fees—instead, customers get hit with a myriad of other fees. Charges may include a $2 hit every time a customer with a low

balance calls a service rep, $20 for closing an account within six months of opening it, and $30 per hour when a staffer helps a customer reconcile an account.

None of the new fees is more controversial than bounce protection. Critics contend that bounce-protection fees, as high as $37 per transaction, are little more than high-priced credit. For now consumers need to remember that at many banks there’s no free lunch—or checking accounts.

—Adapted from BusinessWeek

Think About It
1. Explaining What actions are banks taking to earn more profits?
2. Problem Solving How can you as a banking customer avoid paying fees?
Money functions as a **medium of exchange**, a **unit of accounting**, and a **store of value**.

### Functions of Money

- **Medium of exchange:** Sellers accept money in exchange for a good or service.
- **Unit of accounting:** Money is the yardstick that allows people to compare the values of goods and services in relation to one another.
- **Store of value:** The purchasing power that results from selling something (including labor) can be stored as money.

- All money, whether bills, coins, or some other item, must have specific **characteristics**.

- **Durable**
- **Accepted**
- **Portable**
- **Scarce**
- **Divisible**
- **Stable in value**

Money and near moneys include bills, coins, checkable deposits, savings accounts, debit and credit cards, and time deposits.
Review Content Vocabulary

1. Write a paragraph or two explaining how money and the banking system work in the United States. Use all of the following terms.

money barter commodity money representative money fiat money legal tender overdraft checking

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. indicate e. varies
b. transport f. consists
c. convert g. create
d. issue

2. One reason coins make a good medium of exchange is that they are easy to ______ in a purse or a pocket.

3. Banks no longer need to ______ paper money into coin or bullion because paper money has value through a government order.

4. The government has the power to ______, or supply, currency for use in the United States.

5. The markings on a coin or bill ______ its value in the country in which it was made.

6. The size and shape of coins ______ from country to country.

7. A country cannot simply ______ money; it must be backed up by something of value or it is worthless.

8. Money ______ of currency, checking and savings deposits, and certain other investments.

Review the Main Ideas

Section 1 (pp. 367–371)

9. What is one alternative to using money?

10. Money should be durable and divisible. What other characteristics should it have?

11. Is the type of money used in the United States commodity money, representative money, or fiat money? How do you know?

Section 2 (pp. 373–377)

12. During the Revolutionary War, what caused bills of credit issued by the Continental Congress to become worthless?

13. Electronic banking is increasingly common today. What forms of this system do most consumers use?

14. According to the Electronic Funds Transfer Act of 1978, what happens if a person’s ATM card is stolen or used illegally?

Section 3 (pp. 378–383)

15. What are the only denominations of paper currency being issued today by the federal government?

16. Why were checking accounts formerly called demand deposits?

17. What is the distinction between money and near moneys?

18. Fill in a graphic organizer like the one below to show what is included in M1 and M2 when defining the money supply.

M2:

M1:
Thinking Like An Economist

19. The three functions of money are as a medium of exchange, a unit of accounting, and a store of value. Use a chart like the one below to keep track of any time you use money, see money used, or see dollar values written somewhere. Do this for three to five days. Try to determine in each instance what function the money is serving. For example, if you see a headline that says “Microsoft Corporation Sales Increased to $10 Billion,” you know that money is being used as a unit of accounting.

<table>
<thead>
<tr>
<th>Medium of Exchange</th>
<th>Unit of Accounting</th>
<th>Store of Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking

20. The BIG Idea Create a table like the one below to compare the costs and benefits of engaging in barter to the costs and benefits of using money.

<table>
<thead>
<tr>
<th></th>
<th>Costs</th>
<th>Benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barter</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Money</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

21. Explaining Why are debit cards similar to money, whereas credit cards are not?

22. Defending The U.S. government is considering discontinuing the production and use of pennies. Do you think pennies should be discontinued? Why or why not?

Analyzing Visuals

23. Study the cartoon below, and then answer the following questions.

a. Where does Clare work? How do you know?

b. What is the manager’s concern about what Clare is doing online?

c. Why does Clare seem unconcerned with the possibility of identity theft?
How does identify theft impact consumers?

THE ISSUE
What if you went to the bank and were told you had no money in your account—even though you had deposited $300 last week? What if you tried to buy something with a credit card and the card was taken away by the store—even though you’d made all your payments on time? These are some of the problems encountered by victims of identity theft, the fastest-growing crime in the United States.

Just as your character, your appearance, and your personal traits make you unique as a person, your name, social security number, birth date, mother’s maiden name, and other personal information give you a unique identity as a consumer. You need them to access your money and credit. How might the theft of your identity affect your life?

THE FACTS
Identity theft, or identity fraud, is the taking of a person’s private information in order to use it for a variety of purposes. Identity thieves may steal funds from their victims’ bank accounts, obtain credit and credit cards, apply for loans, establish accounts with utility companies, rent apartments, or even obtain jobs using their victims’ names. The victims may not know what has happened for days, weeks, or even months—until they apply for credit, check their credit report, or begin receiving calls from collection agencies demanding payment for purchases they didn’t make. Some thieves even use stolen identities to commit crimes ranging from traffic violations to felonies.

THE ECONOMIC CONNECTION: MONEY AND BANKING
Every 79 seconds, a thief steals someone’s identity and goes on a buying spree. That’s almost 9 million thefts a year. Victims each spend between 40 and 175 hours repairing the damage, trying to explain to banks and other financial institutions what has happened to them. The average theft amounts to $6,383. The victim usually loses about 7 percent of the fraudulent amount, plus additional expenses.

△The Internet has made identity theft easier.
For stolen credit cards, the consumer is liable for only the first $50 charged after reporting the theft to the company. But identity theft costs American businesses almost $53 billion annually.

How is identity theft accomplished? Thieves employ several methods to steal information. A “dumpster diver” may go through your trash, finding unshredded bank or credit card statements or offers. A dishonest sales clerk or server may write down your name, card number, and expiration date from the credit card you give them. Thieves might also divert your billing statements to another location by completing a change-of-address form, or simply steal your wallet, cards, or mail. About 35 percent of frauds reported to the Federal Trade Commission were initiated by e-mail or Web sites. Someone could hack into your computer, place links in a chat room, or clone a legitimate Web site to collect your information when you place an online order.

The fact is that anywhere your private information can be found is a potential theft site. All a criminal needs is your social security number, your birth date, and other identifying information such as your address and phone number. With this information and a false driver’s license, they apply for credit, in person or through the mail, posing as you.

**CONCLUSION**

Anyone can become a victim of identity theft, but consumers are not helpless. Consumer pressure for privacy rights has caused more than 22 states to pass laws requiring companies to notify consumers when their data may have been exposed to theft. And 11 states have “credit freeze” laws, which make identity theft nearly impossible when consumers actually exercise the right to freeze their credit files. Check the “Do” and “Don’t” list above to learn about some of the ways you can reduce your susceptibility to identity theft.

**Analyzing the Impact**

1. **Synthesizing**  How would having your identity stolen affect you?
2. **Critical Thinking**  Is your private information as safe as it could be? If not, what changes might you make to protect your identity?
The BIG Idea
Governments strive for a balance between the costs and benefits of their economic policies to promote economic stability and growth.

Why It Matters
In this chapter, read to learn about who is in charge of the U.S. money supply and how they decide how much currency to put into circulation.
GUIDE TO READING

Section Preview
In this section, you will learn about how the Federal Reserve System, or Fed, is organized, and its role in determining the nation's monetary policy.

Content Vocabulary
· Fed (p. 392)
· monetary policy (p. 392)
· Federal Open Market Committee (FOMC) (p. 393)
· check clearing (p. 395)

Academic Vocabulary
· assist (p. 392)
· network (p. 392)

Reading Strategy
Organizing As you read, complete a diagram similar to the one below to illustrate the organization of the Federal Reserve System.

Federal Reserve System

ISSues In ThE NeWS
— from HowStuffWorks.com

WHY THE FED WAS CREATED Before the Federal Reserve was created in 1913, there were over 30,000 different currencies floating around in the United States. Currency could be issued by almost anyone—even drug stores issued their own notes.

There were many problems that stemmed from this, including the fact that some currencies were worth more than others. Some currencies were backed by silver or gold, and others by government bonds. There were even times when banks didn’t have enough money to honor withdrawals by customers. Imagine going to the bank to withdraw money from your savings account and being told you couldn’t because they didn’t have your money!

Before the Fed was created, banks were collapsing and the economy swung wildly from one extreme to the next. The faith Americans had in the banking system was not very strong. This is why the Fed was created.

Congress created the Federal Reserve System in 1913 as the central banking organization in the United States. Its major purpose was to end the periodic financial panics (recessions) that had occurred during the 1800s and into the early 1900s. In this section, you’ll learn how the system is organized to carry out its many functions.
Organization of the Federal Reserve System

**Main Idea** The Federal Open Market Committee of the Federal Reserve is responsible for implementing monetary policy.

**Economics & You** Would you want power over the entire money supply to be concentrated in the hands of only a few people? Why or why not? Read on to learn about how the Fed is organized.

The Federal Reserve System, or Fed, as it is called, is made up of a Board of Governors assisted by the Federal Advisory Council, the Federal Open Market Committee, 12 Federal Reserve district banks, 25 branch banks, and many thousand banks and thrift institutions. (See Figure 15.1 below.) As its name states, the Fed is a system, or network, of banks. Power is not concentrated in a single central bank but is shared by the governing board and the 12 district banks.

The Fed is responsible for monetary policy in the United States. **Monetary policy** involves changing the rate of growth of the supply of money in circulation in order to affect the amount of credit, thereby affecting business activity in the economy.

**Fed:** the Federal Reserve System created by Congress in 1913 as the nation’s central banking organization

**monetary policy:** policy that involves changing the rate of growth of the supply of money in circulation in order to affect the cost and availability of credit

---

**Figure 15.1 Organization of the Fed**

- Since the change in banking regulations in the early 1980s, nonmember banks are also subject to control by the Federal Reserve System.

**Organization of the Federal Reserve System**

- **Federal Open Market Committee**: 12 members
  - (Board of Governors, head of NY Fed Bank, 4 rotating heads of other Fed District Banks)

- **Board of Governors**: 7 members

- **Federal Advisory Council**: 12 members

- **Federal Reserve Bank**: 12 District Banks 25 Branch Banks

- **Most banks and thrift institutions**

**Economic Analysis**

**Explaining** Why do we include most banks and thrift institutions as part of the Fed?
The Federal Reserve System and Monetary Policy

**The Main Bank**

The Federal Reserve System is headquartered in the Eccles Building on Constitution Avenue in Washington, D.C.

---

**Board of Governors** The Board of Governors directs the operations of the Fed. It supervises the 12 Federal Reserve district banks and regulates certain activities of member banks and all other depository institutions.

The 7 full-time members of the Board of Governors are appointed by the president of the United States with the approval of the Senate. The president chooses one member as a chairperson. Each member of the board serves for 14 years. The terms are arranged so that an opening occurs every 2 years. Members cannot be reappointed, and their decisions are not subject to the approval of the president or Congress. Their length of term, manner of selection, and independence in working reduces their exposure to political pressures.

**Federal Advisory Council** The Board of Governors is assisted by the Federal Advisory Council (FAC). It is made up of 12 members elected by the directors of each Federal Reserve district bank. The FAC meets at least 4 times each year and reports to the Board of Governors on general business conditions in the nation.

**Federal Open Market Committee** The 12 voting members on the Federal Open Market Committee (FOMC) meet 8 times a year to decide the course of action that the Fed should take to control the money supply. The FOMC determines such economic decisions as whether to raise or lower interest rates. It is this committee’s actions that have a resounding effect throughout the financial world.
The Banks  As shown in **Figure 15.2** below, the nation is divided into 12 Federal Reserve districts, with each district having a Fed district bank. Each of the 12 district banks is set up as a corporation owned by its member banks. The system also includes 25 Federal Reserve branch banks. These smaller banks act as branch offices and aid the district banks in carrying out their duties. All national banks are required to become members of the Federal Reserve System. State-chartered banks may join if they choose to do so.

In the past, only member banks were required to meet Fed regulations, such as keeping a certain percentage of their total deposits in reserve. Now all institutions that accept deposits from customers must keep reserves in their Fed district bank.

Today, the advantage of membership in the Fed is that member banks, as stockholders in their district bank, receive dividends on their stock in the district bank. Member banks also are able to vote for 6 of the district bank’s 9 board members.

**Identifying** What part of the Fed is responsible for raising or lowering interest rates?

---

**Figure 15.2**  The Federal Reserve System

- The 12 Federal Reserve district banks that serve the nation’s banks are distributed throughout the country. Trillions of dollars a year pass through the Fed as it processes billions of checks. Note that the Fed is headquartered in Washington, D.C.

Each Federal Reserve district has an identifying letter and number. These are used on Federal Reserve Notes to identify the issuing bank for each note. This bill, labeled with an “E,” was issued in Richmond.

**Economic Analysis**

**Explaining**  How is each Fed district bank structured?

---

**Source:** Federal Reserve Bulletin, Board of Governors of the Federal Reserve System.
Functions of the Fed

Main Idea The primary function of the Federal Reserve is to control the money supply.

Economics & You What happens to a check after you write it? How is it turned into money? Read on to learn about this and other important functions of the Federal Reserve.

Among the Fed’s functions are check clearing, acting as the federal government’s fiscal agent, supervising banks, holding reserves and setting reserve requirements, supplying paper currency, and regulating the money supply.

The primary responsibility of the Fed is regulating the money supply. To do this, it determines the amount of money in circulation, which, in turn, affects the level of interest rates, the availability of credit, and business activity in general. You’ll learn more about this process in Section 3. As you can see from Figure 15.3 above, check clearing—the transferring of funds from one bank to another when you write or deposit a check—is also an important and complex function.
As the federal government’s fiscal, or financial, agent, the Fed keeps track of federal deposits of tax revenues and holds a checking account for the United States Treasury. Checks for such payments as Social Security, tax refunds, and veterans’ benefits are drawn on this account. The Fed also acts as a financial adviser to the federal government, regulates state banks that are members of the Federal Reserve System, holds reserves of checkable deposits and sets reserve requirements, and supplies and maintains much of the nation’s paper money.

Finally, the Fed sets standards for certain types of consumer legislation, mainly truth-in-lending legislation. By law, sellers of goods and services must make some kinds of information available to people who buy on credit. This information includes the amount of interest and the size of the monthly payment to be paid. The Federal Reserve System decides what type of financial information must be supplied to consumers.

**Functions of the Fed**

1. **Regulating the money supply**
2. **Clearing checks**
3. **Supervising banks**
4. **Setting and managing reserves**
5. **Holding reserves and setting reserve requirements**
6. **Acting as government’s fiscal agent**

**Vocabulary**

1. **Explain** the significance of: Fed, monetary policy, Federal Open Market Committee (FOMC), check clearing.

**Main Ideas**

2. **Interpreting** In a chart like the one below, explain how the Fed performs each function listed.

<table>
<thead>
<tr>
<th>Federal Reserve Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearing checks</td>
</tr>
<tr>
<td>Supervising members</td>
</tr>
<tr>
<td>Setting and managing reserves</td>
</tr>
<tr>
<td>Supplying paper money</td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. **The BIG Idea** What is the major function of the Fed?

4. **Predicting Consequences** Which decision by the Federal Open Market Committee affects the entire financial world?

**Applying Economics**

5. **Learning About Money** Find the Web site of the Federal Reserve district bank for the region where you live. Then create a list of the kinds of information, such as facts about counterfeiting, that the Web site provides.
It’s not surprising that the nation’s top banker showed an interest in numbers early in his life. At the age of three, Ben Bernanke played with pennies and could do basic math. A straight-A student, he taught himself calculus in high school, achieved a near-perfect score on the SAT, and then earned degrees in economics from both Harvard and the Massachusetts Institute of Technology.

Dr. Bernanke is an expert in monetary policy—managing the country’s money supply by adjusting interest rates. His job is to help keep the economy growing while keeping inflation and unemployment low. He finds lessons for today by studying the U.S. stock market crashes of 1929 and 1987, as well as Japan’s in 1990: “There’s no denying that a collapse in stock prices today would pose serious macroeconomic challenges for the United States. . . . History proves, however, that a smart central bank can protect the economy and the financial sector from the nastier side effects of a stock market collapse.”

Dr. Bernanke believes the hardships people suffered in the Great Depression could have been lessened if the central banks had taken control of deflation. He also believes the U.S. economy can withstand stock market crashes if the central banks can maintain a targeted inflation rate of about 2 percent:

“A collapse in U.S. stock prices certainly would cause a lot of white knuckles on Wall Street. But what effect would it have on the broader U.S. economy? If Wall Street crashes, does Main Street follow? Not necessarily.”

Checking for Understanding

1. **Explaining** What does the Federal Reserve Bank do?

2. **Contrasting** What is the difference between inflation and deflation?
Money Supply and the Economy

GUIDE TO READING

Section Preview
In this section, you will learn how the Fed controls the money supply and interest rates.

Content Vocabulary
- loose money policy (p. 399)
- tight money policy (p. 399)
- fractional reserve banking (p. 400)
- reserve requirements (p. 400)

Academic Vocabulary
- function (p. 398)
- portion (p. 401)

Reading Strategy
Synthesizing As you read the section, complete a flowchart like the one below to contrast the effects that a loose or tight money policy can have on the economy.

PeOPLE In ThE NeWS
—from the Washington Post

BERNAKE STANDS TOUGH Ben S. Bernanke rattled world financial markets . . . with his tough talk about combating inflation, but he also buffed up his image as a strong Federal Reserve chairman committed to the fight, analysts said . . .

Gone, during Bernanke’s remarks to a bankers’ conference, was any mention of a Fed pause in its two-year series of interest rate increases. Gone was any fretting over the danger of pushing interest rates too far and triggering a slump. Instead, he declared the recent rise in inflation would not be tolerated . . .

Bernanke’s remarks followed extensive discussion within the central bank about its strategy for communicating with the public. Bernanke has long argued that Fed officials should be more open about their thinking to help the markets anticipate the likely course of interest rates.

As you learned in Section 1, the jobs of the Fed today range from processing checks to serving as the government’s banker. As you read this section, however, you’ll learn that the Fed’s most important function involves control over the rate of growth of the money supply and, consequently, changes in interest rates.
Loose and Tight Money Policies

The goal of monetary policy is to promote economic growth and employment without causing inflation.

Economics & You Have you ever wondered why the government doesn’t eliminate poverty by printing money until everyone has enough? Read on to learn why this “loose” money policy would be problematic.

You may have read a news report in which a business executive complained that money is “too tight” or an economist warned that it is “too loose.” In these cases, the terms tight and loose refer to the monetary policy of the Fed. Monetary policy, as you recall, involves changing the rate of growth of the money supply in order to affect the cost and availability of credit.

Credit, like any good or service, has a cost—the interest that must be paid to obtain it. As the cost of credit increases, the quantity demanded decreases. In contrast, if the cost of borrowing drops, the quantity of credit demanded rises.

Figure 15.4 below shows the results of monetary policy decisions. If the Fed implements a loose money policy (often called “expansionary’’), credit is abundant and inexpensive to obtain. If the Fed follows a tight money policy (often called “contractionary”), credit is in short supply and is expensive to obtain. A loose money policy encourages economic growth, while a tight money policy controls inflation. If money becomes too plentiful too quickly, prices increase.

Analyzing What happens to the availability of credit when the interest rate rises? When it falls?

Skills Handbook
See page R57 to learn more about Understanding Interest Rates.

loose money policy: monetary policy that makes credit inexpensive and abundant, possibly leading to inflation

tight money policy: monetary policy that makes credit expensive and in short supply in an effort to slow the economy
Fractional Reserve Banking

Main Idea  Banks are not required to keep 100 percent reserves to back their deposits.

Economics & You  What happens to the money you deposit in your bank? Read on to learn how the Fed uses it to increase the money supply.

Before you can understand how the Fed regulates the nation’s money supply, you need to understand the basis of the U.S. banking system and the way money is created. The banking system is based on what is called fractional reserve banking.

Since 1913 the Fed has set specific reserve requirements for many banks. This means that they must hold a certain percentage of their checkable deposits either as cash in their own vaults or as deposits in their Federal Reserve district bank. Banks must hold these reserves in case many of their banking customers decide to withdraw large amounts of cash from their checking accounts. Currently, many financial institutions must keep 10 percent of their checkable deposits as reserves with the Fed.

Figure 15.5  Expanding the Money Supply

The chart shows how $1,000 in new reserves expands to $5,000 by simple loans. In Round 1, the Fed deposits $1,000 of “new” money in Bank A. With a 20 percent reserve requirement, Bank A must hold $200 of the new deposit on reserve. This leaves the bank with $800 of excess reserves.

In Round 2, Mr. Jones applies to Bank A for an $800 loan to buy a computer. Bank A grants the loan, and Mr. Jones writes a check to Computer World, which deposits the funds at Bank B. Bank B’s reserves increase by $800. Of this amount, $160 (20 percent of $800) are required reserves, and the remaining $640 are excess reserves.

In Round 3, Bank B—to earn profits—loans its excess reserves to Ms. Wang, who wants to borrow $640. She, in turn, buys something from Mr. Diaz, who does his banking at Bank C. He deposits the funds from Ms. Wang. Bank C now has $640 in new deposits, of which $128 are required reserves. Bank C now loans $512 of excess reserves to Mrs. Fontana, who buys something from Mrs. Powers, and so on.

<table>
<thead>
<tr>
<th>Round</th>
<th>Deposited by</th>
<th>Amount of Deposit</th>
<th>Required reserves (20%)</th>
<th>Excess reserves (80%)</th>
<th>Loaned to</th>
<th>Paid to</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The Fed (Bank A)</td>
<td>$1,000.00</td>
<td>$200.00</td>
<td>$800.00</td>
<td>Mr. Jones</td>
<td>Computer World</td>
</tr>
<tr>
<td>2</td>
<td>Computer World (Bank B)</td>
<td>$800.00</td>
<td>$160.00</td>
<td>$640.00</td>
<td>Ms. Wang</td>
<td>Mr. Diaz</td>
</tr>
<tr>
<td>3</td>
<td>Mr. Diaz (Bank C)</td>
<td>$640.00</td>
<td>$128.00</td>
<td>$512.00</td>
<td>Mrs. Fontana</td>
<td>Mrs. Powers</td>
</tr>
<tr>
<td>4</td>
<td>Mrs. Powers (Bank D)</td>
<td>$512.00</td>
<td>$102.40</td>
<td>$409.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>All Others</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Eventual totals</strong></td>
<td><strong>$5,000.00</strong></td>
<td><strong>$1,000.00</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Economic Analysis

Analyzing  Why are banks required to hold a certain percentage of deposits in reserve, rather than loan them all out?
Currency is a small part of the money supply. A larger portion consists of funds that the Fed and customers deposit in banks. Because banks are not required to keep 100 percent of their deposits in reserve, they can use these reserves to create what is, in effect, new money. (See Figure 15.5.)

Suppose Bank A sells a government bond to the Fed and receives $1,000. This is $1,000 in “new” money because the Fed simply creates it by writing a check. With a 20 percent reserve requirement, the bank must hold $200 of that money in reserve. The bank is free to lend the remaining $800.

Suppose that Bank A now provides an $800 loan to an independent business. The business then deposits the $800 in Bank B, which must keep in reserve 20 percent of this new deposit, or $160. Bank B can then loan out the remaining $640. If the business or person receiving the $640 loan then deposits it in Bank C, that bank must keep 20 percent and can loan out the rest. The process continues—$1,000 of “new money” in the banking system becomes a $5,000 increase in the money supply.

So, as we see, each bank uses the nonrequired reserve portion of money deposits to make loans to businesses and individuals. This process is known as the multiple expansion of the money supply.

Explain Explain the process of money expansion.

Vocabulary
1. Explain the significance of: loose money policy, tight money policy, fractional reserve banking, reserve requirements.

Main Ideas
2. Determining Cause and Effect Copy the arrows below, and write at least three characteristics of loose and tight money inside the appropriate arrow.

Loose $ $ $ Tight $

Critical Thinking
3. The BIG Idea Why does the government require banks to keep reserves against certain deposits?
4. Evaluating What is the advantage to a bank of fractional reserves?

Applying Economics
5. Inflation and the Money Supply Check the newspaper or an online source for an article about either current interest rates (which are affected by the money supply) or inflation. Write a paragraph or create a chart to show how interest rates affect inflation.
Regulating the Money Supply

GUIDE TO READING

Section Preview
In this section, you will learn about several tools that the Fed uses to control the size of the U.S. money supply.

Content Vocabulary
- discount rate (p. 404)
- prime rate (p. 404)
- federal funds rate (p. 405)
- open-market operations (p. 406)

Academic Vocabulary
- precise (p. 403)
- contract (p. 405)

Reading Strategy
Listing As you read, complete a diagram similar to the one below by filling in the tools the Fed uses to regulate the money supply.

ISSues In ThE NeWS
—from BusinessWeek

RATE DEBATE HEATS UP Federal Reserve meetings are about to get a lot more interesting than they have been in several years. Some policymakers are already raising questions about tightening too much, while others are concerned that labor market pressures and rising energy costs could fuel inflation outside of energy. From here on, policy decisions will depend almost totally on what the economic data imply about growth and inflation, but different people can interpret data in different ways.

One of the hottest topics around the Fed’s table will be the role of globalization in policy decisions. U.S. prices of everything from copper to bonds to labor are now influenced by market forces overseas. Globalization ups the ante on finding the right level of interest rates that will keep U.S. inflation at bay.

The main goal of the Federal Reserve is to keep the money supply growing steadily and the economy running smoothly. The Fed attempts to control the money supply efficiently while avoiding both inflation and recession. As you’ll learn in this section, the Fed uses several tools to achieve a smoothly running economy.
Changing Reserve Requirements

Main Idea  The Fed can change the growth rate of the money supply by changing reserve requirements on bank deposits.

Economics & You  If you have a job and save part of your paycheck, you cannot spend the part that you “reserve.” Read on to learn about how the Fed uses a similar process to control the money supply.

The Federal Reserve can choose to control the money supply by changing the reserve requirements of financial institutions. One option the Fed has is to raise reserve requirements. When this happens, a bank can call in some loans, sell off investments, or borrow from another bank or from the Fed. Obviously, because all banks would have to increase their reserves, this action would decrease the amount of money in the economy. Raising reserve requirements, then, can be used to help slow down the economy if it is expanding too rapidly.

Even small changes in the reserve requirement can have major effects on the money supply. As a result, some believe that this tool is not precise enough to make frequent small adjustments to the money supply. In recent years, changing the reserve requirement has not been used to regulate the money supply.

Determining Cause and Effect  How does raising the reserve requirement slow down the economy?

### Raising and Lowering Reserve Requirements

<table>
<thead>
<tr>
<th>Bank Deposits</th>
<th>Reserve Requirement</th>
<th>$ Amount Bank May Loan</th>
<th>Fed Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Part A</td>
<td>10% ($1,000,000)</td>
<td>$900,000</td>
<td>Suppose a bank has $1 million in deposits, and the reserve requirement is 10%. The bank must keep at least $100,000 in reserves.</td>
</tr>
<tr>
<td>Part B</td>
<td>5% ($1,000,000)</td>
<td>$950,000</td>
<td>If the Fed wanted to increase the money supply, it could lower the reserve requirement to 5%, for example. The bank would then need to keep only $50,000 in reserves. It could lend out the other $950,000. This additional $50,000 would expand the money supply many times over as it was lent and redeposited. This could help pull the economy out of a recession.</td>
</tr>
<tr>
<td>Part C</td>
<td>15% ($1,000,000)</td>
<td>$850,000</td>
<td>Suppose instead that the Fed wanted to decrease the money supply, or at least slow down its rate of growth. It could do this by increasing the reserve requirement from 10% to 15%. The bank in this example would then need to keep $150,000 on reserve—$50,000 more than with a 10% reserve requirement.</td>
</tr>
</tbody>
</table>

The Federal Reserve System and Monetary Policy  403
Changing the Discount Rate

Main Idea The Fed can change the growth rate of the money supply by changing short-term interest rates.

Economics & You Have you ever borrowed money from a friend? Banks sometimes borrow from each other as well. Read on to learn about how this practice can also affect the money supply.

Sometimes a bank will find itself without enough reserves to meet its reserve requirement. This situation may occur if customers unexpectedly borrow a great deal or if depositors suddenly withdraw large amounts. The bank must then borrow funds to meet its reserve requirement. One of the ways it can do this is to ask its Federal Reserve district bank for a loan. The district bank, like any other bank, charges interest. The rate of interest the Fed charges banks is called the discount rate.

If the bank does borrow from the Fed, this newly created money would then be available for lending to individuals or businesses, thus increasing the money supply. If the discount rate is high, the bank passes its increased costs on to customers in the form of higher interest rates on loans. For example, it might raise its prime rate—the interest rate it charges its best business customers. High discount rates, which discourage borrowing, might keep down the growth of the money supply.

In contrast, if the discount rate is low, even a bank with sufficient reserves might borrow money to raise its reserves and increase its ability to make loans. Thus, a reduction in the discount rate may increase the total money supply.

Changing the discount rate, like changing the reserve requirement, is now rarely used by the Fed as a tool of monetary policy. Rather, either through its chair or its Federal Open Market Committee, the Fed periodically states that it is going to change “the” interest rate. Because there are many interest rates in the economy, which one does the Fed mean?

**discount rate:** interest rate that the Fed charges on loans to commercial banks and other depository institutions

**prime rate:** rate of interest that banks charge on loans to their best business customers

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FOXTROT ▼ Smart consumers pay attention to interest-rate changes.
The Federal Reserve System and Monetary Policy

The interest rate the Fed is referring to is the federal funds rate. This is the interest rate that banks charge each other for short-term loans (usually overnight). Why would one bank need to borrow from another? Suppose a customer walks into Bank A late in the day and withdraws a large amount. In order to provide funds to the customer, the bank must dip into its required reserves. Before the banking day ends, Bank A must raise its reserves to the required amount or pay a penalty to the Federal Reserve.

Bank A could borrow from the Fed as discussed earlier, but the discount rate may be too high. Instead, Bank A approaches Bank B for a loan. Bank B happens to have excess reserves that day, so it loans Bank A the funds it needs, charging the federal funds rate. This federal funds market is active—billions of dollars of reserves are borrowed and loaned each business day.

If the Fed causes the federal funds rate to drop, banks will borrow more and, thus, lend more. In contrast, the chairman of the Fed may publicly state the opposite—that the Fed is causing the federal funds rate to rise. At the higher rate, banks will reduce their borrowing from other banks and raise the interest rates they charge their own customers. Economic activity may contract. (See Figure 15.6 above.)

Predicting Consequences What happens to the money supply if the Fed raises the discount rate? Lowers it?

**Figure 15.6 Federal Funds Rate**

- When the media discuss a rate hike or reduction by the Fed, they are referring to the federal funds rate, or the interest rate that banks charge each other for overnight loans. This affects how much both banks and individuals will borrow.

The media may refer to the federal funds rate, which is the interest rate that banks charge each other on loans (usually overnight). This rate affects how much banks and individuals will borrow.
Open-Market Operations

Main Idea The Fed controls the money supply primarily through the purchase and sale of government securities.

Economics & You How long does it take for a change in the money supply to directly affect you? Read on to learn about delays in the effects of the Fed's monetary policy, as well as criticisms of the Fed.

Buying and selling government securities, a practice known as open-market operations, is the major tool the Fed uses to control the money supply. An open market is one that is open to private businesses and not controlled or owned by the government.

Security dealers specialize in buying and selling government securities. When the Fed buys securities—such as Treasury bills, notes, and bonds—it pays for them by making a deposit in the dealer’s bank. This deposit increases the bank’s reserves, thus increasing the money supply. When the Fed adds even a relatively small amount of new reserves into the banking system, banks taken as a whole can create money by holding on to required reserves and loaning out the rest.

In contrast, when the Fed sells Treasury bills to a dealer, the dealer’s bank must use its deposits to purchase the securities. This action means that banks have fewer reserves to support loans and must reduce their lending. The multiple expansion of money works in reverse by taking more money out of circulation than just the initial withdrawal.

open-market operations: buying and selling of United States securities by the Fed to affect the money supply

How Much Money?
No matter what tool of monetary policy the Fed uses, the goal is to manipulate the supply of money in circulation.
Delays in the Effects of Monetary Policy  No matter what tool of monetary policy the Fed uses, the effects are not felt immediately. Rather, after a monetary policy change, months may pass before the full effects make much change in the economy. Researchers believe that on average, 12 months go by before monetary policy changes are fully felt.

Criticisms of Fed Policies   Throughout its history, the Fed’s monetary policies have been criticized. In some instances of rising inflation, the Fed increased the amount of money in circulation, thereby worsening inflation. During other periods when the economy was slowing down and going into recession, the Fed decreased the money supply. This action made the recession worse. To prevent such misjudgments, some critics of the Fed have requested that the money supply simply be increased at the same rate every year. They recommend that the Fed not engage in monetary policy.

Although the Fed is protected from direct political pressure, it nonetheless still receives conflicting advice from many directions. In addition, the Fed is not the only force working to affect the economy. The spending and taxing policies of the federal government are also at work. The Fed’s task is to consider all of these factors as it plots a course for the economy.

**Examining**  On average, how long does it take for a change in Fed monetary policy to affect the economy?

---

**Review**

**Vocabulary**

1. **Explain** the significance of: discount rate, prime rate, federal funds rate, open-market operations.

**Main Ideas**

2. **Summarizing**  In a chart like the one below, insert the correct amount a bank can lend given the deposit amounts and reserve requirements listed.

<table>
<thead>
<tr>
<th>Original Amount</th>
<th>% Reserved</th>
<th>Amount Banks Can Lend</th>
</tr>
</thead>
<tbody>
<tr>
<td>$800</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>$800</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>$1,000</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>$1,000</td>
<td>20%</td>
<td></td>
</tr>
</tbody>
</table>

3. **Explaining**  Why does raising reserve requirements decrease the money supply?

**Critical Thinking**

4. **The BIG Idea**  Explain why it is more expensive for everyone to borrow when the Fed raises the federal funds rate.

5. **Contrasting**  What is the difference between the discount rate and the prime rate?

**Applying Economics**

6. **Government Policy**  Construct a written argument that either supports or refutes having government strongly influence the economy. Find at least one quote from another source to defend your opinion.
INFLATION EXPECTATIONS

What you foresee is what you get.

Check It Out! In this chapter you learned that the Fed decides whether to raise or lower interest rates to control inflation. In this article, read to learn about a new economic indicator the Fed looks at when making this decision.

What the heck are inflation expectations, anyway? You won’t find the term in any of the major economic data releases put out by the government. Yet whether inflation expectations are rising or falling may turn out to be a critical factor in determining how far and how fast the Federal Reserve raises interest rates.

That, at least, is the new line coming out of the Fed these days. Inflation expectations—a bit of a touchy-feely concept—represent the beliefs of consumers, investors, corporate execs, and economists about how fast prices will rise in the future. To Fed Chairman Ben S. Bernanke, inflation expectations are a key indicator. If people believe inflation will stay low, the Fed can afford to relax a bit. But if the masses start anticipating faster inflation, the odds are greater that the Fed will need to hit them with higher rates even if actual price hikes remain moderate.

. . . How are beliefs about future inflation measured? One way is to ask economists what they think is going to happen.

Another way to judge expectations is to look at the behavior of investors. . . .

The danger, of course, is that expectations about future prices might jump, forcing the Fed to raise rates sharply to maintain its credibility as an inflation fighter. . . . [Today] the Fed has built credibility by both aggressively fighting inflation and communicating its commitment to price stability. As a result, even as energy prices skyrocketed in recent years, inflation expectations hardly budged, and non-energy inflation stayed relatively low.

—Reprinted from BusinessWeek

Think About It
1. Defining What are inflation expectations?
2. Summarizing How does the Fed plan to use inflation expectations as an economic indicator?
The primary function of the Federal Reserve System is to control the money supply, but it has other responsibilities as well.

The Fed can implement either a loose or tight money policy to try to promote economic growth and employment.

The Fed has several tools at its disposal to use to regulate the money supply.
Review Content Vocabulary

1. Write a paragraph or two explaining the role of the Federal Reserve in the U.S. economy. Use all of the following terms.

   Federal Reserve
   monetary policy
   check clearing
   loose money policy
   tight money policy
   reserve requirement
   discount rate
   federal funds rate
   prime rate
   open-market operations

Review the Main Ideas

Section 1  (pp. 391–396)

8. What does the Board of Governors do within the Fed?

9. How many Federal Reserve banks and branches are there?

10. What are the main functions of the Federal Reserve?

Section 2  (pp. 398–401)

11. What are the two basic types of monetary policies?

12. In a 10 percent fractional reserve banking system, what happens to the money supply when the Fed injects $100 of new money into the American economy?

13. Why do banks have to keep money in reserve accounts?

Section 3  (pp. 402–407)

14. Fill in a table like the one below to list methods the Fed can use to change the money supply, and explain how these methods can be used to increase or decrease the money supply.

<table>
<thead>
<tr>
<th>Method</th>
<th>To Increase the Money Supply...</th>
<th>To Decrease the Money Supply...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change reserve requirements</td>
<td>Lower reserve requirements to allow banks to lend more</td>
<td></td>
</tr>
</tbody>
</table>

15. Why do some of the Fed’s critics think the Fed should not engage in manipulating the nation’s money supply?
Problem Solving

16. Look at Figure 15.1 on page 393. Use the map to answer the following questions.

a. In what federal district do you live?

b. What is the Federal Reserve Bank city of district 9?

c. What is the Federal Reserve Bank city of district 4? What are district 4’s branch cities?

d. What are the branch cities of district 11?

e. To what district bank would checks written in Hawaii go first?

f. Imagine that the population of district 12 grows very quickly and the district bank has trouble keeping up with the demand for services there. How might the Fed solve this problem?

g. Suppose that there are suddenly many large withdrawals from banks in district 6, and these banks do not have enough in reserve to cover these withdrawals. How might the Fed solve this problem?

Critical Thinking

17. The BIG Idea How do you think the Fed would operate differently if it were under the control of the executive branch?

18. Contrasting What is the advantage for banks to be members of the Federal Reserve today? How does this differ from the past?

19. Understanding Cause and Effect Create a flowchart like the one below to show how fractional reserve banking increases the money supply.

Analyzing Visuals

20. Study the cartoon on the right, and then answer the following questions.

a. Who is the man holding the door, and what is his job?

b. What does the dragon represent?

c. Why does the man look unhappy about his welcome?
The **BIG Idea**

All levels of government use tax revenue to provide essential goods and services.

**Why It Matters**

How does the government impact your daily life? Highways and bridges, as well as the taxes you pay on gasoline, are just two examples of government involvement in your day-to-day activities. In this chapter, read to learn why the government collects taxes and what it spends those funds on.

**Economics ONLINE**

**Chapter Overview**  Visit the *Economics Today and Tomorrow* Web site at [glencoe.com](http://glencoe.com) and click on Chapter 16—*Chapter Overviews* to preview chapter information.
As you learned in Chapter 2, the United States is not a pure market economy. In addition to the market forces of supply and demand, other forces affect the use of resources throughout the economy. As you read this section, you’ll learn that government at every level—local, state, and federal—is one of the most important of these forces.

As you read the section, complete a timeline similar to the one below by listing key events and dates that led to increasing government size and spending.

**ISSues In ThE NeWs**

— from *Reason*

**CONTROL SHIFT** Bill Clinton famously proclaimed that “the era of big government is over.” He was wrong: it just moved to the suburbs. State and local governments now dwarf the national government. Fully 86 percent of civilian government employees work for state and local entities. That translates into 46 million Americans who either work for local governments or depend on someone who does.

By long-standing tradition, Americans prefer their government to be close to home, where . . . we can control it. We’ve got half our wish: most government is local, but it is out of control. Local governments are multiplying . . . at a rate of one new entity added each day. They operate the schools our children attend, determine the uses of our property, and tax us at a higher rate than the national government.
Government has grown considerably in the last 80 years or so. In 1929 government at all levels employed slightly more than 3 million civilian workers. During the Depression, however, there was a demand for more government services.

Today, about 2.7 million people work for the federal government alone. If you add local and state employees, the government employs over 22 million civilian workers. This figure represents more than a sevenfold increase during a period in which the population a little more than doubled.

The number of government workers has increased because the number of government functions has risen and the size of the population has grown. (See Figure 16.1 below.)

**Figure 16.1 Government Involvement in the Economy**

- Government plays a major role in many aspects of our lives. Some individuals believe that government has grown too large and that the private sector should provide most goods and services without government intervention. Others argue that government should be even larger.

**A. Transportation**
When you travel on a highway, you are using a resource financed by federal and state funds.

**B. Education**
Your school probably receives some form of aid from the local, state, or federal government.
During the late 1960s, state and local governments spent less than the federal government. The federal government paid for national defense; the salaries of members of Congress, federal judges, and the employees of executive departments such as the State Department; and public-works projects. Public-works projects are publicly used facilities such as schools and highways that are built and paid for with tax dollars.

This situation continued until about 1970. Around that time, federal funds started diminishing, while state and local government spending for such items as sewers, roads, and schools increased rapidly. As you can see from the graph on the right, the different levels of government have grown at different rates over the past several years.

\[\text{Government Purchases}\]

<table>
<thead>
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<th></th>
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<td>1,200</td>
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<td>800</td>
<td>1,000</td>
<td>1,200</td>
<td>1,400</td>
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</tbody>
</table>


Explaining Why has the number of government workers increased so drastically over the last 80 years?

C. Product Safety
Many goods that you buy are produced in accordance with local, state, and federal regulations.

D. Worker Safety
If you have a job, government safety and other regulations often determine your working conditions.

E. Taxation
If you own property, buy goods, or earn income, you probably pay taxes that help pay for many government activities.

public-works projects: publicly used facilities, such as schools and highways, built by federal, state, or local governments with public money.

Economic Analysis
Synthesizing Why do you think government funds, rather than private funds, are used to build highways and bridges?
Why Has Government Grown?

Main Idea The level of government spending reflects political decisions about how much goods and services should be provided by the public or private sectors.

Economics & You Do you think that a large, growing government is good or bad for society? Why? Read on to learn why the government has grown over the years and about the opportunity costs of this growth.

Economists have often tried to explain the huge growth in government spending. During the Great Depression, there appeared to be a need for more government services. In the 1940s, the government spent billions of dollars to pay for World War II. Why has the government continued to grow since then?

One theory is that as the nation became richer, especially in the late 1960s and early 1970s, people demanded more government services to even out certain income inequities. This goal relates to the economic question of who should share in what is produced.

Today, total government purchases represent about 19 percent of GDP. This figure does not include such items as interest payments on the national debt and transfer payments such as welfare programs. If you add these items, total government outlays easily exceed one-third of GDP.

The True Size of Government

The size of government cannot be measured merely by the cost of government spending. Any discussion of the government’s size must include where government spends these funds.

Americans disagree about how much the government should be involved in social spending. For the past several decades, the question of whether the government should provide universal health care has been a topic of great debate.
When the government taxes you to provide you with a particular service, such as Medicare (health care for the aged), this cost of government is included in government spending. What if the government also requires that your employer provide that same service? State governments are doing just that. In Massachusetts, for example, employers with six or more employees must provide medical insurance for each employee. So, the federal government taxes employees to pay for government-provided health insurance, and a state government requires that employers provide health insurance directly. The true size of government, then, may be even greater than government estimates show because some “private sector” spending is required by law.

**The Growth of Government—Good or Bad?** We know that government in the United States grew throughout the 1900s and even faster in the early 2000s. Although no one can know how much government is good for society, a general rule is that government taxing and spending have opportunity costs. Government activity displaces private economic decision making along the production possibilities curve, which you learned about in Chapter 1. This private decision making involved in buying and selling is at the core of wealth creation and a rising standard of living for all citizens.

**Reading Check**  How has the nation’s increasing wealth affected the size of government?

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**section 1**  Review

**Vocabulary**

1. Explain the significance of: public-works projects, Medicare.

**Main Ideas**

2. Defending In a chart like the one below, indicate whether you think the government should fund the items listed, and why. Also give a reason or reasons for your opinion.

<table>
<thead>
<tr>
<th>Should Government Fund:</th>
<th>Yes/No</th>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highway construction</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public schools</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product safety information</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Worker safety information</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. The Big Idea  What political factors influence how much government spends on goods and services?

4. Synthesizing  Why is it difficult to measure the true size of government?

**Applying Economics**

5. Public Education  In recent years, there has been much debate about whether the public school system should be privatized. Do you think private schools would do a better job than public schools? Write a paragraph defending your view, and share your paragraph with the class.
The general purpose of government in the United States is to protect individual rights, to promote a stable legal environment for economic activity, and to promote policies that support the general well-being of all citizens. In this section, you’ll learn about how the government works toward accomplishing these goals.
Providing Public Goods

Main Idea Public goods are goods or services that many people can use at the same time.

Economics & You Have you ever visited a museum, library, or public park? Read on to learn about these and other public goods provided by the government.

Public goods are a special type of goods or services that government supplies to its citizens. Many people can use public goods—such as streetlights—at the same time, without reducing the benefit each person receives. Usually, different levels of government share responsibility for public goods, such as the legal system. Federal, state, and local governments maintain separate systems of courts, correctional institutions, and law-enforcement agencies. The most important public good that only government can provide is a sound system of property rights. In such a system, individuals have the right to own factors of production and to take entrepreneurial risks.

In any society, certain goods and services are considered to have special merit. A merit good is one that is deemed socially desirable by government leaders—museums, ballets, and classical music concerts, for example. The government may subsidize such goods by requiring all taxpayers to support them. This allows everyone to enjoy such goods for less than the full market price.

The opposite of merit goods are demerit goods, or goods which government officials have deemed socially undesirable, such as tobacco, alcohol, and gambling. The government exercises control over demerit goods by taxing, regulating, or prohibiting the manufacture, sale, and use of them. Taxes on these goods are sometimes called “sin taxes.”

Reading Check Evaluating What is the most important public good that only the government can provide?

National Defense

National defense is one of the few public goods controlled solely by the federal government. Usually, state and local governments share the burden of providing public goods.

public goods: goods or services that can be used by many individuals at the same time without reducing the benefit each person receives
Promoting the General Welfare

Main Idea  Government can use its power to tax and spend to alter market outcomes.

Economics & You  Do you think that you have a responsibility to help out those less fortunate than yourself? Read on to learn about how the government redistributes income to the needy.

Some Americans do not have sufficient income for a tolerable level of living, placing them at the bottom of the distribution of income in this country. These people profit from another function of government: to provide for the public well-being by assisting specific groups. These groups include the aged, the ill, and the poor. Through their elected representatives, Americans have chosen to see that almost everyone in the nation is provided with a certain minimum level of support. This task is accomplished primarily through **income redistribution**, or using tax receipts to assist citizens in need. Tax dollars are used to subsidize two general categories of assistance: social-insurance programs and public-assistance programs.

**Social-Insurance Programs**  When you receive a paycheck, you will notice that a portion of your pay has been withheld by various levels of government. Some of these taxes are earmarked for **social-insurance programs**—programs that pay benefits to retired and disabled workers, their families, and the unemployed. These benefits are financed by taxes that you, other workers, and employers pay into the programs. Examples of social-insurance programs include **Social Security**, a federal program that provides monthly payments to people who are retired or unable to work. Upon retirement, you are also eligible for Medicare, a federal program that provides low-cost health care for the elderly.

**Supplemental Security Income**

Some American citizens with special needs receive assistance from this federally financed and administered aid program. The blind are one group that receives such benefits.
The federal Social Security program has always been intended to provide supplemental, or additional, income—sometimes referred to as a safety net—rather than serve as a retired person’s primary source of income. Often, Social Security income alone is not enough for a retired person to live on comfortably.

Another social-insurance program is workers’ compensation, a state program that provides payments for medical care to workers who have been injured on the job and are therefore unable to work for a period of time. People who have lost jobs altogether can receive payments through unemployment insurance. Unemployment insurance is intended to provide income temporarily to people who are unemployed through no fault of their own. People receiving such benefits are expected to actively seek employment.

Public-Assistance Programs Often called welfare, public-assistance programs are different from social-insurance programs. Public-assistance programs make payments to individuals based on need, regardless of a person’s age and whether or not the person has paid taxes into the program.

Supplemental Security Income is a federally financed and administered program that makes payments to the aged, blind, and disabled who have little or no income. It provides funds to meet basic needs for food, clothing, and shelter. Another program in this category is Temporary Assistance for Needy Families, a state-run program that provides assistance and work opportunities to needy families raising young children.

Medicaid, a state and federal program that helps pay health care costs for low-income and disabled persons, is another public-assistance program. Medicaid does not provide funds to individuals; instead, it sends payments directly to health care providers.

Contrasting What is the difference between social-insurance and public-assistance programs?

workers’ compensation: government program that extends payments for medical care to workers injured on the job

public-assistance programs/welfare: government programs that make payments to citizens based on need

Supplemental Security Income: federal programs that include food stamps and payments to the disabled and aged

Temporary Assistance for Needy Families: state-run program that provides assistance and work opportunities to needy families

Medicaid: state and federal public-assistance program that helps pay health care costs for low-income and disabled persons

LUCKY COW ▼ Only serious, debilitating injuries qualify a person for workers’ compensation.
Regulation and Economic Stability

Main Idea Stable growth, low unemployment, and low inflation are the primary economic goals of government.

Economics & You Should the government step in to protect citizens from pollution or unfair business practices? Read on to learn about ways that the government intervenes in economic activity.

Two other functions of government involve regulating economic activity and trying to ensure economic stability.

Regulating Economic Activity Figure 16.2 below illustrates four ways in which the government intervenes in economic activity. One of the most important regulatory functions concerns the side effects of the production process—also called externalities. When a steel mill produces steel, for example, the resulting pollution from the smokestacks may cause health problems in the surrounding area. In the absence of legal rules that limit such pollution, the steel mill does not have to correct these negative externalities.

Ensuring Economic Stability Ensuring economic stability has meant smoothing the ups and downs in the nation’s overall business activity. Such intervention has been sought to shield citizens from the harmful effects of business fluctuations, including unemployment, high inflation, recessions, and even depressions. In Chapter 17, you’ll learn more about the government’s attempt to stabilize the economy.

Figure 16.2 Government Regulation

- Government under the American free-enterprise system regulates certain aspects of the economy.

Economic Analysis Analyzing Why would the government be interested in promoting competition?
Critics of Government Involvement  There are many critics of government involvement in the economy. They point out that merit goods, for example, should be provided by private organizations instead of being funded by taxpayer dollars. If people pay fewer taxes, they have more disposable income and can choose to fund parks, museums, arts programs, or other merit goods if they really want such services.

Opponents of redistribution programs think that most government assistance discourages personal initiative, affects incentives, and harms self-development. Critics of government regulations argue that most regulations raise the prices of goods and services. A better approach, these critics say, would be to encourage market solutions to such problems as pollution.

Reading Check  Summarizing  What are three criticisms of government involvement in the economy?

Review

Vocabulary

Main Ideas
2. Identifying In diagrams like the ones below, provide examples of the kinds of assistance listed.

Let the Market Be?
Critics of government regulation argue that the market will take care of problems if left on its own. For example, they believe that consumers will stop buying cars that cause excessive pollution, and therefore, the government should not regulate car emission standards.

Critical Thinking
3. The BIG Idea  The government regulates negative externalities of production. Explain what this means, and give one example.

4. Comparing and Contrasting  What are two arguments supporting government intervention and two arguments opposing intervention in the economy?

Applying Economics
5. Government Rules and You  Make a double-sided chart. On the left side of the chart, make a list of specific ways local, state, and national governments affect you. On the right side of each item, tell whether you do or do not support this policy.
John Maynard Keynes was probably the most influential economist of the twentieth century. During the Great Depression of the 1930s, economic distress was widespread. Industrial output in the United States fell by over 30 percent, and unemployment rose to over 25 percent of the workforce. Capitalism appeared to be inherently unstable, and traditional laissez-faire economic theory seemed to offer few solutions other than waiting for free markets to readjust on their own.

In the midst of the suffering, Keynes’s *General Theory of Employment, Interest and Money*, published in 1936, offered an alternative, arguing that government should actively stimulate the economy and reduce unemployment through its spending and taxing policies. According to Keynes, the assumptions of classical economic theory “are seldom or never satisfied, with the result that it cannot solve the economic problems of the actual world.”

Ten years earlier, in an essay entitled *The End of Laissez-Faire*, Keynes had already made a case for greater government involvement:

“It is not true that individuals possess a prescriptive ‘natural liberty’ in their economic activities. There is no ‘compact’ conferring perpetual rights on those who Have or on those who Acquire. . . .

“The important thing for government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all.”

The school of economic thought known as Keynesian economics grew out of these ideas that it is the duty of government to intervene in the economy to help the disadvantaged.

**Checking for Understanding**

1. **Explaining** According to Keynes, why couldn’t classical economic theory solve the economic problems of the Great Depression?

2. **Synthesizing** What was Keynes’s attitude toward Adam Smith’s concepts of natural liberty and self-interest?
To carry out all of its functions, government must spend large sums. As a result, the federal budget is large and has numerous categories. Because all resources are scarce, an increase in spending in one area will cause a decrease in spending in some other area. As you read this section, you’ll learn how the government prepares its budget and decides where to spend its funds.
The Budget-Making Process

**Main Idea** Congress and the president work together to prepare an annual budget showing the anticipated federal expenditures and revenues for the coming fiscal year.

**Economics & You** How do you decide how to spend your income? Read on to learn about the process the federal government goes through to plan its annual spending.

Considerable debate and compromise are necessary when lawmakers go about preparing an annual budget. (See Figure 16.3 below.) A complicated budget-making process goes on every year, not just in Washington, D.C., but in every state and local government unit as well. State and local budgeting processes vary, but the federal government follows the same process every year. This process calls for the president and various congressional offices to work together.

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**Figure 16.3 Federal Taxation and Spending**

- The goal of the budget-making process is to balance what the government takes in with what it spends. If the government takes in more than it spends, there is a budget surplus. If it spends more than it takes in, there is a budget deficit.

**A. Federal Tax Receipts** This graph illustrates the sources from which the federal government collects taxes and the percentage it gets from each.

**Federal Tax Receipts**

- **Excise taxes**: 3.6%
- **Social-insurance taxes and contributions**: 39.0%
- **Corporate income taxes**: 11.3%
- **Other**: 3.2%
- **Individual income taxes**: 42.9%

*Source: U.S. Office of Management and Budget.*

**B. Federal Spending** The federal budget is based on a fiscal year, rather than the calendar year. Spending is calculated from the beginning of the budget year on October 1 of one year to September 30 of the next year.

**Federal Spending**

- **Income security, Social Security, and Medicare**: 48.3%
- **National defense**: 18.8%
- **Net interest**: 7.4%
- **Health**: 10.5%
- **Other**: 13.4%
- **International affairs**: 1.6%

*Source: U.S. Office of Management and Budget.*

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**Economic Analysis**

**Using Graphs** Where does the largest chunk of federal spending go? The smallest?
About 18 months before the fiscal year begins on October 1, the executive branch of the government begins to prepare a budget. Working with the president, the Office of Management and Budget (OMB) makes an outline of a tentative budget for the next fiscal year. The various departments and agencies receive this outline and usually start bargaining with the OMB for a larger allocation of federal funds.

The director of the OMB eventually puts together a set of figures and takes them to the president, along with the OMB’s analysis of the nation’s economic situation. At this point, the president and various advisers make key decisions about the potential impact of the budget on the nation’s economic policy and goals. They discuss such issues as: Will the budget increase or reduce federal spending? Which federal programs will be cut back, and which will be expanded? Should taxes be raised or lowered?

Eventually, the president approves the budget plan. The budget is printed, and the president submits the budget to Congress by January. Then various committees and subcommittees of Congress examine the budget’s proposals, while the Congressional Budget Office (CBO) advises the committees about different aspects of the budget. Throughout the year, each committee holds a series of discussions.

Congress is supposed to pass two budget resolutions that set binding limits on spending and taxes for the upcoming fiscal year. In practice, however, the required budget resolutions often do not get passed on time. Moreover, when they are passed, the resolutions are not always treated as binding. As a result, the fiscal year sometimes starts without a budget, and the government must operate on the basis of a continuing congressional resolution. Agencies that allocate funds can continue spending as they spent the year before until the new budget resolution is passed.

Steps in the Budget Process

**February–September**
Executive branch agencies develop requests for funds and submit them to the Office of Management and Budget (OMB).

**September–December**
The president and OMB review the requests and make the fiscal decisions on what goes in the budget. The budget is printed and formally sent to Congress.

**January–September (of following year)**
The House and Senate Budget Committees review the president’s proposed budget. By April 15, these committees prepare an initial resolution for the budget that goes to the entire Congress for debate. By September 25, the congressional budget should be finalized and passed by the House of Representatives, which approves spending and revenue bills.

**October 1**
The fiscal year begins.

**October 1–September 30**
Agency program managers implement the budget and disburse funds.

**October–November**
Data on actual spending and receipts for the completed fiscal year become available, and the Government Accountability Office audits the fiscal-year outlays.

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**Examining**
What is the president’s role in preparing the national budget?
The National Debt

**Main Idea**
A budget deficit results when government expenditures exceed revenues collected, and the difference is financed through borrowing, which adds to the national debt.

**Economics & You** Have you ever run out of funds while waiting for your next paycheck? What did you do? Read on to learn about what happens when the federal government overspends its budget.

Federal government revenues are usually not equal to expenditures. Most years, the government spends more than it collects in taxes, causing a budget deficit. When a budget deficit occurs, the government must raise the extra funds through borrowing. This borrowing is similar to an individual overspending his or her income. The government’s overspending is called deficit financing.

Government borrows to cover the deficit by selling government securities to individuals, businesses, and foreign governments. When you buy U.S. savings bonds, you are lending funds to the federal government. In addition, individual agencies of the federal government are authorized to sell bonds. State and local governments can borrow by selling bonds to finance some of their activities.

Each year the federal government creates new debt by issuing new securities. At the same time, it retires old debt by paying off bonds, notes, and bills as they come due. The total amount of outstanding debt for the federal government is called the national debt, or public debt. (See Figure 16.4 below.)

---

**Figure 16.4 The National Debt**

- The U.S. net national debt (gross national debt minus intergovernmental borrowing) increased for many decades up to 1997, started to decline in 1998 as a result of annual budget surpluses, and then began to rise again in 2002 as budget deficits reappeared.

**Economic Analysis**

**Using Graphs** By how much did the gross national debt exceed the net national debt in 2006?

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**Graphs In Motion**

See StudentWorks™ Plus or go to glencoe.com.
In 1998, the government began to run a **budget surplus**—that is, government revenues exceeded expenditures during the fiscal year. When President George W. Bush took office in 2001, the government was projecting a 10-year budget surplus of $5.6 trillion. In less than three years, though, the government was projecting deficits totaling $4.4 trillion in the next ten years. What happened? After the terrorist attacks of September 11, 2001, the federal government began spending a great deal on terrorist-related activities. Also, Congress, with President Bush’s approval, increased domestic spending at one of the fastest rates in U.S. history, while at the same time cutting taxes.

**Identifying** How does the federal government acquire funds to cover a deficit?

**Vocabulary**
1. **Explain** the significance of: fiscal year, budget deficit, deficit financing, national debt, budget surplus.

**Main Ideas**
2. **Summarizing** Create a diagram like the one below, and describe the steps in the federal budget-making process.

**Critical Thinking**
3. **The BIG Idea** What factors caused the large budget surplus in 2001 to turn into a large deficit by 2006?

4. **Determining Cause and Effect** How is the national debt affected by deficit financing?

**Applying Economics**
5. **The President and the Budget** The deficit can be reduced by cutting programs and/or increasing taxes. Make a list of cuts you would recommend and/or taxes you would recommend raising if you were president. Use graphics from this section or other sources to support your argument.
ISSues In ThE NeWS

PAID IN FULL  What is Tax Freedom Day?

Tax Freedom Day is the day when Americans will finally have earned enough money to pay off their total tax bill for the year. Every dollar that’s officially called income by the government is counted, and every payment to the government that is officially considered a tax is counted. Taxes at all levels of government are included, whether levied by Uncle Sam or state and local governments.

Tax Freedom Day gives Americans an easy way to gauge the overall tax take. . . . In effect, Tax Freedom Day provides taxpayers with a tax barometer that measures the total tax burden over time and by state.

The United States has traditionally been a low-tax country. From the founding of the republic until the early part of this century, total government spending at the federal, state, and local levels rarely exceeded 10 percent of national income, except during wartime.

Y ou, the American taxpayer, are the source of most of the funds the government spends. Almost all federal, state, and local government revenue comes from taxes paid by individuals, small businesses, and corporations. In this section, you’ll learn about the taxation process and the major kinds of taxes paid in this country.
Principles of Taxation

Main Idea Taxes are usually justified according to either one’s ability to pay or the benefits received.

Economics & You Should you have to pay taxes for the upkeep of a public park or museum, even if you never visit these places? Why or why not? Read on to learn about the different principles of taxation.

The various levels of government use several different major taxes to raise revenue. Taxes are usually justified according to one of two major principles. Under the benefits-received principle, those who use a particular government service should support it with taxes in proportion to the benefit they receive. Those who do not use a service do not pay taxes for it. A gasoline tax to pay for highway construction and repair is based on the benefits-received principle. Frequent users of the highways often buy more gasoline and, therefore, pay more in gasoline taxes.

A tax based on the benefits-received principle is useful in raising funds to pay for a service only certain individuals use. Many government services—national defense, for example—benefit everyone equally, however. Also, those who most require services, such as the aged and poor, are the individuals least able to pay taxes.

Under the ability-to-pay principle, those with higher incomes pay more taxes than those with lower incomes, regardless of the number of government services they use. For example, in most cities all property owners, even those without school-aged children, must pay property taxes to support the local school system. Property taxes are calculated as a percentage of the value of a person’s home. Thus, wealthier people with more expensive homes pay more property taxes.

Analyzing Why is national defense paid for according to the ability-to-pay principle?

Where Your Taxes Go

Ultimately, it is the American taxpayer who pays for military items such as ships, tanks, and submarines, as well as other government expenditures.
Forms of Taxation

**Main Idea** Taxes are classified as regressive, progressive, or proportional, depending on whether the tax as a percentage of income declines, increases, or remains the same as income increases.

**Economics & You** How much of your paycheck is taken out in taxes? Read on to learn how the government decides what proportion of a person's income should be spent on taxes.

Actual taxes are classified according to how they are set up and the effect they have on those who are taxed. In the United States today, these classifications include proportional, progressive, and regressive taxes.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Description</th>
<th>Type</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Personal income</strong></td>
<td>Tax is a percentage of income and a major source of federal revenue; many state governments also levy</td>
<td>Progressive at the federal level, but sometimes proportional at the state level</td>
</tr>
<tr>
<td><strong>Social insurance</strong></td>
<td>Taxes covered by the Federal Insurance Contributions Act (FICA); the second-largest source of federal revenue</td>
<td>Proportional up to income of $94,200 in 2006, regressive above that</td>
</tr>
<tr>
<td><strong>Corporate income</strong></td>
<td>Federal tax as a percentage of corporate profits; some states also levy</td>
<td>Progressive up to $18.3 million at the federal level, proportional above that</td>
</tr>
<tr>
<td><strong>Excise</strong></td>
<td>Tax paid by the consumer on the manufacture, use, and consumption of certain goods</td>
<td>Regressive if people with higher incomes spend a lower proportion of income on taxed items</td>
</tr>
<tr>
<td><strong>Estate</strong></td>
<td>Federal tax on the property of someone who has died; some states also levy</td>
<td>Progressive; rate increases with the value of the estate</td>
</tr>
<tr>
<td><strong>Inheritance</strong></td>
<td>State tax paid by those who inherit property</td>
<td>Varies by state</td>
</tr>
<tr>
<td><strong>Gift</strong></td>
<td>Federal tax paid by the person who gives a large gift</td>
<td>Progressive; rate increases with the value of the gift</td>
</tr>
<tr>
<td><strong>Sales</strong></td>
<td>Tax paid on purchases; almost all states as well as many local governments levy; rate varies from state to state and within states; items taxed also vary</td>
<td>Regressive if people with higher incomes spend a lower proportion of income on taxed items</td>
</tr>
<tr>
<td><strong>Property</strong></td>
<td>State and local taxation of the value of both real and personal property</td>
<td>Proportional; rate is set by state and local governments</td>
</tr>
<tr>
<td><strong>Customs duties</strong></td>
<td>Tax on imports; paid by the importer</td>
<td>Proportional</td>
</tr>
</tbody>
</table>
**Proportional Tax** A proportional tax is the easiest type of tax to understand. The taxes you owe are simply a proportion of the money income you have earned. If there is a tax of 10 percent on all income and you earn $1,000, then you pay $100 in taxes. If you earn $10,000, you pay $1,000 in taxes, and so on.

**Progressive Tax** With a progressive tax, when an individual earns a higher income, his or her taxes increase more than in proportion to the increase in money income. A good example of a progressive tax is our federal individual income tax system. As you make more reported income, you pay an increasingly higher percentage of that additional income in taxes to the federal government. A progressive income tax has often been justified on the basis of the ability-to-pay principle.

**Regressive Tax** A regressive tax is the opposite of a progressive tax. The percentage that you pay in taxes actually goes down as you make more money income. Some economists believe that a good example of a regressive tax is the sales tax on food, because poorer families spend a larger proportion of their income on food than wealthier families do.

**Explaining** The federal individual income tax system is an example of what type of tax? Explain.

---

**Vocabulary**

1. Explain the significance of: benefits-received principal, ability-to-pay principle, proportional tax, progressive tax, regressive tax.

**Main Ideas**

2. Describing Copy the chart below, and for each form of taxation listed, provide a definition of how the tax works.

<table>
<thead>
<tr>
<th>Forms of Taxation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proportional</td>
</tr>
<tr>
<td>Regressive</td>
</tr>
<tr>
<td>Progressive</td>
</tr>
</tbody>
</table>

---

**Critical Thinking**

3. The BIG Idea Which of the three forms of taxation would likely bring in the most funds for the government, and why?

4. Synthesizing Create an argument a wealthy person might make against the progressive income tax.

**Applying Economics**

5. Taxes and You Look back at the chart you filled out listing the kinds of taxes people pay. Of these, which ones do you pay now? Which ones does your family pay now? List an example of each from your own experience.
THE DEFICIT: A DANGER OR A BLESSING?

Good arguments can be made either way.

**Check It Out!** In this chapter you learned about budget deficits. In this article, the federal deficit and debt are looked at from both a positive and negative angle.

The federal government’s fiscal stance is muddled. What’s disturbing is how the ledger made a swing from a record surplus in 2000 to a record deficit now. How worried should Americans be about the red ink?

Some observers believe the administration’s fiscal recklessness will end in catastrophe. Princeton University professor Paul Krugman is a harsh critic. Krugman argues that the gap between what America spends and what it takes in is so large that the nation will eventually careen into a major financial crisis.

Others aren’t convinced. Take the perspective of historian John Steele Gordon. As a general rule, Gordon dislikes deficits. Yet he notes that the current deficit is “a blessing because a national debt properly funded is a powerful tool that allows us to guard America’s security, whether economic or military,” Gordon says.

Whether you believe the deficit reflects irresponsible fiscal management or a rational response to crisis, one thing is clear: Better numbers are needed.

One suggestion Gordon puts forward is for the federal government to create an independent body. This watchdog’s job would be to keep the books honest as well as easily understandable to the average citizen. At the same time, it might be a good idea to dust off an old idea: In the 1800s, governments could issue debt only to finance capital items like roads. As for everything else, the ordinary budget had to be paid when the bill came due.

—Adapted from BusinessWeek

**Think About It**

1. **Summarizing** What are the arguments for and against a large federal deficit?

2. **Synthesizing** What suggestions are given in the article to help balance the budget?
Government spending at all levels—federal, state, and local—has increased significantly over the years.

Under the American free-enterprise system, the government regulates certain aspects of the economy.

The goal of the government’s budget-making process is to balance what the government takes in with what it spends.
Review Content Vocabulary

1. Write a paragraph or two explaining how the government is involved in the U.S. economy. Use all of the following terms.
   - public-works projects
   - Medicare
   - public goods
   - income redistribution
   - Social Security

2. Write a paragraph or two explaining the federal budget and taxation. Use all of the following terms.
   - fiscal year
   - budget deficit
   - deficit financing
   - national debt
   - budget surplus
   - benefits-received principle

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

   a. core  b. exceed  c. maintain  d. intervene  e. submit  f. allocate  g. major  h. justify

3. A national budget will ______ spend by dividing funds among government agencies.

4. Each agency must ______ its budget requests to the OMB months in advance.

5. Emergency spending often causes the government to ______ its budget.

6. A natural disaster is an example of something that would ______ emergency spending.

7. Decision making by private citizens is at the ______ of wealth creation.

8. Agencies must ______ records of their spending to help determine the next year’s budget.

9. Changing the tax system would be a ______ undertaking for the federal government.

10. The government can ______ in economic activity in a variety of ways.

Review the Main Ideas

Section 1  (pp. 413–417)

11. In what ways has the government grown since the Great Depression?

12. What percentage of GDP is accounted for by total government purchases?

Section 2  (pp. 418–423)

13. What are government’s main functions?

14. Give five examples of public goods.

15. What would be a negative externality of having an airport built near your home? What would be a positive externality?

Section 3  (pp. 425–429)

16. About how long does it take the federal government to prepare a budget?

17. What causes the nation’s public debt?

Section 4  (pp. 430–433)

18. Identify the two principles of taxation and give an example of each.

19. Fill in a table like the one below by identifying the three forms of taxation and explaining how each works.

<table>
<thead>
<tr>
<th>Form of Taxation</th>
<th>How It Works</th>
</tr>
</thead>
<tbody>
<tr>
<td>public-works projects</td>
<td>Medicare</td>
</tr>
<tr>
<td>public goods</td>
<td>Social Security</td>
</tr>
<tr>
<td>income redistribution</td>
<td>Medicaid</td>
</tr>
<tr>
<td>externalities</td>
<td>workers’ compensation</td>
</tr>
<tr>
<td>fiscal year</td>
<td>ability-to-pay principle</td>
</tr>
<tr>
<td>budget deficit</td>
<td>proportional tax</td>
</tr>
<tr>
<td>deficit financing</td>
<td>progressive tax</td>
</tr>
<tr>
<td>national debt</td>
<td>regressive tax</td>
</tr>
<tr>
<td>budget surplus</td>
<td>benefits-received principle</td>
</tr>
</tbody>
</table>

Chapter 16
Math Practice

20. The U.S. federal income tax is a progressive tax. This means that the more a person makes, the higher percentage of that income he or she pays in taxes. Look at the tax rate schedule below and answer the questions that follow.

2006 Tax Rate for Single Filers

<table>
<thead>
<tr>
<th>Taxable income is over</th>
<th>But not over</th>
<th>The tax is</th>
<th>Plus</th>
<th>Of the amount over</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$7,550</td>
<td>$0.00</td>
<td>10%</td>
<td>$0</td>
</tr>
<tr>
<td>$7,550</td>
<td>$30,650</td>
<td>$755.00</td>
<td>15%</td>
<td>$7,550</td>
</tr>
<tr>
<td>$30,650</td>
<td>$74,200</td>
<td>$4,220.00</td>
<td>25%</td>
<td>$30,650</td>
</tr>
<tr>
<td>$74,200</td>
<td>$154,800</td>
<td>$15,107.00</td>
<td>28%</td>
<td>$74,200</td>
</tr>
<tr>
<td>$154,800</td>
<td>$336,550</td>
<td>$37,675.50</td>
<td>33%</td>
<td>$154,800</td>
</tr>
<tr>
<td>$336,550</td>
<td>no limit</td>
<td>$97,653.50</td>
<td>35%</td>
<td>$336,550</td>
</tr>
</tbody>
</table>

a. What is the range of tax rates that a single person might pay?

b. If Kim made $30,000 in 2006, how much did she pay in taxes?

c. If Kim got a raise to $45,000 per year in 2007 and tax rates stayed the same, how much did she pay in taxes?

d. If Joe made $1 million in 2006, how much did he pay in taxes?

Critical Thinking

21. The BIG Idea In general, are you in favor of more or less government involvement in the economy? Explain your position.

22. Explaining IRS records show that in 2003, 96.5% of total federal income taxes were paid by the top 50% of earners. The bottom 50%, therefore, paid just 3.5% of all income taxes. Based on your understanding of the progressive tax system and the information in the tax schedule on this page, explain how half of the taxpayers can pay almost all of the total taxes.

Analyzing Visuals

23. Study the cartoon on the right, and then answer the following questions.

a. What do the doors represent?

b. What is humorous about the three doors?

c. What point is the cartoonist making about government bureaucracy?
Should “junk food” be taxed?

For the first time in history, almost two-thirds of Americans are overweight or obese, including one in every five children. Healthful food costs more than junk food, and obesity rates are higher among poor people—50 percent higher for poor teens. Increases in the percentage of Americans living in poverty coupled with higher rates of obesity have caused the World Health Organization and others to propose taxing high-calorie, low-nutrition foods to discourage people from eating them. Is a “Twinkie tax” a good idea?

The obesity epidemic is a national problem.

We live in a toxic food environment where high-calorie and high-fat foods are available at low cost. . . . The American food system is set up as if maximizing obesity were the aim. . . . you use the income from such a tax to subsidize the sale of healthy foods in order to reverse what is the unfortunate reality now: that it costs more to eat a healthier diet. The tax . . . would be a proactive response to a food industry and consumer culture that increasingly promotes high-fat/low-nutrition products as the cheapest, tastiest, most convenient and most available dietary options.

. . . The prevailing approach for dealing with obesity, which is to blame people who have the problem and hope the situation will disappear, is a fantasy. Something dramatic needs to be done to change the environment in order to prevent this problem from occurring in the first place. A 1-cent federal tax on each can or bottle of soda . . . could be used for a massive advertising and education program, especially aimed at children. . . . Once you are obese, it is very hard to treat, so prevention makes sense.

—Kelly Brownell, Ph.D., director, Yale Center for Eating and Weight Disorders and author, Food Fight
Debating the Issue

1. Explaining Why is the idea of a “Twinkie tax” popular now?

2. Choosing Sides The two writers disagree on whether a tax on junk food is the best way to solve the increasing problem of obesity. With whom do you agree? Why?

Find Out More!

3. Analyzing Using the Internet or other resources, find out why junk food costs less than healthful foods.
The **BIG Idea**
Governments strive for a balance between the costs and benefits of their economic policies to promote economic stability and growth.

**Why It Matters**
In this chapter, read to learn about the factors that destabilize the economy and the actions that can be taken in response.

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**Economics ONLINE**

**Chapter Overview** Visit the Economics Today and Tomorrow Web site at [glencoe.com](http://glencoe.com) and click on Chapter 17—Chapter Overviews to preview chapter information.
GUIDE TO READING

Section Preview
In this section, you will learn why unemployment and inflation are two major threats to a nation’s economic stability.

Content Vocabulary
- stabilization policies (p. 442)
- unemployment rate (p. 442)
- full employment (p. 443)
- underground economy (p. 443)
- demand-pull inflation (p. 444)
- stagflation (p. 445)
- cost-push inflation (p. 445)

Academic Vocabulary
- expert (p. 442)
- survey (p. 443)
- adapt (p. 444)

Reading Strategy
Determining Cause and Effect As you read the section, complete a diagram like the one below by listing the main causes of demand-pull and cost-push inflation.

1. 2.
3. 4.
5.

Causes of Inflation

Demand-pull inflation
Cost-push inflation

ISSUES IN THE NEWS
— from the New York Times

The Return of Stagflation? In the 1970s, soaring prices of oil and other commodities led to stagflation—a combination of high inflation and high unemployment, which left no good policy options. If the Fed cut interest rates to create jobs, it risked causing an inflationary spiral; if it raised interest rates to bring inflation down, it would further increase unemployment.

. . . [In April 2005,] fears of a return to stagflation sent stock prices to a five-month low. What few seem to have noticed, however, is that a mild form of stagflation has already arrived.

. . . [I]nflation is leading the Fed to tap on the brakes, even though this doesn’t look or feel like a full-employment economy.

We shouldn’t overstate the case: we’re not back to the economic misery of the 1970s. But the fact that we’re already experiencing mild stagflation means that there will be no good options if something else goes wrong.

When people are unemployed, they experience uncertainty. In the same way, unemployment in general causes uncertainty in the American economy. As you read this section, you’ll learn that two of the biggest threats to a nation’s economic stability are high unemployment and another issue—inflation.

Stabilizing the National Economy 441
AP/Wide World Photos
Measuring Unemployment

Main Idea Unemployment can be classified as cyclical, structural, seasonal, or frictional.

Economics & You Have you ever known someone who was out of work? Read on to learn about why unemployment is such a serious problem for workers and the national economy.

To keep the economy healthy and to make the future more predictable for planning, saving, and investing, the federal government uses monetary and fiscal policies. Together these are called stabilization policies.

Expert economists advise the president and Congress, but they often disagree about the causes and cures of the economic problems that the nation periodically faces. One statistic they all look at is the unemployment rate—the percentage of the civilian labor force that is without jobs but is actively looking for work. (See Figure 17.1 below.) Note that not everyone is in the labor force. Students, retired people, and people in long-term hospital stays, for example, are not counted as part of the labor force.

High unemployment is usually a sign that all is not well with the economy. Moreover, the waste of human resources that unemployment causes is an extremely serious problem. As a result, maintaining a low unemployment rate is one of the major goals in stabilizing the economy.
Many types of unemployment exist, as shown in Figure 17.2 above. Some people work in seasonal jobs or jobs that are sensitive to technological advances or to changes in the marketplace. As a result, not all unemployment can or should be eliminated. Moreover, economists disagree over what the level of full employment should be. Economists today generally have come to consider the economy at full employment when the unemployment rate is around 5 percent.

It is important to remember that the unemployment rate is only an estimate. The unemployment rate does not include people who have stopped looking for work, nor does it include people who work in family businesses without receiving pay.

Unemployment is difficult to measure accurately because government statisticians cannot possibly interview every person in and out of the labor force. Survey results are also imperfect because of the existence of the underground economy. The underground economy consists of people who do not follow federal and state laws with respect to reporting earnings. Examples might include tax evaders, gamblers, and drug traffickers.

Economic Analysis

Synthesizing Which type of unemployment is most likely to affect highly skilled and experienced workers? Why?
Inflation

Main Idea Inflation is caused by excessive expansion of the money supply or government spending, according to the demand-pull theory.

Economics & You If you have a job, have you ever received a raise? Read on to learn why raises are important if workers are to maintain their standard of living in the face of rising prices.

A second major problem that may face any nation is inflation. The economy can usually adapt to gradually rising prices. If prices rise about 2 percent every year, for example, everyone comes to expect and understand that. Unpredictable inflation, however, has a destabilizing effect on the economy.

Inflation may affect consumers’ standard of living. Suppose you receive a 5 percent pay raise in a year in which inflation was 8 percent. Your real (adjusted for inflation) income has decreased. Inflation is normally a serious problem only for people who live on fixed incomes, such as those who are retired.

Not all economists agree on a single explanation of why inflation occurs. Two competing ideas have developed: the demand-pull theory (prices are pulled up by high aggregate demand) and the cost-push theory (prices are pushed up by high production costs and wages).

Demand-Pull According to the theory of demand-pull inflation, prices rise as the result of excessive business and consumer demand. If economy-wide, or aggregate, demand increases faster than aggregate supply, the resulting shortage will lead to the bidding up of prices.

demand-pull inflation: theory that prices rise as the result of excessive business and consumer demand; demand increases faster than total supply, resulting in shortages that lead to higher prices

Two Theories of Inflation

Demand-Pull Theory

Cost-Push Theory
Demand-pull inflation can occur for several reasons. If the Fed causes the money supply to grow too rapidly, individuals will spend the additional dollars on a limited supply of goods and services. Higher demand will cause prices to rise. Increases in government spending and in business investment can also increase overall demand. Aggregate demand can also increase if taxes are reduced or consumers begin saving less.

**Cost-Push** The demand-pull theory assumes that increased demand will increase output and reduce unemployment, but experience has shown that rising prices and unemployment can occur at the same time. This combination of inflation and stagnation (low economic activity) is sometimes called **stagflation**.

According to some economists, stagflation is a result of cost-push inflation at work in the economy. The theory of **cost-push inflation** states that the wage demands of labor unions push up prices. When businesses have to pay higher wages, their costs increase. To maintain their profit levels, businesses must raise the prices of the goods and services they produce.

During periods of cost-push inflation, unemployment can remain high. Prices are being adjusted for higher wages and profits—not because of increased aggregate demand. Without additional aggregate demand, producers have no reason to increase output by hiring new workers.

**Predicting Consequences** What group of people does inflation affect the most? Why?

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**Vocabulary**

1. **Explain** the significance of: stabilization policies, unemployment rate, full employment, underground economy, demand-pull inflation, stagflation, cost-push inflation.

**Main Ideas**

2. **Identifying** In a diagram like the one below, define each type of unemployment listed.

   ![Unemployment Types Diagram]

   - Cyclical
   - Frictional
   - Structural
   - Seasonal

**Critical Thinking**

3. **The BIG Idea** When government tightens the money supply to slow inflation, what might happen to the unemployment rate? Why?

4. **Determining Cause and Effect** What is the relationship between fixed income and inflation?

**Applying Economics**

5. **Inflation** Create a chart with headings labeled *Weather, The Fed, Oil Shortage,* and *War.* Under each heading, list ways that this factor could lead to inflation.
There are dollar signs in the sky.

**Check It Out!** In this chapter you learned about the four kinds of unemployment. In this article, read to learn about a growing industry that may help to keep many people employed, and handsomely.

Mammas, let your babies grow up to get Web ad gigs. With the online ad business up 30% to $12.5 billion [in 2006], a labor crunch is raising salaries and recruitment efforts... Pay for some jobs—such as creating ads or measuring their impact—has risen as much as 20% from 2005. And openings abound: Boston’s Digitas, an online ad shop with a staff of 1,500, advertised to fill nearly 100 positions in April alone. T3, an Austin interactive-ad agency, is also struggling to fill openings. “I’ve kind of gulped at a few salaries, but I’m willing to pay,” says President Gay Gaddis, who adds that not long ago, a freelancer turned down a creative director job at T3 paying $150,000 to $200,000 a year.

One reason for the shortage is that making Web ads requires high-level tech know-how. Rich-media ads involving flash animation or video, for instance, call for math, programming, and design skills. Gaddis says she stopped by a cubicle recently where two employees were using calculus to program video game ads. “It’s hard to do both—left-brain and right-brain,” she notes.

... Beyond paying high salaries, agencies are responding by moving some jobs to where the talent is, by dropping some smaller clients, and by amping up training. “If you can find the people, you can find the revenue.”

—Reprinted from BusinessWeek

**Think About It**

1. **Recalling** What types of skills are necessary to perform the job described in the article?
2. **Explaining** According to the article, why is there a shortage in this field?
Most economists belong to one of two groups on the question of stabilization. One group emphasizes the role of the Federal Reserve in stabilizing the economy, which you learned about in Chapter 15. In this section, you’ll learn about the other group and what they believe concerning the issue of economic stabilization.
The Circular Flow of Income and Output

Main Idea Keynesian economists advocate the use of government spending to stimulate economic activity and reduce unemployment during recessions.

Economics & You When you spend your wages on a new outfit, computer game, or other purchase, you are putting your funds back into the economy. Read on to learn about this “circular flow” of income.

The term fiscal policy refers to the federal government’s deliberate use of its taxation rates and expenditures to affect overall business activity. John Maynard Keynes developed fiscal policy theories during the Great Depression. Keynes believed that the forces of aggregate supply and demand operated too slowly in a serious recession, and that government should step in to stimulate aggregate demand.

To understand Keynesian theory, you must first understand what is known as the circular flow of income and output. (See Figure 17.3 below.) You learned about this model in Chapter 2. The model pictures money income as flowing from businesses to households as wages, rents, interest, and profits. Money income flows from households to businesses as payments for consumer goods and services.
Outside the circular flow of income and output, we have leakages and injections.

A. **Leakages**

When people deposit their income into savings accounts, this is considered a leakage from the circular flow. Government taxation is another form of leakage.

B. **Injections**

Government spending on activities such as maintaining national parks is one form of income injection. Business investment is another form.

**Economic Analysis**

**Defining**

What is the term for the state in which leakages and injections are in balance?

Not all income, however, follows this circular flow. Some of it is removed from the economy through consumer saving and government taxation. Economists use the term *leakage* to refer to this removal of money income.

**Offsetting** leakages of income are injections of income into the economy. Injections occur through business investment and government spending. (See **Figure 17.4** above.) The term *investment*, in this sense, means the purchase of new plants and equipment and increases in inventories. Much of the funds for investment comes from saving—a part of the leakage from circular flow.

Ideally, leakages and injections balance each other. In this state of equilibrium, the income that households save is reinjected through business investment. Income taken out through taxes is returned through government spending.

**Reading Check**

**Evaluating**

What is the federal government’s role in the circular flow of income and output?
Fiscal Policy and Supply-Side Effects

Main Idea Supply-side economists advocate reductions in tax rates to stimulate private investment and employment.

Economics & You If your taxes went down, how would you use the additional spendable income? Read on to learn about how cutting taxes on a large scale can help stimulate the economy.

Many public officials and labor leaders have suggested starting jobs programs to reduce unemployment and stimulate the economy. Cuts in federal taxes are another way in which fiscal policy has been used in an attempt to speed up economic activity and fight unemployment. Giving businesses tax credits on investments allows them to deduct from their taxes some of the costs of new capital equipment. The goal is to encourage businesses to expand production and hire more workers.

Some argue that tax cuts lead to more work, saving, and investment. These are called supply-side effects because they affect the supply of key ingredients of economic growth. President Bush used this supply-side argument to promote his Jobs and Growth Tax Act of 2003.

Theories on Job Creation

In 1935, in the midst of the Great Depression, President Franklin Roosevelt created the Works Progress Administration (WPA) to combat high unemployment. Supply-side economists would argue that tax cuts are a more efficient way of creating jobs than government-sponsored programs.
Many features of this act were aimed at increasing economic growth. Tax rates that were to be phased in over several years instead became effective in January 2003. The highest tax rate fell from 39.6 percent to 35 percent. Investors got a big break, too. The tax rate applied to most dividends—income payments to shareholders of corporations—fell from as high as 39.9 percent to 15 percent. The tax rate on long-term capital gains (see Chapter 6) dropped from 20 percent to 15 percent. For some low-income earners, this rate fell to 5 percent.

Identifying What are two actions that the federal government can take to stimulate the economy? Which method has been used more frequently in recent years?

**Vocabulary**

1. *Explain* the significance of: fiscal policy, circular flow of income and output.

**Main Ideas**

2. *Synthesis* In a diagram like the one below, list examples of fiscal policy leakages and injections.

   ![Diagram of leakages and injections]

**Critical Thinking**

3. **The BIG Idea** Describe one positive aspect and one negative aspect of Keynesian economics.

4. **Analyzing** Briefly describe the characteristics of a stable economy.

**Applying Economics**

5. **Your Effect on the Economy** Make a list of the five most expensive items you or your family purchased this year. What industries would have suffered had you not bought these items?
Monetarism and the Economy

GUIDE TO READING

Section Preview
In this section, you will learn about the theory that the control of the money supply by the Federal Reserve, rather than fiscal policy, should be used to stabilize the economy.

Content Vocabulary
- monetarism (p. 453)
- monetarists (p. 453)
- monetary rule (p. 455)
- inflation targeting (p. 455)
- time lags (p. 457)

Academic Vocabulary
- guideline (p. 455)
- target (p. 455)

Reading Strategy
Organizing  As you read, complete a web diagram similar to the one below by listing the reasons why monetarists oppose using fiscal policy to slow or stimulate the economy.

Oppose Fiscal Policy

ISSues In ThE NeWS
—from CNNMoney.com

THE U.S. MONEY SUPPLY  How much money would you need to give everyone in the U.S. $1 million, and still have change left over?

. . . One way to do this would be to have the U.S. mint run off enough crisp new bills so that every one of the 296 million or so people in the U.S. comes away with a million bucks. But other than a monumental printing job—even if you went with $1,000 bills, you would need 296 billion of them—what would you have accomplished?

Such a jolt to the money supply would be a huge shock to the U.S. and the global economy, most likely revving up inflation and at the very least forcing a big re-adjustment in prices and currency values.

Many economists do not believe that fiscal policy, which you learned about in the last section, plays a major role in stabilizing the U.S. economy. In this section, you’ll learn about another theory that states that Federal Reserve monetary policy has a much greater impact on stabilization. You will also learn about the supporters of this alternative theory.
The Theory of Monetarism

Monetarists favor monetary policy rather than fiscal policy to stabilize the economy.

Economics & You  If your money income suddenly rose dramatically, chances are you would put it back into the economy by making purchases. Read on to learn about this theory on a larger scale: that putting more money into circulation may help to stimulate the economy.

Monetarism is the theory that deals with the relationship between the amount of money the Federal Reserve places in circulation and the level of activity in the national economy. The supporters of this theory are called monetarists.

Monetarism is often linked with economist Milton Friedman (see page 458). As you remember from Chapter 15, the Federal Reserve can change the growth rate of the money supply. Friedman and many other economists believe that the Fed should increase the money supply at a smooth, given percent each year. They argue that when the amount of money in circulation expands too rapidly, people borrow more and spend more. If the economy is operating below capacity, this extra demand will lead to a rise in output. To produce more, businesses will have to hire more workers, and unemployment will decrease. If there is already full employment, however, the increased aggregate demand will lead to a rise in prices—inflation.

Determining Cause and Effect  According to monetarist theory, what will happen to a stable economy if too much money is put into circulation too quickly?

Too Much of a Good Thing

A major argument of monetarists is that when the money supply expands rapidly, people will spend more, especially on big-ticket items like cars. This situation could potentially lead to inflation.
Government Policy According to Monetarists

Main Idea Monetarists believe that the money supply should be increased at a steady rate of 3 to 5 percent per year for stable economic growth with low inflation.

Economics & You Should the federal government intervene to stabilize the economy in times of trouble, or is the economy better left on its own? Read on to learn about monetarists’ criticism of government fiscal policies.

Friedman and his monetarist followers believe the economy is so complex and so poorly understood that government does more harm than good in trying to second-guess businesspeople and consumers. As a result, monetarists generally oppose using fiscal policy to stimulate or slow the economy.

Figure 17.5 Changing Fed Policies

To monetarists, the reduction in the amount of money in circulation can mean only one thing—a reduction in aggregate demand. With less aggregate demand, fewer workers are needed and unemployment increases in the short run.

Effects of Changing Monetary Policies of the Fed

- Fed continues with a so-called discretionary monetary policy, allowing the rate of growth of the money supply to change depending on other factors in the economy. The Federal funds rate is targeted as a way to increase or decrease the rate of growth of the money supply. Inflation slows dramatically by the end of the century.


Economic Analysis

Determining Cause and Effect What happened to the unemployment rate when Fed policies began to lower inflation from 1980 to 1982?
For example, they do not believe the government should operate with budget deficits each year in an attempt to stimulate the economy. Instead, monetarists believe that the government should balance the federal budget. This action would keep government from competing with private business in borrowing funds in the credit market.

**Monetary Rule** The Fed, according to monetarists, should also stop trying to smooth the ups and downs in the economy. Rather, the Fed should follow a monetary rule, or allow the money supply to grow smoothly and consistently at a rate of perhaps 3 to 5 percent per year. Monetarists believe that a steady growth in the money supply within strict guidelines (or targets, as they are called) is the best way to provide businesses and consumers with more certainty about the future. According to monetarism, this policy would result in a controlled expansion of the economy without rapid inflation or high unemployment.

The current chair of the Federal Reserve System, Ben S. Bernanke, has at times favored something similar to a monetary rule. He has said that the United States should target an inflation rate, such as 2 percent per year, and then steer inflation toward the target rate through the use of interest rate changes and other monetary tools. Some countries, such as the United Kingdom and New Zealand, already use inflation targeting.

**Monetarist Theory and the Federal Reserve** Monetarist theory had a major influence on Fed policies in the 1980s. You can trace the effects of the changing monetary policies of the Fed in Figure 17.5 on the previous page.
Monetarists’ Criticism of Fiscal Policy

Main Idea Monetarists believe that the main problem with fiscal policy is that it cannot be implemented effectively.

Economics & You Have you ever had an idea that sounded good at first but didn’t work out in the long run? Read on to learn about what monetarists think the fundamental problems with fiscal policy are.

Monetarists believe that the theory of fiscal policy seldom matches the reality. Two main reasons account for this discrepancy.

The first reason concerns the political process involved in implementing fiscal policy. Monetarists point out that no single government body designs and implements fiscal policy. (See Figure 17.6 below.) The president, with the aid of the director of the Office of Management and Budget (OMB), the secretary of the Treasury, and the Council of Economic Advisers, designs the desired mix of taxes and government expenditures, but then only recommends the policy to Congress. The president is not responsible for implementing the policy, nor does he determine exactly when the policy will be enacted.

Figure 17.6 Implementing Fiscal Policy

As you can see from the chart, fiscal policy travels through many channels before reaching Congress and possibly being enacted. The complexity of the process is one of the main reasons monetarists criticize fiscal policy.

Implementing Fiscal Policy

President

Advises

Director of OMB

Secretary of the Treasury

Council of Economic Advisers

Recommends policy to

Congress

Aids

House Ways and Means Committee

Senate Finance Committee

Senate Budget Committee

Other committees

Enacts Policy

Economic Analysis

Explaining Why might some members of Congress vote to enact fiscal policy even if they do not believe it will actually help the economy?
Congress, with the aid of many committees (the House Ways and Means Committee, the Senate Finance Committee, and the Senate Budget Committee, to name a few), actually enacts fiscal policy. One built-in organizational problem is that the power to enact fiscal policy does not rest with a single government institution. Disagreement as to the proper fiscal policy emerges among members of Congress and between Congress and the president. Furthermore, being politicians, they have incentives to take actions that will look good today and help them get reelected, but which may hurt the economy in the long run.

Monetarists also point out that even if fiscal policy could be enacted when the president wanted, there are various time lags between when it is enacted and when it becomes effective. It takes many months, if not years, for fiscal policy stimuli to cause employment to rise in the economy. Consequently, a fiscal policy designed to combat a recession might not produce results until the economy is already experiencing inflation. In this event, the fiscal policy could worsen the situation.

Examining According to monetarists, what should the federal government do in order to maintain a stable economy?

Vocabulary
1. Explain the significance of: monetarism, monetarists, monetary rule, inflation targeting, time lags.

Main Ideas
2. Determining Cause and Effect Copy the arrows below. In the first arrow, list policies that monetarists would use to slow the economy. In the second arrow, list policies that monetarists would use to stimulate the economy.

Critical Thinking
3. The BIG Idea What is the major difference between fiscal policy and monetary policy?

4. Interpreting What reasons does Milton Friedman have for wanting the government to follow a monetary rule?

Applying Economics
5. Government Intervention Find and bring to class one article that shows how government policies are influencing the economy. Write a paragraph explaining why you agree or disagree with the government’s policies.
As a reminder that there is a price to pay for everything, including all government services, Milton Friedman entitled one of his books, There’s No Such Thing as a Free Lunch. He was not the first to use the expression, but thanks to him, this phrase is now part of our everyday language, just as his ideas about competitive capitalism—once considered somewhat extreme—are an established part of current economic thinking.

Friedman was an early and forceful critic of the economic theories of John Maynard Keynes and his followers, especially the idea that government spending is necessary to counter the instability of free markets. Friedman examined the historical record and found that it is usually government policies—particularly monetary policy—rather than free markets that are most destabilizing. For example, the Federal Reserve allowed the money supply to fall by about a third during the Great Depression, with disastrous effects on output and employment. His research also led him to conclude that “inflation is always and everywhere a monetary phenomenon”—the result of excessive growth in the money supply.

Though he believes that the government that governs least governs best, Friedman is not an anarchist—that is to say, someone totally opposed to any government at all. Friedman has stated, “I believe we need government to enforce the rules of the game. . . . We need a government to maintain a system of courts . . . [and] to ensure the safety of its citizens—to provide police protection.”

On the other hand, he has little faith in government as a source of solutions for economic problems.

“Generally...I think the government solution to a problem is usually as bad as the problem and very often makes the problem worse.”

Checking for Understanding

1. Defending Name some government programs that you think are necessary and explain why.

2. Theorizing If someone who pays no taxes participates in a government program, why is the program still not really “free”?
One of the major goals in stabilizing the national economy is maintaining a low unemployment rate. Economists classify unemployment as one of four types.

According to the demand-pull theory of inflation, prices rise as the result of high demand. The cost-push theory states that high wages push up prices.

Most economists subscribe to one of two theories on the best way to stabilize the economy.

Fiscal Policy Approach:
Economists in this camp believe that modifying the federal government’s use of taxation and spending policies to affect overall business activity is the best way to stabilize the economy.

Monetarist Approach:
Monetarists believe that the Federal Reserve’s control of the money supply and how it exercises that control have a bigger impact on stabilization than fiscal policy does.
Review Content Vocabulary

1. Write a paragraph or two explaining how the government tries to ensure economic stability. Use all of the following terms.

   stabilization policies  circular flow of income
   unemployment rate      monetarism
   demand-pull inflation  monetary rule
   inflation               inflation targeting
   cost-push inflation    time lags
   fiscal policy

Review the Main Ideas

Section 1 (pp. 441–445)

9. Fill in a web diagram like the one below to identify and describe four types of unemployment.

[Diagram of Four Types of Unemployment]

10. What causes demand-pull inflation?
11. What causes cost-push inflation?

Section 2 (pp. 447–451)

12. What are the leakages out of the circular flow of income?
13. What are the injections of income into the circular flow of income?
14. What do Keynesian economists think the federal government should do to reduce unemployment?
15. What do supply-side economists believe is the best way to stimulate the economy?

Section 3 (pp. 452–457)

16. Who is the economist most often linked to monetarism?
17. What do monetarists believe the Fed should do in terms of monetary policy?
18. What is meant by “monetary rule”?
19. Why do some monetarists oppose using fiscal policy to slow or stimulate the economy?

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. expert   e. offset
b. survey   f. guidelines
c. adapt    g. target
d. remove

2. The Fed can set a ________ rate of growth for the money supply.

3. The chair of the Federal Reserve System should be a(n) ________ economist.

4. By setting strict ________ for inflation and employment rates, the Fed can be more effective at stabilizing the national economy.

5. An employment ________ would not include people earning a living through the underground economy.

6. Government spending is sometimes meant to ________ leakages of income.

7. The economy can ________ to gradual, predictable inflation.

8. When you put some of your income in savings, you ________ those funds from the money supply.
Problem Solving

20. Oil prices have a tremendous impact on the economy as a whole because almost every individual and business is affected by the price of gas. Using the Internet, research what the average price of gas per gallon was in your state or region over the past several years. Then answer the questions below.

<table>
<thead>
<tr>
<th>Average Price of Gas Per Gallon</th>
<th>5 years ago</th>
<th>4 years ago</th>
<th>3 years ago</th>
<th>2 years ago</th>
<th>1 year ago</th>
<th>Today</th>
</tr>
</thead>
</table>

a. How can individuals try to make up for a sudden sharp rise in gas prices?

b. How might businesses try to make up for a huge jump in gas prices?

c. How might the government try to ease the instability caused by changes in gas prices?

Critical Thinking

21. The BIG Idea  Use a Venn diagram like the one below to compare and contrast the goals, methods, and outcomes of Keynesian theory and monetarism.

22. Analyzing Why is it that full employment cannot be defined as zero unemployment?

23. Understanding Cause and Effect Explain why the unemployment rate might rise if fiscal policy were used to combat inflation.

Analyzing Visuals

24. Study the cartoon below, and then answer the following questions.

a. Which kind of inflation is most likely happening in the cartoon?

b. What is the rate of inflation reflected in the game show’s new title?

c. If the inflation rate had been 5 percent instead, what would have been the new title of the show?
In this unit, read to find out...
- how the United States trades with the rest of the world.
- why certain nations have little or no economic growth.
- the impact of corporations that run businesses throughout the world.
Chapter Overview
Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 18—Chapter Overviews to preview chapter information.

The BIG Idea
Trade and specialization lead to economic growth for individuals, regions, and nations.

Why It Matters
What percentage of goods in American stores are foreign-made? What happens to the dollars Americans spend outside the United States? In this chapter, read to learn why international trade is important and how it affects you.
As you read this section, ask yourself what would happen if the United States could no longer sell goods to other countries or buy goods in return. Before you answer, you should be aware that the value of goods bought from other countries for domestic use is about 15 percent of GDP in the United States. That figure may not seem large, but many inconveniences would result if international trade came to a halt.
Benefits of Trade

**Main Idea** Countries benefit from trade with each other when each concentrates on the goods and services that it can produce most efficiently.

**Economics & You** Have you ever traded baseball cards or lunches with someone else? Why? Read on to learn about how nations also make trades that are mutually beneficial.

**Imports** are goods bought from other countries for domestic use. If not for imports, we would have no coffee, chocolate, or pepper. Consider also that more than 60 percent of the radios, television sets, and motorcycles sold in the United States are imported. Many raw materials also come from foreign sources.

Imports tell only half the story, however. Many American workers are employed in industries that export their products overseas. **Exports** are goods sold to other countries. For example, more than 40 percent of the nation’s engineering and scientific instruments are sold to consumers overseas.

Nations benefit through world trade because each nation differs in the type and amount of the factors of production it has available for use. For example, much of the economy of the United States is based on high-technology production. A highly skilled labor force and large amounts of capital—in the form of advanced equipment and machinery—make this possible. Another nation—with the same natural resources but without the same labor and capital resources—could have a very different economy.

**Identifying** Name at least one U.S. import.

**Who Made the Parts?**

Consider the Boeing 777. This plane is hardly “made in America.” International suppliers provide rudders, elevators, outboard flaps, wingtip assemblies, engines, landing gear, and other parts. The complicated Boeing 777 jet aircraft is a jigsaw puzzle in which the pieces come from all over the world.
Absolute and Comparative Advantage

Main Idea A nation does not need to have an absolute advantage over another country in producing a certain good or service to benefit from trade with that country.

Economics & You Because of your talents and weaknesses, you are probably better suited to some jobs than others. Read on to learn about how countries, too, are better suited to produce some goods than others.

If the United States could produce everything more cheaply than every other nation, it might not want to import anything. We know this situation does not exist for any nation, however, because of opportunity cost. All nations must make choices in how they use their scarce resources.

Absolute Advantage The particular distribution of resources in a nation often gives it an advantage over another nation in the production of one or more products. Brazil’s tropical climate and inexpensive labor make it ideally suited for growing bananas. A country with a moderate climate, such as France, would produce far fewer bananas. Brazil, therefore, has an absolute advantage in banana production over France. A country has an absolute advantage when it can produce more output per unit of input than can another country.

Economic Analysis

Analyzing Graphs For which product or products does the U.S. export more than it imports?

Figure 18.1 U.S. Exports and Imports

If you look carefully at the graph on the right, you will see that for many products, the U.S. imports more than it exports.

Source: Standard and Poor’s.
A nation often finds it profitable to produce and export a limited assortment of goods for which it is particularly suited. This concept is known as specialization. For example, Japan’s specialization in consumer electronics has led many nations to import these types of products from Japan.

**Comparative Advantage** A nation doesn’t need to have an absolute advantage in the production of a certain good to find it profitable to specialize and then to trade with other countries. For example, consider two imaginary nations, Alpha and Beta. Assume that each country produces only soybeans and corn.

When producing only soybeans, Alpha produces 10 million bushels, while Beta produces only 8 million. The next year, suppose the two countries decide to grow only corn. Alpha produces 50 million bushels, while Beta produces 25 million. According to this example, Alpha has an absolute advantage in the production of both soybeans and corn.

Does this mean that Alpha will produce both crops and, therefore, have no reason to trade with Beta? No. Alpha can produce slightly more soybeans than Beta. In contrast, it can produce a great deal more corn. It would make little sense for Alpha to take land, labor, and capital resources away from the efficient production of corn and use them for the less efficient production of soybeans. Alpha’s opportunity cost—what it gives up to get something else—would be less if it invested all its resources in the production of corn. It could export its surplus corn and use the revenues it receives to import soybeans from Beta.

**Absolute Advantage**

In addition to tangible natural resources, a nation’s climate has a major impact on what the nation produces. Because Brazil’s climate is ideally suited for growing bananas, Brazil has an absolute advantage in banana growing over other nations whose climates are not suited for growing bananas.
Alpha has a comparative advantage in corn production. **Comparative advantage** is the ability of a country to produce a product at a lower opportunity cost than another country. Beta has a comparative advantage in soybean production. It can produce almost the same amount of soybeans as Alpha, but only half as much corn. By using its resources to grow only soybeans, Beta is just giving up the relatively inefficient production of corn. Beta, then, has a lower opportunity cost for soybean production than does Alpha. Beta should produce the maximum amount of soybeans, export soybeans to Alpha, and import corn. Both countries benefit when each country concentrates on that production for which it is relatively most efficient.

You should consider international trade as an economic activity just like any other. It is subject to the same economic principles. International trade can be looked at as a kind of production process that transforms exports into imports. For you and everyone else in the United States, the purpose of international trade is to obtain imports, not to export. What we gain as a country from international trade is the ability to import the things that we want. We have to export other things in order to pay for those imports.

**Reading Check**  
What does it usually mean when a country specializes in producing a particular product?

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### Vocabulary

1. **Explain** the significance of: imports, exports, absolute advantage, specialization, comparative advantage.

### Main Ideas

2. **Comparing** In a diagram like the one below, use the boxes to list an advantage each situation gives a country.

<table>
<thead>
<tr>
<th>Advantages in Production</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute</td>
</tr>
<tr>
<td>Specialization</td>
</tr>
<tr>
<td>Comparative</td>
</tr>
</tbody>
</table>

### Critical Thinking

3. **The BIG Idea** Explain why it is advantageous for a country to trade in order to specialize.

4. **Contrasting** What is the difference between an import and an export?

### Applying Economics

5. **Comparative Advantage** List at least three activities in your daily life in which you have a comparative advantage (such as cooking or lawn maintenance). Describe how you and those who live at your house could use comparative advantage in order to “trade” to get more accomplished.
David Chu
cofounder of Nautica

David Chu came to the United States from Taiwan with his parents when he was 15 years old. After graduating from high school in New York, he planned to become an architect. Little did he realize when he enrolled in a drawing course at the Fashion Institute of Technology that he was taking the first step toward founding Nautica, a brand name that would become a billion-dollar global enterprise.

In 2003 Nautica was purchased by VF Corporation, a giant in the clothing industry whose brands include Lee and Wrangler. Chu made over $100 million in the transaction. Today Nautica Enterprises employs over 3,300 people and sells its products worldwide. Chu stayed on as CEO, but he retired in 2004. His retirement, however, didn’t last long.

“In no time at all he was reestablishing the international relationships he’d built while at Nautica. His former colleagues there have nothing to fear from Chu as a competitor. The new line is very expensive: $185 shirts, $400 sweaters, $2,000 suits. The time he spent building Nautica from scratch made his new venture much easier to get off the ground.”

“"I didn’t study business, but after a couple of years of experience I learned the business. . . . I think what’s driving me is the stimulation. . . . It’s not about the destination; it’s about the journey."
GUIDE TO READING

Section Preview
In this section, you will learn how nations convert their different currencies in order to trade more easily with one another.

Content Vocabulary
- exchange rate (p. 472)
- foreign exchange markets (p. 472)
- fixed rate of exchange (p. 473)
- International Monetary Fund (IMF) (p. 473)
- devaluation (p. 473)
- flexible exchange rate (p. 474)
- depreciation (p. 474)
- balance of trade (p. 475)

Academic Vocabulary
- affect (p. 473)
- benefit (p. 476)

Reading Strategy
Comparing and Contrasting As you read the section, complete a diagram like the one below by listing the advantages and disadvantages of a fixed rate of exchange.

ISSues In ThE NeWs
—from Money Magazine

What’s Driving Dollar Prices? . . . [Americans] consume more stuff from the rest of the world than we sell back to them, resulting in an annual trade deficit set to top $600 billion. . . . We’ve racked up $2 trillion in consumer debt. . . .

What all this adds up to is that we’ve borrowed a lot of money from foreign investors—most notably China. About 40 percent of U.S. Treasuries, for example, are held by foreigners.

If investors start to think America is overextended, they may sell a lot of those assets, in the process selling dollars as they convert the money back into their own currency. . . .

Investment flows into the U.S. have already begun to weaken, and the currency market may be driving dollar prices down in anticipation of more of the same.

The United States uses the dollar as its medium of exchange; Mexico, the peso; India, the rupee; and Japan, the yen. As you read this section, you’ll learn that to engage in world trade, people must have a way of knowing what the price of their currency is in terms of another nation’s currency. They must also be able to exchange one type of currency for another.
Fixed Exchange Rates

**Main Idea** Under a system of fixed exchange rates, national governments set the value of their currencies relative to other currencies.

**Economics & You** What if your boss tried to pay you for a month’s work in euros or in Japanese yen? These currencies would not be useful to you unless you exchanged them for U.S. dollars. Read on to learn about how countries must find a common way to pay one another for the goods they import and export.

The price of one nation’s currency in terms of another nation’s currency is known as the *exchange rate*. Why are exchange rates needed? A Chinese MP3 player manufacturer who exports MP3 players to the United States probably does not want American dollars in payment. The firm needs Chinese currency to pay its workers and suppliers.

Fortunately, international trade is organized so that individuals and businesses can easily and quickly convert one currency to another. *Foreign exchange markets* allow for these conversions. People in these markets deal in buying and selling foreign currency for businesses that want to import goods from other countries. Some of the currency trading also takes place through banks. **Figure 18.2** below gives examples of the information in a typical exchange rate list on any given day. You can find these rates in newspapers and on the Internet.

---

**Economic Analysis**

**Using Tables** How many Venezuelan bolivars would you receive if you exchanged five U.S. dollars?

**Selected Exchange Rates**

<table>
<thead>
<tr>
<th>Country (currency)</th>
<th>U.S. Equivalent</th>
<th>Currency per U.S. $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia (dollar)</td>
<td>.7323</td>
<td>1.3655</td>
</tr>
<tr>
<td>Brazil (real)</td>
<td>.4488</td>
<td>2.2282</td>
</tr>
<tr>
<td>Britain (pound)</td>
<td>1.8228</td>
<td>.5486</td>
</tr>
<tr>
<td>Canada (dollar)</td>
<td>.8905</td>
<td>1.1173</td>
</tr>
<tr>
<td>China (yuan renminbi)</td>
<td>.1249</td>
<td>8.0064</td>
</tr>
<tr>
<td>European Union (euro)</td>
<td>1.2579</td>
<td>.7949</td>
</tr>
<tr>
<td>India (rupee)</td>
<td>.0215</td>
<td>46.5116</td>
</tr>
<tr>
<td>Japan (yen)</td>
<td>.0085</td>
<td>117.6470</td>
</tr>
<tr>
<td>Mexico (peso)</td>
<td>.0871</td>
<td>11.4810</td>
</tr>
<tr>
<td>South Africa (rand)</td>
<td>.1354</td>
<td>7.3855</td>
</tr>
<tr>
<td>Venezuela (bolivar)</td>
<td>.000466</td>
<td>2,145.9227</td>
</tr>
</tbody>
</table>

---

In the second column of this listing, on a particular day one British pound is worth 1.8228 American dollars. The third column shows that one United States dollar is worth .5485 British pounds.
From 1945 to the early 1970s, the foreign exchange market operated with a fixed rate of exchange. Under this system, national governments set the value of their currency in relation to other currencies. With a fixed rate of exchange, a government could compare its currency to that of other countries. The International Monetary Fund (IMF) supported a fixed exchange rate system. Member governments of the IMF were obligated to keep their foreign exchange rates more or less fixed.

A fixed rate of exchange had some advantages for world trade. Importers and exporters knew exactly how much of a foreign currency they could purchase with their own nation’s money. Also, the system allowed central banks to affect the level of exports and imports in their country by devaluing the currency. Devaluation means lowering a currency’s value in relation to other currencies by government order. Figure 18.3 above shows how the cost of a Chinese MP3 player would decrease if China devalues its currency.

This system of fixed exchange rates eventually proved impractical. The basic problem was that it was difficult to hold fixed exchange rates in an international economic climate that was constantly changing due to inflation and other factors. By the 1970s, many nations had begun to see the need to move to a more flexible system of exchange rates.

Examining What is devaluation? How does it affect a country’s role in foreign trade?
Flexible Exchange Rates

**Main Idea** Under a system of flexible exchange rates, supply and demand determine currency values.

**Economics & You** How much is your American dollar worth in Canada? In Mexico? In Europe? Read on to learn about how flexible exchange rates mean that the value of the dollar in other nations is constantly changing.

On August 15, 1971, President Richard Nixon officially announced what would become the end of fixed American exchange rates. Most of the world’s nations turned to a flexible exchange rate system. Under this arrangement, the forces of supply and demand are allowed to set the prices of various currencies. With flexible exchange rates, a currency’s price may change, or float, up or down a little each day.

The forces actually determining exchange rates are the supply and demand of goods and services that can be bought with a particular currency. For example, suppose the amount of dollars wanted by Mexican exporters is greater than the quantity of dollars supplied by Americans who want to buy Mexican goods. Because the quantity demanded exceeds that supplied, the American dollar will become more expensive in relation to the peso. When the price of a currency falls through the action of supply and demand, it is termed **depreciation**. As with devaluation, depreciation of a country’s currency improves its competitive edge in foreign trade.

Besides import-export transactions, political or economic instability within a country may encourage people to exchange their currency for a more stable currency, often the U.S. dollar. In that case, the value of the dollar would rise in relation to the other nation’s currency. A country that is experiencing rapid inflation will find its currency falling in value in relation to other currencies.

**Analyzing** Why might people want to exchange their own currency for a more stable currency?

**Sticker Shock**

Because of differences in currency values, goods priced in a foreign currency might seem to an American to cost much more than they actually do. A guitar that costs several thousand Japanese yen, for example, actually costs only a couple of hundred U.S. dollars.
Balance of Trade

Main Idea: The United States has had a negative balance of trade since the 1970s.

Economics & You: Traditionally, American video game systems do not sell well overseas, while Japanese consoles dominate the American market. Could this situation harm the American economy? Read on to learn about the delicate balance of trade between nations.

A currency’s exchange rate can have an important effect on a nation’s balance of trade. The balance of trade is the difference between the value of a nation’s exports and the value of its imports. If a nation’s currency depreciates, or becomes “weak,” the nation will likely export more goods because its products will become cheaper for other nations to buy. Conversely, if a nation’s currency increases in value, or becomes “strong,” the amount of its exports will decline because its products will become more expensive abroad.

When the value of goods leaving a nation exceeds the value of those coming in, a positive balance of trade is said to exist. In this case, the nation is bringing in more funds as payments for goods than it is paying out. A negative balance of trade exists when the value of goods coming into a country is greater than the value of those going out. This situation is called a trade deficit. The United States has had a negative balance of trade, or trade deficit, for many years beginning in the 1970s and in fact, the trade deficit is growing, as you can see from the chart below.

It is important to realize that a continued trade deficit is not necessarily a bad thing. A trade deficit continues because there are opportunities for foreigners to invest in the U.S. economy. For example, many Japanese automobile companies have built factories in the United States to satisfy the U.S. demand for Japanese cars. This creates supporting industries that benefit U.S. citizens by providing a great many domestic jobs.

Contrasting Explain the difference between a positive and negative balance of trade.
To trade or not to trade? The difficulties that different currencies cause are only one problem of world trade. There are also natural barriers, which include the differences in languages and cultures between various trading partners. As you read this section, you’ll learn that some nations may set restrictions to discourage or limit trade.
Three Ways to Restrict Imports

**Main Idea** Tariffs, quotas, and embargoes are three ways to restrict imports.

**Economics & You** Should the U.S. trade freely with nations that support communism or terrorism? Why or why not? Read on to learn about how embargoes are used to restrict trade with certain nations, often for political reasons.

Three major barriers to world trade are tariffs, quotas, and embargoes. The most commonly used barrier to free trade is the **tariff**, a tax on imports.

**Tariffs** Two types of tariffs can be applied to an import. A **revenue tariff** is used primarily to raise government revenue without restricting imports significantly. Although tariffs today account for less than 2 percent of the federal government’s income, they were the major sources of federal funding until the early 1900s.

A **protective tariff** is one designed to raise the cost of imported goods and thereby protect domestic producers. As you learned from the law of demand, the quantity demanded of an item falls as the price rises. Higher prices for foreign goods because of tariffs mean that Americans will buy more domestic goods and fewer goods from abroad.

Some protective tariff rates have been as high as 62 percent of the value of the imported goods. Tariffs are much lower today, but they are still used to protect some industries from foreign competition.

**Figure 18.4** The Free Trade Controversy

- Free trade makes more products available to consumers at the best prices, but it also exposes domestic workers to greater foreign competition. Most Americans are neither completely for nor completely against free trade. They recognize that it carries both benefits and drawbacks, both for Americans and for citizens of countries we trade with.

<table>
<thead>
<tr>
<th>Arguments Against Free Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Job Security</strong></td>
</tr>
<tr>
<td>Protectionists argue that many domestic workers will be unemployed if foreign competitors sell goods at lower prices than American firms. In the 1980s, for example, American steel mills laid off many workers because of foreign competition.</td>
</tr>
<tr>
<td><strong>National Economic Security</strong></td>
</tr>
<tr>
<td>Protectionists argue that certain industries are crucial to the economy of the United States. They believe that entire industries, such as oil, should be protected against foreign competition.</td>
</tr>
<tr>
<td><strong>Infant Industries</strong></td>
</tr>
<tr>
<td>Protectionists believe that tariffs and quotas are needed as temporary protection for new, infant industries. If foreign competition is restricted for a time, a young industry may become strong enough to compete in a world market.</td>
</tr>
</tbody>
</table>
Quotas An alternative method for restricting imports is the quota system. An import quota usually restricts the number of units of a particular good that can be brought into the country. At one time or another, the United States has placed quotas on imports of sugar, dairy products, various types of apparel, and cloth.

Embargoes An embargo is a complete restriction on the import or export of a particular good. Often embargoes are enacted for political reasons. For example, in 2003 an embargo was ordered against Syria for its support of terrorism.

The United States has also ordered embargoes on goods coming in from certain countries. For example, an embargo on trade with Cuba has been in place for more than four decades because the U.S. government does not agree with the political policies of Fidel Castro, Cuba’s Communist dictator.

Arguments for and Against Free Trade The pros and cons of trade restrictions are still often the subject of intense public debate. Protectionists are those who argue for trade restrictions. They believe that certain restrictions are necessary to protect domestic industries. On the other side are free-trade supporters, who believe that exports and imports should not be restricted. There are three main arguments against and for free trade—see Figure 18.4 below.

Predicting Consequences Explain how an embargo affects trade. What are two examples of embargoes ordered by the United States?

### Arguments for Free Trade

<table>
<thead>
<tr>
<th>Improved Products</th>
<th>Foreign competition encourages U.S. firms to improve their technology and production methods. Better technology increases the production and supply of goods and services available, which raises our standard of living.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export Industries</td>
<td>American workers involved in export industries may become unemployed when trade restrictions are implemented. When the United States imports fewer goods, there is less American money available outside the United States to buy American exports. When the United States restricts imports, other nations may retaliate and restrict their own imports.</td>
</tr>
<tr>
<td>Specialization and Comparative Advantage</td>
<td>Those in favor of free trade admit that too much economic specialization puts the country at the mercy of world demand. However, some specialization benefits consumers because comparative advantage in production results in more goods at lower prices.</td>
</tr>
</tbody>
</table>

**Economic Analysis**

**Evaluating** Would a recently unemployed American steel worker more likely be in favor of or against free trade policies? Why?
International Trade Agreements

Main Idea International trade agreements are negotiated to reduce trade restrictions between countries.

Economics & You Have you ever visited Mexico or Canada? Why might the United States want to maintain good trade relations with its neighbors? Read on to learn about the importance of trade agreements between countries.

There have been continuing efforts worldwide to reduce tariffs and encourage more world trade.

The World Trade Organization The most important international trade organization is the World Trade Organization (WTO). As of 2007, the WTO had 147 member nations. The WTO has made decisions that affected the U.S. steel tariffs used in the early 2000s. As a result, the United States canceled its tariffs on steel imported from other countries.

The WTO is working hard at breaking down trade barriers in agriculture. The United States and the European Union, though, have not reached agreement on how to reduce their large government payments to domestic farmers. Some economists believe that if world agricultural trade were made freer, poor people in developing countries would be better off. Additionally, consumers both here and in Europe would not pay so much for food. Taxpayers would see fewer tax receipts go to support large agricultural businesses.

World Trade Organization (WTO): world’s largest trade agreement, currently with more than 140 member nations

WTO Protests

Although the stated aim of the WTO is to promote free trade and stimulate economic growth, critics contend that it does not treat less-developed countries fairly. They also claim that the issues of health, safety, and the environment are ignored by the organization.
Regional Trade Agreements  In many parts of the world, regional trade agreements have been reached in order to increase free trade. Certain nations in Southeast Asia as well as in Central and South America have such regional trade agreements. The United States formed one with Canada and Mexico called the North American Free Trade Agreement (NAFTA). The U.S. Congress approved NAFTA in 1993. Since then, trade has increased between the three nations to the general benefit of all.

The Central American Free Trade Agreement (CAFTA) was signed into law in the summer of 2005. This agreement covers most countries in Central America plus the Dominican Republic. CAFTA eliminated tariffs on more than 80 percent of U.S. exports to that geographic area.

Perhaps the most important regional trade agreement in the world today is the European Union (EU). Currently, the EU consists of 25 European countries. On January 1, 1993, the EU began eliminating most of its restrictions on trade between its member countries. Many European nations use a common currency, the euro. Eventually, the EU will have a common currency for over 400 million European consumers. It will rival the United States in market size.

Determining Cause and Effect  What is NAFTA? How has it affected U.S. trade?

North American Free Trade Agreement (NAFTA): trade agreement designed to reduce and gradually eliminate tariff barriers between Mexico, Canada, and the United States

Central American Free Trade Agreement (CAFTA): trade agreement designed to reduce tariff barriers between Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic, and the United States

European Union (EU): organization of European nations whose goal is to encourage economic integration as a single market

Vocabulary


Main Ideas

2. Examining In a table like the one below, explain how each trade agreement listed helps U.S. exports.

<table>
<thead>
<tr>
<th>Agreement</th>
<th>Impact on U.S. Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>NAFTA</td>
<td></td>
</tr>
<tr>
<td>CAFTA</td>
<td></td>
</tr>
<tr>
<td>EU</td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking

3. The BIG Idea  How does the WTO assist global trade?

4. Interpreting  Explain why a protectionist would likely favor protective tariffs, import quotas, and embargoes.

Applying Economics

5. Free Trade  Think of five foreign-made items you used or wore today. Where was each item made? How much did you pay for the items? Explain why you think each item might be cheaper or more expensive if made in the U.S.
A MAJOR SWIPE AT SWEATSHOPS

Working toward a living wage.

Check It Out! In this chapter you learned about regional trade agreements. In this article, read to learn about an agreement that could improve the lives of workers in sweatshops around the globe.

Remember sweatshop exposés? They haven’t hit the headlines much in the past few years. In part that’s because high-profile companies such as Nike Inc. and Gap Inc. now work regularly with labor rights groups to monitor their vast global networks of supplier factories. Still, only about 100 U.S. and European multinationals participate in such efforts to find and remedy abuses. . . . Perhaps the most troublesome absence has been that of the large retailers such as Wal-Mart Stores Inc. and Target Corp. These giants increasingly control the pricing power in overseas manufacturing that in turn dictates how much money factories can spend on improving labor conditions.

Now global labor monitoring may get a big leg up. Nike, Patagonia, Gap, and five other companies have joined forces with six leading anti-sweatshop groups to devise a single set of labor standards with a common factory-inspection system. The goal: to replace today’s overlapping hodgepodge of approaches with something that’s easier and cheaper to use—and that might gain traction with more companies. After two years of debate, the parties quietly signed an agreement to run a pilot project in several dozen Turkish factories that produce garments and other products for the eight companies.

. . . There may be little media attention paid to workers [in developing nations] these days, but human rights groups still routinely find abuses of every description.

—Reprinted from BusinessWeek

Think About It

1. Explaining Why do we not hear as much about sweatshops today as we did in the past?

2. Identifying Central Issues Why is it a problem that giant retailers are not part of the joint project discussed in the article?
Countries benefit if they specialize in the production of goods for which they have a **comparative advantage** and then trade for other goods.

If country Alpha has a comparative advantage in corn production, it should produce only corn.

If country Beta has a comparative advantage in soybean production, it should produce only soybeans.

A nation has a **positive balance of trade** if the value of its exports is greater than the value of its imports. It has a **negative balance of trade** if the value of its imports is greater than the value of its exports.

As international trade continues to increase, intense debate goes on worldwide about the pros and cons of **trade agreements and restrictions**.

**Protectionists**
- Argue for trade restrictions. They feel that certain restrictions are necessary to protect domestic industries.

**Free-Trade Supporters**
- Argue against trade restrictions. They feel that the world market will take care of itself if left to operate with minimal restrictions.
Review Content Vocabulary
1. Write a paragraph or two explaining the basics of world trade. Use all of the following terms.
   - imports
   - exports
   - specialization
   - exchange rate
   - flexible exchange rate
   - depreciation
   - balance of trade
   - tariff
   - import quota
   - embargo
   - protectionists
   - World Trade Organization (WTO)
   - North American Free Trade Agreement (NAFTA)
   - European Union (EU)

Review the Main Ideas

Section 1 (pp. 465–469)
8. How does a country determine whether it has a comparative advantage in the production of certain goods?
9. What does the United States gain from international trade?
10. “America can produce more DVDs per labor hour than can any other country in the world.” Is this an example of an absolute advantage or a comparative advantage?
11. How does a nation benefit from specialization?

Section 2 (pp. 471–476)
12. Why are foreign exchange markets necessary?
13. In the past, why was it difficult to maintain a system of fixed rates of exchange?
14. What does it mean when a nation’s currency devaluates?
15. How does a nation come to have a negative balance of trade?

Section 3 (pp. 477–481)
16. Fill in a graphic organizer like the one below to list three ways to restrict imports and explain how each one works.

<table>
<thead>
<tr>
<th>Trade Restriction</th>
<th>How It Works</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

17. What is the difference between a revenue tariff and a protective tariff?
18. What are three arguments for free trade and three arguments against free trade?
Thinking Like an Economist

19. International trade affects all Americans. To understand how international trade affects you, describe what your world would be like if international trade were outlawed. You can do this by making a list of all the products you would not be able to purchase or whose price would go up dramatically without international trade. For example, the United States imports far more oil than it produces. If the United States stopped importing oil, it could not produce enough to meet current needs. Use a chart like the one below to record your thoughts, and then write a paragraph describing the impact of international trade on your life.

<table>
<thead>
<tr>
<th>Product</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking

20. **The BIG Idea** Are you in favor of free trade, protectionism, or some combination of the two? Explain your position.

21. **Understanding Cause and Effect** If the value of the dollar fell in relation to other currencies, what would you expect to happen to American exports?

22. **Synthesizing** The U.S. Constitution forbids restrictions on trade between the 50 states. What are two examples of problems that might have arisen if the Constitution had been silent on trade between the states?

Analyzing Visuals

23. Study the cartoon on the right, and then answer the following questions.

   a. The man’s words are a play on a common saying. What is the original saying?

   b. What does the bull represent?

   c. What does the china shop represent?

   d. What is the cartoonist’s message?
The European Union  The European Union (EU) is an organization of 25 independent European nations whose goal is to create a unified and strong market. The map below shows the value of trade between the European Union and other regions of the world.

The euro is the legal tender for more than 300 million people in Austria, Belgium, Finland, France, Germany, Greece, Italy, Ireland, Luxembourg, the Netherlands, Portugal, and Spain. Denmark, Sweden, and the United Kingdom are not currently using the euro. The 10 member states that joined the European Union in 2004 are committed to adopting the euro eventually.
Thinking Globally

1. **Listing**  With which regions of the world does the EU have a trade surplus? A trade deficit?

2. **Identifying**  Which region is the EU’s biggest trade partner?

3. **Critical Thinking**  Three EU countries—Great Britain, Denmark, and Sweden—do not use the euro. Why do you think this is so? Write down some possible reasons, and then conduct research on the Internet to find out whether your theories are correct.
The BIG Idea
Economists look at a variety of factors to assess the growth and performance of a nation’s economy.

Why It Matters
What do you think it would take to improve economic conditions in less developed nations? In this chapter, read to learn how developing countries are working to become a bigger part of the global economy.

Economics ONLINE
Chapter Overview Visit the Economics Today and Tomorrow Web site at glencoe.com and click on Chapter 19—Chapter Overviews to preview chapter information.
Many Americans may not realize it, but even the poorest families in the United States usually have an income far above the average income in much of the rest of the world. About one-half of the world’s population lives at or close to subsistence, with just enough to survive. As you read this section, you’ll learn about the characteristics of these developing countries.
Developed and Developing Nations

**Main Idea** Developed nations have increased their standards of living by moving from agricultural to industrialized economies.

**Economics & You** Take a moment to think about the clothing, electronic goods, and other items that you own. People in many other countries cannot afford these luxuries. Read on to learn about the differences between the United States and other, less developed, nations.

Of the more than 190 nations in the world, only about 35 are considered **developed nations**. These nations include the United States, Canada, all European countries, Japan, Australia, and New Zealand.

The remaining people in the world live in **developing nations**. These are nations with less industrial development and a relatively low standard of living. Within this general definition, however, developing nations differ in many ways. The average income per person in Mexico, for example, is only about 24 percent that of the United States, but Mexico is much more developed and prosperous than almost all other developing nations.

Religion influences economic policies in some developing countries. This is not new. During the Middle Ages, the Church influenced many economic decisions throughout Europe. In colonial America, various churches influenced economics. Today some developing countries forbid lending money with interest. As a result, foreign investment in these countries is low.

**Reading Check** Describing What is a developing nation?

**Ahead of the Pack** Among developing nations, Mexico is one of the most modernized and prosperous. Its large cities, like Mexico City, for example, look very much like urban areas of the United States.
Figure 19.1  Measuring GDP

As you can see from the graph, there is a huge difference in per capita GDP between developing and developed countries.

Per Capita GDP Around the World

<table>
<thead>
<tr>
<th>Developed Countries</th>
<th>Developed Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$40,100</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$29,600</td>
</tr>
<tr>
<td>Japan</td>
<td>$29,400</td>
</tr>
<tr>
<td>Germany</td>
<td>$28,700</td>
</tr>
<tr>
<td>Italy</td>
<td>$27,700</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Developing Countries</th>
<th>Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>$9,700</td>
</tr>
<tr>
<td>China</td>
<td>$5,600</td>
</tr>
<tr>
<td>Indonesia</td>
<td>$3,500</td>
</tr>
<tr>
<td>Pakistan</td>
<td>$2,200</td>
</tr>
<tr>
<td>Haiti</td>
<td>$1,500</td>
</tr>
</tbody>
</table>


Economic Analysis

Contrasting  How does the GDP gap affect everyday life in developing and developed countries?

Economic Characteristics

Main Idea  Developing nations are usually characterized by low GDP per capita, emphasis on agriculture, poor health conditions, low literacy rates, and rapid population growth.

Economics & You  How would your everyday life be different if you lived in a developing nation? Read on to learn about the economic characteristics that many developing nations have in common.

Economists often use per capita GDP as a rough measure of a nation’s prosperity. Estimates of per capita GDP in the United States and other industrial nations range from $25,000 to about $40,000 per year.

Low GDP  Per capita GDP in developing nations, in contrast, is considerably less, and in the world’s poorest nations it is extremely low. Look at Figure 19.1 above, which shows per capita GDP for a number of developing countries. While developing nations may have many natural and human resources, they lack the equipment, financing, and knowledge necessary to put those resources to use.

See StudentWorks™ Plus or go to glencoe.com.

Skills Handbook

See page R37 to learn about Making Generalizations.
An Agricultural Economy  Agriculture is central to the economies of developing nations. Much of the population exists through subsistence agriculture, in which each family grows just enough to take care of its own needs. This means that no crops are available for export or to feed an industrial workforce.

Poor Health Conditions  Poor health conditions are also common in many developing nations. Many people die from malnutrition or illness due to lack of food. Developing nations may also suffer from a shortage of modern doctors, hospitals, and medicines. The result is often a high infant mortality rate and a low life expectancy among adults.

Low Literacy Rate  A fourth characteristic of developing nations is a low adult literacy rate—the percentage of people who are able to read and write. There are few schools, and many children miss school to help their families farm. The lack of a large pool of educated workers makes it difficult to train the population for needed technical and engineering jobs.

Rapid Population Growth  A fifth characteristic of developing nations—rapid population growth—is often the source of many other problems, such as lack of food and housing. The population in the United States grows at a rate of about 1 percent a year. The growth rate in many developing nations is three and sometimes four times this rate.

Determining Cause and Effect  What conditions lead to high infant mortality rates?

### Economic and Social Statistics for Selected Nations

<table>
<thead>
<tr>
<th>Country</th>
<th>Life expectancy at birth</th>
<th>Infant mortality (deaths per 1,000 live births)</th>
<th>Literacy (% of people who can read and write)</th>
<th>Population (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>78</td>
<td>6</td>
<td>97</td>
<td>295.7</td>
</tr>
<tr>
<td>Japan</td>
<td>81</td>
<td>3</td>
<td>99</td>
<td>127.4</td>
</tr>
<tr>
<td>Australia</td>
<td>80</td>
<td>5</td>
<td>100</td>
<td>20.1</td>
</tr>
<tr>
<td>Israel</td>
<td>79</td>
<td>7</td>
<td>97</td>
<td>6.3</td>
</tr>
<tr>
<td>Italy</td>
<td>80</td>
<td>6</td>
<td>99</td>
<td>58.0</td>
</tr>
<tr>
<td>China</td>
<td>72</td>
<td>24</td>
<td>91</td>
<td>1,306.3</td>
</tr>
<tr>
<td>Mexico</td>
<td>75</td>
<td>21</td>
<td>92</td>
<td>106.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>72</td>
<td>30</td>
<td>86</td>
<td>186.1</td>
</tr>
<tr>
<td>India</td>
<td>64</td>
<td>56</td>
<td>60</td>
<td>1,080.3</td>
</tr>
<tr>
<td>Mozambique</td>
<td>40</td>
<td>131</td>
<td>48</td>
<td>19.4</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>62</td>
<td>63</td>
<td>43</td>
<td>144.3</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>49</td>
<td>95</td>
<td>43</td>
<td>73.1</td>
</tr>
</tbody>
</table>

Weak Property Rights

Main Idea A weak system of legally protected property rights frequently undermines economic development.

Economics & You You probably know exactly where your property stops and your neighbors’ property starts. This is not always so clear in developing nations. Read on to learn about how this lack of strong property rights causes problems in developing countries.

Economists have found that governments in developing countries generally do not support a system of strong, well-defined private-property rights. A good example is Peru. Only 20 percent of Peru’s land is legally owned. Without specifically defined private-property rights, individuals cannot exchange land. As a result, no large-scale farming has occurred in Peru, and farmers have little incentive to improve the value of the property they farm.

Take another example. Many of the poorest countries in the world are on the African continent. A fundamental reason that there is little economic growth in Africa is that less than 10 percent of its land is formally owned. African residents who do not own the land or their houses cannot easily borrow against the values of those items. They cannot sell them, either.

Speculating Why might governments in developing countries not support private-property rights?

Review

Vocabulary
1. Explain the significance of: developed nations, developing nations, subsistence agriculture, infant mortality rate.

Main Ideas
2. Explaining Create a diagram like the one below to list and explain five economic characteristics of developing nations.

Critical Thinking
3. The BIG Idea How does the lack of private-property rights keep some nations in poverty?
4. Defending Should developing nations be forced to develop? Explain your answer.

Applying Economics
5. Political Economics Draw up a plan to help a developing nation develop more quickly. List each negative economic characteristic you learned about in this section, and explain what you would propose to overcome that condition in your chosen country.
Mexico is swiftly upgrading its workforce.

Check It Out! In this chapter you learned about some factors that hinder development in some nations. In the following article, read to learn how Mexico is working toward a new trend.

For years, the Mexican workforce has meant one thing to multinationals: cheap, reliable labor, perfect for assembling cars, refrigerators, and other goods in the maquiladoras lining the border with America. But as maquila-style assembly work migrated to cheaper locales, and India and China grabbed more sophisticated design and engineering assignments, Mexican officials knew they had to do something to stay in the global race. Quietly and steadily, they have. Over the past 10 years, the country’s policymakers have been building up enrollment in four-year degree programs in engineering, developing a network of technical institutes that confer two-year degrees, and expanding advanced training programs with multinationals from the U.S. and elsewhere.

The result is a bumper crop of engineers. Currently, 451,000 Mexican students are enrolled in full-time undergraduate programs, vs. just over 370,000 in the U.S. The Mexican students benefit from high-tech equipment and materials donated to their schools by foreign companies, which help develop course content to fit their needs. . . .

Mexican officials hope that as more multinationals get hooked on the expertise of local technicians and engineers, they will keep sending more sophisticated work to Mexico, providing plenty of quality jobs for everyone and moving the country further up the ladder of development.

—Reprinted from BusinessWeek

Think About It
1. Specifying What led Mexican officials to increase the number of undergraduates in engineering?
2. Synthesizing How are multinationals helping Mexico’s engineers?
GUIDE TO READING

Section Preview
In this section, you will learn how foreign investment and aid help nations to develop economically.

Content Vocabulary
- confiscation (p. 497)
- foreign aid (p. 497)
- economic assistance (p. 497)
- technical assistance (p. 497)
- military assistance (p. 497)

Academic Vocabulary
- devote (p. 498)
- enhance (p. 500)

Reading Strategy
Organizing As you read the section, complete a table similar to the one below by listing three types of foreign aid and a definition and example for each one.

<table>
<thead>
<tr>
<th>Types of Foreign Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type of Aid</td>
</tr>
<tr>
<td>-------------</td>
</tr>
<tr>
<td>-------------</td>
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<tr>
<td>-------------</td>
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</tbody>
</table>

ISSues In ThE NeWS
— from CNNMoney

WORLD BANK FOR SALE Don’t like the policies of the World Bank? Then sell it on eBay.

The Center for Economic Justice tried to do just that.

The activist group, which aims to minimize the negative effects of globalization, initiated the eBay auction by posting a desktop globe last Friday with a coin slot cut in the top. The posting’s headline read “World Bank—Antiquated (does not work).”

Social and environmental activists have long derided the World Bank, an international lending institution, for championing policies that they say lead to increased poverty and environmental disruption in the developing world.

The bank has argued that its loans for development projects are crucial to modernization and economic growth.

[The globe had a] starting bid of 30 cents, or, according to the product description, the hourly minimum wage under World Bank policies in Haiti. . . .

Most nations pass through three stages of economic development. The first is the agricultural stage, and the second is the manufacturing stage. In the third stage, many workers shift into the service sector—sales, food service, and technical services. As you read this section, you’ll learn how developing nations use foreign investment and aid to move through the three stages of economic development.
Financing Economic Development

Main Idea The major outside sources of capital for developing nations are foreign investment and aid from developed nations.

Economics & You You have probably heard about controversial overseas labor practices of companies such as Nike and the Gap. Read on to learn about low wage rates and other reasons why developing countries are attractive to some American companies.

A basic problem for many developing nations is how to finance the equipment and training necessary to improve their standard of living. Domestic savings, which provide this financing in developed nations, are often limited or take a different form in developing nations. Therefore, many such nations must look to outside sources for investment capital. The two major outside sources of capital are investment by foreign businesses and foreign aid from developed nations.

Foreign Investment: Attractions and Risks
Investors are attracted to developing countries because of their low wage rates, few regulations, and abundant raw materials. Investment may include setting up branch offices and new companies, building new factories, or buying into companies already established.

Figure 19.2 Foreign Aid

Three main types of foreign aid are provided by developed nations to developing nations—economic assistance, technical assistance, and military assistance. Such aid is provided by both governments and private organizations. Often, foreign aid plays an important role in economic development.

A. Economic Assistance This consists of loans and outright grants of funds or equipment to other nations. One use of such aid is to purchase basic producer goods, including machinery that will increase a nation’s productivity.
Besides attractions, there are also risks to investing in developing countries. If the government is unstable, or if terrorist groups threaten stability, foreign businesses may lose their investment. In some cases, the governments in developing nations have taken over private firms—a practice called confiscation—forcing the firms’ owners out of those countries.

Problems exist from the developing nation’s viewpoint as well. In nations with heavy foreign investment, citizens often criticize the economic control these foreign companies have over their resources. What these critics may not realize is that factors of production will remain idle unless such firms organize the materials and skills of the country’s inhabitants.

**Foreign Aid**  
A second type of financing available to nations is foreign aid—the funds, goods, and services given by governments and private organizations to help other nations. Types of foreign aid include economic assistance, technical assistance, and military assistance. (See Figure 19.2.) Emergency shipments of food, clothing, and medical supplies to victims of drought, earthquakes, floods, and other disasters are also considered foreign aid. This type of foreign aid, however, is not directed toward economic development.

---

**Reading Check**  
Explaining Name three reasons why foreign investors are attracted to developing countries.

---

**Confiscation:** taking over industries by governments without paying for them

**Foreign Aid:** funds, goods, and services given by governments and private organizations to help other nations and their citizens

**Economic Assistance:** loans and outright grants of funds or equipment to other nations

**Technical Assistance:** aid in the form of engineers, teachers, and technicians to teach skills to individuals in other nations

**Military Assistance:** aid given to a nation’s armed forces

---

**B. Technical Assistance**  
This includes providing professionals such as engineers, teachers, technicians, and consultants to teach skills. This strengthens a nation’s human resources in the same way economic assistance increases a nation’s capital resources.

**C. Military Assistance**  
This involves giving either economic or technical assistance to a nation’s armed forces. Such assistance might include providing extensive training for a developing nation’s military.

---

**Economic Analysis**  
**Extending** What might foreign aid be used for besides economic development?
Who Supplies Foreign Aid?

Main Idea The United States devotes a smaller fraction of its GDP to foreign aid than many other countries.

Economics & You Do wealthy nations have a responsibility to help developing countries? Why or why not? Read on to learn about which nations supply the most foreign aid to developing countries.

Many developed nations offer some type of foreign aid to developing nations. After World War II, the United States devoted most of its foreign assistance to help rebuild Europe’s war-torn economy. Today, most American foreign aid is sent to developing nations in the Middle East and Southeast Asia. Nations in Africa receive about 11 percent, Latin America about 14 percent, and East Asia and the Pacific about 5 percent.

Comparing Aid Many other major industrial nations also give foreign aid. France and Great Britain, for example, have concentrated most of their aid programs on their former colonies in Africa and Asia. Germany and Japan both began giving aid to developing nations after their own economies had recovered from World War II.

The dollar amount of American foreign aid may sound high—$27.5 billion in 2005. When viewed as a percentage of Gross National Income (GNI), however, that amount is just a fraction of what many other nations give in foreign aid. (See Figure 19.3 below.) Norway’s foreign aid, for example, is 0.9 percent of that nation’s GNI. By comparison, foreign aid given by the United States is less than 0.25 percent of its GNI.

Skills Handbook See page R53 to learn about Comparing Data.

Illustration: Figure 19.3 Sources of Aid

Leading Suppliers of Foreign Aid

<table>
<thead>
<tr>
<th>In Billions of U.S. Dollars</th>
<th>As Percentage of GNI*</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>$27.46</td>
</tr>
<tr>
<td>Japan</td>
<td>13.10</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10.75</td>
</tr>
<tr>
<td>France</td>
<td>10.06</td>
</tr>
<tr>
<td>Germany</td>
<td>9.92</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5.13</td>
</tr>
<tr>
<td>Italy</td>
<td>5.06</td>
</tr>
<tr>
<td>Canada</td>
<td>3.73</td>
</tr>
<tr>
<td>Sweden</td>
<td>3.28</td>
</tr>
<tr>
<td>Spain</td>
<td>3.12</td>
</tr>
</tbody>
</table>


Economic Analysis Making Inferences Most of the countries in the chart are in what part of the world? Why do you think this is so?
Channels of Aid  The United States channels much of its foreign aid to other nations through the U.S. Agency for International Development (USAID). Funds are also channeled through United Nations agencies, including the International Bank for Reconstruction and Development—usually called the World Bank. Founded in 1944, the World Bank provides loans and other services to developing nations. Two affiliates of the bank are the International Development Association (IDA), which lends to nations that are the least able to obtain financing from other sources, and the International Finance Corporation (IFC), which encourages private investment in developing nations.

Recently, the International Monetary Fund (IMF) has become a major foreign aid agency. It has offered a variety of loans to Russia, Thailand, South Korea, Indonesia, Malaysia, Brazil, and Mexico.

These foreign aid agencies have grown increasingly alarmed as many developing nations find themselves unable to repay their foreign debts. By the late 1990s, the level of indebtedness had become extremely high, with about 40 of the most heavily indebted nations owing the IMF and the World Bank more than $127 billion. In 1999 the leaders of the major industrial nations proposed a plan that would cancel some of this debt. By 2006, 25 countries had received $83 billion in debt relief under this plan.

Reading Check  Identifying  Where is most American foreign aid sent?
Reasons for Giving Foreign Aid

**Main Idea** Foreign aid is motivated by both humanitarian and political considerations.

**Economics & You** Have you ever donated money to a charity? Why or why not? Read on to learn the reasons why many nations supply foreign aid to developing countries.

Humanitarianism is the basis of some foreign aid, but other reasons are often given as well. The first reason involves economics. It is usually in the best interests of developed nations to encourage international trade. Foreign aid expands a nation’s markets for exports and provides new opportunities for private investment.

Politics is another reason for giving foreign aid. From 1947 to 1991, an important objective of U.S. foreign aid was to enhance the appeal of democracy and stop communism. The United States has also used foreign aid to build political friends.

The final reason for providing foreign aid is to help protect a nation’s own security. Economic aid is often a downpayment on a military alliance with a developing nation. Through alliances, the United States has gained overseas military bases and observation posts. This type of plan can backfire, however, if a friendly government loses power.

**Analyzing** How has the United States benefited from military alliances formed as a result of overseas aid?

---

**Vocabulary**

1. Explain the significance of: confiscation, foreign aid, economic assistance, technical assistance, military assistance.

**Main Ideas**

2. Interpreting In a chart like the one below, explain the reasons countries are willing to provide foreign aid to developing nations.

<table>
<thead>
<tr>
<th>Reasons for Giving Foreign Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Humanitarianism</td>
</tr>
<tr>
<td>Politics</td>
</tr>
<tr>
<td>National security</td>
</tr>
</tbody>
</table>

**Critical Thinking**

3. **The BIG Idea** What risks exist for a country giving aid to another?
4. **Identifying** What two factors prevent some countries from becoming industrialized?

**Applying Economics**

5. **Monitoring Development** The United States is a developed country that has gone through the three stages explained in this section. Make a time line showing how the U.S. has gone from an agriculture-based economy through industrialization to service and technology.
GUIDE TO READING

Section Preview
In this section, you will learn about the problems that developing nations face when trying to achieve economic growth.

Content Vocabulary
- bureaucracies (p. 502)
- capital flight (p. 502)

Academic Vocabulary
- regime (p. 502)
- substitute (p. 502)
- subsequent (p. 503)

Reading Strategy
Organizing As you read, complete a web diagram similar to the one below by listing obstacles to economic growth in Indonesia.

PLACES In ThE NeWS
—from the Commercial Appeal

VIETNAM TODAY In the final days of the Vietnam War, Ly Ngoc Minh watched his friends pack their bags to flee [the country]. On April 30, 1975, as . . . tanks barreled into Saigon, he and his family decided to stay.

. . . [T]hree decades later, as Vietnam emerges from war, poverty, and isolation, and replaces crumbling Communist doctrines with free-market reforms, it turns out that he stayed long enough.

. . . In this reinvigorated nation of 82 million, Communist dogma blared daily over public loudspeakers has become background noise to the bustle of an army of new entrepreneurs. Vietnam’s 7.7 percent annual growth rate is second only to China among Asian countries.

Ruling Communist Party leaders still struggle to define what economic model they are using—"socialism with market orientation" is borrowed from neighboring China. . . .

The successful rebuilding of Europe’s economy following World War II convinced many economists that injections of money capital into a nation could achieve rapid economic growth. As a result, billions of dollars flowed into developing nations during the 1950s and 1960s. Aid to many of these nations, however, failed to produce the same growth as Europe experienced. In this section, you’ll learn why this is so.
Four Obstacles to Growth

Main Idea Local traditions, rapid population growth, misuse of resources, and trade restrictions can all hinder economic development.

Economics & You Would the problem of American poverty be solved by simply giving money to every poor person? Probably not. Read on to learn about how many developing nations also face economic problems that are not so easy to fix.

Many developing nations face a number of obstacles to growth that are not immediately solved by injections of money capital. Europe after World War II already had skilled labor forces, corporations and trade groups, and experienced government bureaucracies, or specialized offices and agencies. This is not the case in developing nations.

One obstacle to economic growth resides in people’s attitudes and beliefs. In many developing nations, people live and work much as their ancestors did hundreds of years ago. Innovation of any sort is often viewed with suspicion. Farmers, for example, may be reluctant to accept a new way of plowing, even though it means better soil conservation and a larger harvest.

A high population growth rate may also reduce the rate of growth of a nation’s standard of living. Even if a nation’s economy is growing, per capita GDP will decrease if its population is growing at a faster rate.

Development in some nations has furthermore been slowed by the misuse of resources. For example, government spending on the military could instead be directed toward agricultural development or training.

Corruption among government and military leaders also weakens the economies of many developing nations. Local currency may be legally exported or illegally sent from the country into leaders’ private bank accounts, a practice known as capital flight. Even if new, honest leaders take over, they may have inherited crushing debts from previously corrupt regimes.

Finally, to develop domestic industries, many developing nations have used import restrictions such as quotas and tariffs. These trade restrictions prevent consumers from purchasing cheaper foreign substitutes.

Explaining How can peoples’ attitudes and beliefs inhibit a developing nation’s economic growth?
Case Study: Indonesia

Main Idea  The availability of natural resources or money for investment does not guarantee economic development if unstable conditions or other obstacles to growth are present.

Economics & You  Do you own any clothing or other goods that were produced or assembled in Indonesia? Read on to learn about barriers to economic success in this nation, despite its large work force.

When Indonesia won independence from the Netherlands in 1949, it seemed well equipped for economic growth. It was rich in minerals and had vast oil reserves, as well as good farmland and rain forests. During his regime, President Sukarno obtained foreign aid totaling more than $2 billion from both capitalist and communist nations. Yet Indonesia’s economy was a disaster.

The reasons behind this failure reveal some of the problems of trying to bring rapid growth to developing nations. One problem involved attitudes. Indonesians lacked a sense of national identity. The country had been formed from several former Dutch colonies, and its people were divided by nationality, religion, and politics. The major blame for economic failure, however, can be placed on Sukarno’s economic policies.

Subsequent improvements in Indonesia’s economy were credited to General Suharto, who assumed power in 1965. Suharto’s initial economic policies made Indonesia one of the fastest-growing economies by the end of the 1970s.

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Strong opposition to capitalism resulted in loss of foreign aid from the United States.</td>
<td>1 Control of the money supply was tightened and confidence in government increased. Initially, corruption was reduced and bureaucracy decreased.</td>
</tr>
<tr>
<td>2 Foreign aid from the former Soviet Union and others was often wasted on projects for the rich such as sports stadiums and department stores. Mineral resources were not developed, and decaying roads and rail lines went without repairs.</td>
<td>2 Alliances with some Western nations were made.</td>
</tr>
<tr>
<td>3 Nationalization of businesses placed them under government ownership, discouraging foreign investment.</td>
<td>3 Foreign aid and investment increased, and resources were focused on improving agricultural output and oil production.</td>
</tr>
<tr>
<td>4 Heavy regulation of business, a huge government bureaucracy, and widespread corruption hurt the economy.</td>
<td>4 Industry was developed. More funds could be spent on industry because fewer funds were needed to import food.</td>
</tr>
<tr>
<td>5 Inflation soared out of control. The nation’s price index rose from 100 in 1953 to 3,000 only 10 years later. By the mid-1960s, the national debt was $2.5 billion.</td>
<td>5 A system of “crony” capitalism developed—family members and close friends owned or controlled major businesses.</td>
</tr>
<tr>
<td>6</td>
<td>6 The economy declined dramatically in 1998, forcing the resignation of General Suharto as the nation’s leader. Currently presidential elections are held every five years.</td>
</tr>
</tbody>
</table>
Unfortunately, Indonesia found that reliance on a few products could be dangerous. In the early 1980s, the world “oil glut” cut deeply into the nation’s trade income. When an economic crisis hit Southeast Asia in 1997–1998, Indonesia’s economy tumbled. Riots ensued and General Suharto resigned.

Indonesia’s value as a case study lies in the variety of lessons it teaches about foreign aid. It illustrates that simply pouring money capital into a developing nation will not guarantee economic growth. Indonesia also shows that growth can occur if government restrictions on economic activity are reduced.

Foreign aid must be used wisely in combination with domestic savings, foreign investment, and government policies that ensure economic stability. Finally, the case study points out that growth of a developing nation’s economy may prove temporary if it depends on only one or two products.

**Examining** Why did Indonesia initially seem well equipped for economic growth after receiving its independence in 1949?

---

**In Recovery**

Indonesia, like most Southeast Asian countries, suffered during the economic crisis that hit the region in the late 1990s. Its economy has stabilized somewhat since then. Major cities like Jakarta show signs of growing prosperity.

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**Vocabulary**

1. Explain the significance of: bureaucracies, capital flight.

---

**Main Ideas**

2. Analyzing Several obstacles prevent development in some countries. Copy the chart below, and for each example given, explain why it may slow growth.

<table>
<thead>
<tr>
<th>Obstacles</th>
<th>Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local traditions</td>
<td></td>
</tr>
<tr>
<td>Rapid population growth</td>
<td></td>
</tr>
<tr>
<td>Misuse of resources</td>
<td></td>
</tr>
<tr>
<td>Corruption</td>
<td></td>
</tr>
<tr>
<td>Trade restrictions</td>
<td></td>
</tr>
</tbody>
</table>

---

**Critical Thinking**

3. The **BIG Idea** Why did providing finances for development help improve Europe after WWII but does not often work today?

4. **Contrasting** How is humanitarian aid different from foreign investment?

---

**Applying Economics**

5. **Foreign Aid Policy** Imagine you are asked by the president to develop guidelines for giving $2 billion in aid to a developing nation. Compose a list of guidelines, and provide an explanation for each of your recommendations.
GUIDE TO READING

Section Preview
In this section, you will learn about the reasons for the rapid growth of China’s economy over the past several years.

Content Vocabulary
- five-year plans (p. 506)

Academic Vocabulary
- interval (p. 507)
- notion (p. 508)

Reading Strategy
Sequencing As you read the section, complete a time line similar to the one below by identifying key events in China’s economic development from its Communist takeover to the present day.

1950s 1970s
1980s 2000s

PLACES In ThE NeWS
— from CNN.com

GROWTH SPURT China is a sleeping giant, Napoleon once warned. “Let her sleep, for when she wakes she will shake the world.”

... Nearly two centuries later and China is well and truly awake. . . . In the space of just 25 years, China has transformed from an inward-looking communist basket case to a nation fast becoming one of the most influential in the world.

. . . [A]ccording to the World Trade Organization, China is expected to produce more than half the world’s textiles by the end of the decade.

. . . “China is certainly growing fast, but it also has a very long way still to go,” says [Dr. Linda Yueh of the London School of Economics]. “In terms of GDP per capita, it still ranks as an early developing country.”

China is growing so fast, she says, because it can’t afford not to. “China’s overriding goal is to help its people develop and achieve a higher standard of living.”

N ot all developing countries stay poor forever. China is a case in point. It now has one of the fastest-growing economies in the world. Indeed, the United States and other Western nations may be overtaken economically in the next 30 years. The main reason is that China is developing a market economy.
Development of China’s Economic System

Main Idea  China’s rapid economic growth is a result of recent free-market reforms.

Economics & You  How many commonly used goods can you think of that bear the label “Made in China”? Read on to learn about how China has transformed itself from a controlled economy into one that more closely resembles a free-enterprise system.

In 1953, the Chinese Communist government started an economic system based on five-year plans, which emphasized central planning. However, in 1957 it reformed the system to give some decision-making powers to local government. The reforms did not transform the Chinese economy, however, because it was still not governed by capitalism’s “three Ps”—prices, profits, and private property.

In 1978 Chinese leaders designed a reform to motivate people to work harder. Private individuals were permitted to rent land for up to 15 years. Each peasant household became responsible for its own plot of land. The household could keep whatever it produced in excess of a minimum amount required by the state. The results were impressive. Between 1979 and 1984, overall farm productivity increased dramatically.

During the 2000s, several hundred million rural residents moved to cities to work in factories and offices. Overseas companies started investing in many business ventures, sometimes with the Chinese government as a partner. Economic growth remains at 7 to 10 percent per year. China’s economy may become the biggest in the world in the not-too-distant future.

Reading Check  Identifying  What are the “three Ps” of capitalism?

The Shift to a Free Market  China—after the failure of command economies throughout the world—has begun to allow free enterprise.
The Transition Toward a Mixed Economy

Main Idea  The legal protection of some private property has encouraged the private investment necessary for China’s transition to a mixed economy.

Economics & You  Have you ever seen a “black market” DVD or video game? Read on to learn about the black market and other factors that challenge China’s economic improvement.

As you may recall, one of the most important aspects of pure capitalism is well-defined private-property rights. In China, the state still owns large parts of the economy, especially urban industries. In the countryside, provincial governors are still held accountable for ensuring that each province grows as much grain as it consumes. The government still leases land for 15-year intervals to farmers. Without complete property rights, farmers are therefore not interested in investing in farm equipment and making improvements to the land. Private-property rights are, however, part of the Chinese constitution.

Establishing the Rule of Law  Countries shifting from noncapitalist to capitalist systems all face the same problem—how to establish the rule of law. When no specific property rights exist, the unavoidable result is corruption. Throughout China there is an atmosphere of lawlessness and unpredictability for anyone in the business world. This is particularly true for foreign investors. Because army and government officials still control many resources, they continue to seek bribes. Thus, such individuals still influence the way business is conducted in China.

Careers Handbook  See pages R76–R80 to learn about becoming a lawyer.
Gradually China is becoming a nation of laws. The notion of property rights is slow to be accepted because communist dogma has for decades criticized private property as detrimental to the state. For example, compact disc factories in China routinely “pirate” CDs. The Chinese government supported this practice, but at one point shut down the factories because of international pressure. The pirates reopened a few years later, however. Chinese government officials ignored the fact that singers and musicians were being denied royalties.

**Dealing With Increasing Pollution** In the middle of the first decade of the 2000s, the Chinese government made a prediction. Pollution levels could rise 400 percent in 15 years! Even today, China is the world’s second biggest producer of undesirable gas emissions into the atmosphere. Acid rain affects a third of the country. China’s air pollution even travels to far-off places, such as Los Angeles, and about 70 percent of China’s rivers and lakes are polluted. Most city residents drink bottled water. In the countryside, people boil water before they drink it.

The question facing the government is not easy to answer. How does it change a booming, pollution-creating economy without slowing economic growth?

**Determining Cause and Effect** Why has China been slow to accept the notion of private property rights?

**China’s Black Market**

In China, consumers can buy Nike T-shirts for less than $2, DVDs for under $3, and music CDs for a fraction of their cost in the United States. Many Chinese “entrepreneurs” produce and sell American brand-name products very inexpensively because they do not pay royalties on the brands they counterfeit.
Prospects for China’s Economic Future

China has encouraged foreign investment in its economy to promote growth and access to global markets.

Economics & You When you think of a Chinese city, what do you imagine? Many places in China are actually quite similar to the United States. Read on to learn about the expanding foreign presence in China.

A foreigner visiting Beijing or Shanghai or another large city in China would have difficulty knowing he or she was in the People’s Republic of China. There are McDonald’s restaurants, business executives with cellular phones and pagers, and advertisements for Levi’s, 7Up, and Heinz products everywhere.

In 2000 that foreign presence began expanding when the United States agreed to allow China to join the World Trade Organization (WTO), which you read about in Chapter 18. This action had far-reaching effects for China and the rest of the world.

China is an enormous market for foreign companies eager to sell their products to the nation’s 1.3 billion people. As a result of being admitted to the WTO, the inefficient state-owned industries draining China’s economy were forced to face many economic reforms. WTO membership has increased the prospects for a more prosperous, democratic, and stable China.

Explaining How has joining the World Trade Organization (WTO) affected the Chinese economy?

Vocabulary
1. Explain the significance of: five-year plan.

Main Ideas
2. Analyzing How did the Chinese economic system develop following World War II?
3. Determining Cause and Effect Create a chart like the one below to explain two major problems China is facing in its move toward capitalism.

<table>
<thead>
<tr>
<th>Problem</th>
<th>Cause</th>
<th>Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea In the past, China’s government has been involved in setting production quotas for industries. This continues to a certain extent today. How could such a practice lead to surpluses and shortages of goods and services?
4. Synthesizing Why has the black market continued to thrive in China?

Applying Economics
5. International Trade Research the World Trade Organization on the Internet. Find and summarize the issues surrounding China’s entry into the organization in 2000.
During the 1900s, Karl Marx’s name was often associated with the Russian Revolution and, later, with the Soviet Union. In fact, though he traveled widely, Marx never set foot in Russia.

He was born into a respectable middle-class family in Germany and was descended, on both sides of his family, from generations of Jewish rabbis and scholars. His father converted to Christianity, and young Karl was baptized as a Lutheran in 1824.

Marx attended a local Jesuit high school, eventually earning a doctorate in 1841. It wasn’t until he moved to Paris that he began to familiarize himself with the tenets of communism. While there he met many well-known socialists, including Friedrich Engels, who became his lifelong friend and collaborator and the person most responsible for converting him to the cause of communism. As the result of his advocacy of revolution, Marx was expelled from Paris. In time he was also expelled from Brussels and Prussia, finally immigrating to England, where he spent the remainder of his life.

His years in London with his wife and children were plagued by poverty, serious illnesses, and death. It was during this period that he wrote, in collaboration with Engels, one of his major works, *Capital: A Critique of Political Economy*.

Marx and Engels were prolific and insightful writers on many social and economic subjects. Their collected works run to 50 volumes. Yet today they are chiefly remembered for the prophetic, if now dated, sentences at the end of *The Communist Manifesto*, one of the most influential pieces of revolutionary propaganda ever written:

“The proletarians have nothing to lose but their chains. They have a world to win. WORKING MEN OF ALL COUNTRIES, UNITE!”

**Checking for Understanding**

1. **Theorizing**  What is it about the quote from *The Communist Manifesto* that makes it so memorable?

2. **Making Inferences**  Why do you think so little of Marx’s writings are known and quoted today?
Economists use per capita GDP as a measure of a nation’s prosperity. There is a huge difference in per capita GDP between developed and developing nations.

Although developing nations receive capital from developed nations in the form of foreign investment and aid, they still face obstacles to growth.

China’s rapid economic growth is a result of recent free-market reforms. An American visitor to Beijing would find that city to be very much like large cities in the United States.
Review Content Vocabulary

1. Write a paragraph or two explaining economic growth in developing nations. Use all of the following terms.
   - developed nations
   - economic assistance
   - technical assistance
   - military assistance
   - subsistence agriculture
   - infant mortality rate
   - confiscation
   - foreign aid

2. After receiving aid, developing countries often see ______ improvement in their economies.

Review the Main Ideas

Section 1 (pp. 489–493)

11. Fill in a graphic organizer like the one below to identify the five characteristics common to most developing nations.

   ![Characteristics of Developing Nations]

12. How does a weak system of legally protected property rights affect economic development?

Section 2 (pp. 495–500)

13. What is the difference between military assistance and technical assistance?

14. What are the three stages of economic development? In what stage are most developing countries?

Section 3 (pp. 501–504)

15. How is rapid population growth an obstacle to economic development?

16. What is the danger of a nation relying too heavily on income from just a few products?

Section 4 (pp. 505–509)

17. Why has China been steadily shifting from a noncapitalist to a more capitalist system? What has been the result?

18. What are the main problems that China must still overcome?
Math Practice

In December 2004, a major earthquake caused a tsunami, or giant tidal wave, to hit parts of Asia and Africa. It caused terrible devastation and loss of life. Almost 200,000 people died, and many more lost their homes and their livelihoods. The United States immediately offered aid that included food and medical supplies, funds for rebuilding, experts to provide training, and programs to restore people's jobs and incomes. Look at the Tsunami Aid Summary below and answer the questions that follow.

### Tsunami Aid Summary

<table>
<thead>
<tr>
<th>Country</th>
<th>Amount of Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>$17.9 million</td>
</tr>
<tr>
<td>Indonesia</td>
<td>$400.1 million</td>
</tr>
<tr>
<td>Maldives</td>
<td>$12.0 million</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>$134.6 million</td>
</tr>
<tr>
<td>Thailand</td>
<td>$5.3 million</td>
</tr>
<tr>
<td>Other Countries</td>
<td>$33.4 million</td>
</tr>
<tr>
<td>Program Management</td>
<td>$21.4 million</td>
</tr>
</tbody>
</table>

Source: www.usaid.gov

Critical Thinking

19. Based on the information in the table, which country was hardest hit by the tsunami?

20. How much more U.S. aid did India receive than Thailand?

21. What is the total tsunami aid budget as represented in this table?

22. What percentage of the tsunami aid budget was dedicated to program management?

Analyzing Visuals

26. Study the cartoon on the right, and then answer the following questions.

a. What does the speaker in this cartoon represent?

b. What irony is the cartoon conveying?

c. What do you think the cartoonist's attitude is about how developed nations treat developing ones?
Case Study: ECONOMICS AND CULTURE

Can developing countries improve local economies while conserving natural resources?

THE ISSUE
As developing countries struggle to expand their economies, some exhaust natural resources, like forests, in the process. Once the trees are gone, communities may lose their livelihood, and the animals that live there lose the habitat they need to survive. Dr. Jane Goodall, a primate scientist, ran headlong into this problem when she first tried to save endangered chimpanzees in Tanzania. In order to save the chimps, she and her team had to save the forests; to save the forests, they had to find better ways than logging for the Tanzanian people to earn a living. Is it possible for developing economies to advance their economies without damaging the environment?

THE FACTS
Forests convert toxic carbon dioxide given off by cars and factories into healthful oxygen. They are also home to millions of animals and medicinal plants. Forests once covered two-thirds of the Earth’s surface (not counting Antarctica and Greenland). In the past few decades, forest loss has greatly accelerated. Today, half the world’s forests are gone—32 million acres are lost each year. Forest loss can have a devastating environmental impact. However, the natural resources of developing nations are often the only foot in the door to the global economy that these nations have available to them.

Resource Capacity
Which countries use more or fewer total resources than they have available?

Source: Global Footprint Network, 2005
THE ECONOMIC CONNECTION: OPPORTUNITY COSTS

The main problem with the use of natural resources in many developing nations is that these resources are depleted for short-term economic gain only. In order to sustain populations and survive economically, nations must learn how to nurture and sustain their resources over the long term.

In Tanzania, for example, forests are lost because logging trees seems more profitable than conservation. In the case of the Tanzanian villages, the residents thought selling the trees and using the land to grow crops made sense. However, land left after forests are destroyed is less profitable and not fertile enough for long-term agriculture or grazing.

The strategy of the nonprofit Jane Goodall Institute (JGI) in Tanzania is to develop local economies by working with villagers to meet both short- and long-term community needs. So far, villagers have raised 2.4 million seedlings for firewood, built fuel-efficient stoves, planted 750,000 trees in 32 villages, and passed bylaws forbidding clear-cutting of trees. Village committees promote nontimber forest use, such as beekeeping and harvesting of herbal medicine. Farmers are trained in sustainable methods for growing coconut, coffee, and vegetables. More than 73 chapters of JGI’s worldwide Roots & Shoots program involve Tanzanian youth in environmental projects. Other issues addressed are health, education, resource management, and small business loans.

CONCLUSION

Whenever short-term profit requires destruction of resources that cannot be replaced, it’s important to weigh the opportunity cost. Although economic development often seems at odds with environmental protection, cooperation among communities, business, and government—combined with long-term vision—can find solutions. As the Jane Goodall Institute has shown in Africa, it is possible to meet human needs while promoting conservation values.

Analyzing the Impact

1. **Synthesizing**: Why do some land owners in developing countries log and burn forests? What are the results?
2. **Critical Thinking**: Name two ways in which your community could use sustainable practices to benefit the local economy.
The **BIG Idea**

The study of economics helps us deal with global economic issues and global demand on resources.

**Why It Matters**

How are you personally affected by activities in the global economy? In this chapter, read to learn why global integration is now a fact of life.

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**Economics ONLINE**

**Chapter Overview** Visit the *Economics Today and Tomorrow* Web site at [glencoe.com](http://glencoe.com) and click on *Chapter 20—Chapter Overviews* to preview chapter information.
In the United States, it is not unusual to ride on a bus that was made in Germany or drive a Japanese-made car. A Canadian may own a local restaurant. Some of the restaurant’s food perhaps has been imported from Mexico, France, and Spain. Interest rates may fall because political upheavals in other countries have caused businesses there to invest their money capital in politically stable America. In this section, you’ll learn that we now live not just as Americans, but as part of the global economy.
Improved Telecommunications

Main Idea Advances in telecommunications have significantly reduced the costs of business.

Economics & You Many of the technologies that you have access to every day, such as the Internet or satellite television, play an important role in worldwide communications as well. Read on to learn about how these innovations have affected the global economy.

Global integration—the interdependency among countries—has increased dramatically over the past several decades. Many reasons explain this increase. One reason is improved telecommunications, or long-distance electronic communication.

The first transatlantic telegraph cable was completed in 1866. Before then it took two weeks to find out the price of the dollar in London. The telegraph cable reduced that time to two minutes. With the invention of the semiconductor—the computer chip—telecommunications grew rapidly. Look at Figure 20.1 below, which shows how much the price of computing power has fallen in just the last few decades.

Several other inventions and factors have influenced the rapid improvement in worldwide telecommunications. Communications satellites circle the Earth day and night. Radio and television waves, beamed up to them, are reflected down to other parts of the Earth. On the Earth’s surface, fiber-optic cables are being placed throughout much of North America and already exist in parts of Europe. The rapid expansion of the Internet has also been an important aspect of the worldwide communications system.

Figure 20.1 Decreasing Costs

The price per million units of computing power (expressed in millions of instructions per second, or MIPS) has fallen dramatically from 1978 to today.

Economic Analysis Synthesizing How does the falling cost of computing power affect the price of computers themselves?


*Author’s estimate
Consider some of the ways cheap and readily available satellite television has transformed the exchange of information between the Eastern Hemisphere and other parts of the world. Before the 1990s, virtually all of the television (and radio) available in the Eastern Hemisphere was both state-run and state-controlled. Viewers saw few programs and advertisements from other parts of the world. Today, people in Asia, Africa, and other regions of the world receive sports, music, soap operas, news, and advertisements via satellite, and much of this information is free of government control.

How does this increase in communications affect the rest of the world? Viewers in other nations are changing their cultural tastes and buying habits. In many countries, viewers buy copies of outfits worn by popular music, film, and television personalities from the United States and Europe. Viewers demand foreign products they see advertised on television, which increases exports from the originating nations. In addition, because many popular television programs are transmitted in English, more of the world’s people want to learn English as a second language.

Predicting Consequences How has the increased availability of satellite television impacted nations of the Eastern Hemisphere?
The Globalization of Financial Markets

Main Idea  U.S. government securities, foreign exchange, and stocks are now traded continuously around the world.

Economics & You  The September 11, 2001, terrorist attacks affected not only the American economy, but foreign stock markets as well. Read on to learn about what it means to have a global economy.

Because of the speed and power of computers and the affordability of telecommunications, the world has become one financial market. This globalization started in the 1970s and 1980s, when U.S. banks developed worldwide branch networks for loans and foreign exchange trading. Today money and financial capital markets are truly global, and many stocks and bonds are traded on them.

United States government securities (bonds that the U.S. government sells), foreign exchange, and shares of stocks are now traded continuously in vast quantities around the world. Trading in U.S. government securities is the world’s fastest growing 24-hour market. Foreign exchange—the buying and selling of foreign currencies—became a 24-hour worldwide market in the 1970s. Markets also exist worldwide in commodities such as grains, gold and silver, and stocks. The worldwide stock market, started in the mid-1970s, however, has some problems.

Global Trading

Computers have transformed the world into one integrated financial market. Here, a man in Kuwait tracks stocks at the Kuwait Stock Exchange.
**Problems With the Worldwide Stock Market**  
The United States economy represents a major part of the world economy. So, when the U.S. stock market falters, so do the stock markets worldwide. For example, on October 19, 1987, the United States stock market suffered one of its worst days ever. The Dow Jones Industrial Average dropped over 500 points. It took two years for the United States stock market to recover, but many foreign stock markets took even longer.

On September 11, 2001, one of the most devastating acts of terrorism in history occurred. The World Trade Towers in New York City were destroyed, and thousands lost their lives. When the stock market reopened on September 17, the Dow fell by almost 700 points. In the meantime, stock markets worldwide had already fallen in response. Fortunately, stock markets at home and abroad started to recover within a few months.

**Spreading Risks**  
It’s possible now to spread both banking and investment risks around the globe. Business conditions might be good in the United States but poor in another country, or vice versa. Banks and investors can spread their risks by lending and investing in a variety of countries. You could, for example, put some of your savings into a mutual fund that buys shares of stock or bonds in companies in different countries. In that way, you would be spreading your risk.

**Reading Check**

**Identifying**  
What is one problem with the worldwide stock market?

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**Vocabulary**

1. **Explain** the significance of: global integration, telecommunications.

**Main Ideas**

2. **Examining** In a diagram like the one below, list the transformations that satellite communication has brought to the world in recent years.

![Satellite Communication Diagram](image)

**Critical Thinking**

3. **The BIG Idea**  
What advantage has globalization brought to stock investors?

4. **Evaluating**  
Why is the U.S. stock market watched so closely?

**Applying Economics**

5. **Innovations**  
Make a list of the most important inventions you have seen come about in your lifetime. Then ask a grandparent or other older adult to tell you about important inventions they have seen in their lifetime. Compare the list and summarize the effect inventions have had in recent years.
On June 14, 2003, Anita Roddick was awarded the title of Dame Commander of the British Empire, an honor awarded to those who have provided valuable service to the United Kingdom. This was quite an achievement for the daughter of Italian immigrants. It was, in fact, just one of many honors and awards she has received over the years.

The source of Roddick’s acclaim is The Body Shop, the cosmetic and toiletries company she founded in 1976 when she opened her first store in the seaside city of Brighton, England. Twenty-nine years later, The Body Shop was a global enterprise with 2,050 stores worldwide and sales of $1.2 billion.

The secret of Roddick’s success has as much to do with operating in an ethical manner and with a dedication to environmentally sound practices as with her business skills. “The business of business,” she wrote, “should not just be about money, it should be about responsibility. It should be about public good, not private greed.” She opposed testing cosmetics on animals, refused to buy products manufactured by sweatshops, and insisted on using raw materials produced by sustainable methods. Apparently this approach appeals to her millions of customers.

“Today, it is impossible to separate the company values from the issues that I care passionately about—social responsibility, respect for human rights, the environment and animal protection. . . .”

Checking for Understanding

1. **Explaining** What type of people are The Body Shop customers likely to be? What issues might they care about?

2. **Analyzing** In what ways can operating in an ethically and environmentally sound manner help or hurt a business?
GUIDE TO READING

Section Preview
In this section, you will learn about the advantages and drawbacks of foreign investment in the United States.

Content Vocabulary
- direct foreign investment (DFI) (p. 524)

Academic Vocabulary
- identical (p. 524)
- despite (p. 526)

Reading Strategy
Organizing As you read, complete a table like the one below by listing the fears that some Americans have about direct foreign investment, along with possible responses to these concerns.

<table>
<thead>
<tr>
<th>Fear</th>
<th>Response</th>
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ISSues In ThE NeWS
—from the Chicago Sun Times

THE OTHER SIDE OF OUTSOURCING Illinois ranks fourth in the nation in the number of “insourced” jobs—jobs from the U.S. operations of companies based abroad—according to a new study that seeks to counter criticism on the loss of jobs to outsourcing.

... “The point of doing this study was to say there’s been a lot of ink spent on outsourcing, people that lost jobs because plants moved to China or India” and elsewhere, said Todd Malan, president and chief executive of the [Organization for International Investment]. “That’s an aspect to global trade we have to look at, but we also have to look at the positive side... jobs coming into the United States and jobs supported by foreign investment.”

Who owns whom? Nothing seems more American than Burger King or the Pillsbury Dough Boy, right? Not quite, for those companies are now owned by the British. In addition, the Japanese own about 20 percent of the office space in downtown Los Angeles, and a Thailand-based firm owns Chicken of the Sea tuna. Throughout the world, American companies have likewise purchased foreign firms. As you read this section, you’ll learn that foreign investment has grown considerably in the past 20 years.
Foreign Investment, Then and Now

Main Idea Direct foreign investment in the United States has continued to grow as global integration of economic activity has progressed.

Economics & You Would you buy a foreign-made automobile? Why or why not? Read on to learn about some Americans’ concerns about the role of foreign companies in the United States.

There is a long history of foreign investment in the United States. For example, Great Britain was the biggest foreign investor in American railroads in the late 1800s and early 1900s. At the beginning of World War I, the United States owed more to foreign lenders than any other country in the world.

Direct Foreign Investment In the United States today, however, direct foreign investment (DFI)—the purchase of real estate and businesses by foreigners—has increased to the point where some Americans want to restrict it. In any single year, foreigners purchase billions of dollars of American real estate and businesses. Any time political upheaval strikes in another part of the world, foreign investment in the United States increases because we remain a politically stable country.

Foreign Control of American Companies Many people argue against foreign ownership of American companies because they worry about foreign control. Is foreign control important? Presumably, foreign investors purchase American assets in order to maximize profits. Foreigners’ interests in running a corporation would seem to be identical to the interest of any domestic investor who owned the same corporation. The profit-making behavior of a corporation does not depend on the nationality of that corporation. If the British took over a hotel on Miami Beach, would the service necessarily be any different in the long run? Economists do not think so.

Visible Foreign Investment

Unlike Burger King or other companies that are not obviously owned by foreigners, some companies are clearly visible as being foreign-owned. Toyota is one of these.
What about the foreign investors’ influence over the U.S. government? Foreigners own about 50 percent of all U.S. government securities that now exist. Can they use this to control American foreign policy? Probably not. Foreigners purchase U.S. government securities only when they think the rate of return is higher than they can get elsewhere.

In reality, the United States government has more control over foreigners. Because they own about 50 percent of the United States public debt, as you can see in Figure 20.2, foreign investors are subject to U.S. government policy. For example, the federal government, through its Federal Reserve System, could create tremendous inflation. In doing so, it would wipe out the real value of the United States government debt that foreigners own.

In a larger sense, foreign corporations may indirectly influence our government. Our government cannot make the business climate in America too difficult for these corporations or they will take their investments elsewhere. The positive side of this situation is that domestic corporations benefit from the hands-off approach of government toward foreign-owned businesses.

Determining Cause and Effect How is foreign investment in the United States affected by political upheaval in other nations? Why?
Investment Here and Abroad

**Main Idea** Consumers usually care more about the quality and price of a company’s product than about the extent to which foreigners control that company.

**Economics & You** Have you ever traveled to another country? Read on to learn about how U.S. investments abroad influence other cultures.

Despite the concern some have about foreigners “owning” the United States, the total share of foreign ownership of American industries is about 10 percent. Although foreign investment here is readily visible, foreign investment is relatively low when compared to that of other nations. How much investing do American companies carry out abroad? The U.S. share of worldwide direct investment is more than 40 percent. Indeed, throughout the world many people fear that U.S. culture has taken over everyone else’s culture. Some people have called this economic imperialism.

Most consumers, however, have little knowledge about who owns the companies that provide the goods or services they purchase—and they do not really care. Some even argue that we should encourage direct investment and debt purchases by foreigners. Foreigners then would have an increased incentive to want the American economy to remain strong and stable.

**Skills Handbook**

See page R38 to learn about Distinguishing Fact from Opinion.

**Explaining** What is economic imperialism?

**Review**

**Vocabulary**

1. Explain the significance of: direct foreign investment (DFI).

**Main Ideas**

2. Determining Cause and Effect In a diagram like the one below, list three effects of foreign investment in the U.S. and three effects of the U.S. investing elsewhere.

   ![Diagram of DFI into the U.S. and DFI by the U.S.]

   $$ $$

   $$ $$

   $$ $$

**Critical Thinking**

3. The BIG Idea Why do Americans accept DFI from foreign countries?

4. Synthesizing What might encourage a foreign country to buy U.S. securities?

5. Analyzing What is the advantage to the U.S. when foreign countries buy our currency?

**Applying Economics**

6. Foreign Investments Use the Internet to find three foreign companies you might want to invest in. What country is the company in? What do they make or own? Why do you think the value of their stock might rise?
Much international or cross-border investing is undertaken by firms that do business or have offices or factories in many countries. In the past, critics argued that because these firms are so large, they may come to dominate the world economy. Such firms were sometimes seen as ruthless companies that would exploit the poor and manipulate governments. In this section, you’ll learn that these large firms usually set up operations on a regional basis, often forming alliances in the process.
The Size and Number of Multinationals

Main Idea The top 100 multinational firms account for almost 50 percent of all cross-border assets.

Economics & You Have you ever made a purchase from Wal-Mart, General Motors, or Microsoft? If so, then you were supporting a multinational company. Read on to learn how many of these multinationals exist today.

Firms that do business and have offices or factories in many countries are known as multinationals. In the 1970s, many people predicted that a few hundred multinationals would control 80 percent of the world’s production by the mid-1980s. By 2006, there were about 60,000 multinational corporations, with about 620,000 foreign affiliates, or branches of their firms. The foreign affiliates of the world’s top nonfinancial companies accounted for about $2.9 trillion in assets.

Worldwide Ownership The top 100 multinationals are very important, accounting for almost 50 percent of all cross-border assets. This means nothing, however, without comparing these assets to the worldwide total. In 2006, the top 100 multinationals accounted for less than 20 percent of the world’s productive assets—hardly an overwhelmingly dominant share. Today, the United States and Great Britain no longer dominate multinationals. Americans, Japanese, Germans, and the Swiss own only a little more than half of them. Numerous multinationals are based in the industrializing nations of Asia, such as China, Taiwan, South Korea, and Malaysia.

### The Largest American Multinationals

<table>
<thead>
<tr>
<th>Rank/Company</th>
<th>Revenue*</th>
<th>Net Income*</th>
<th>Assets*</th>
<th>Market Value*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Citigroup</td>
<td>120.32</td>
<td>24.64</td>
<td>1,494.04</td>
<td>230.93</td>
</tr>
<tr>
<td>2. General Electric</td>
<td>149.70</td>
<td>16.35</td>
<td>673.30</td>
<td>348.45</td>
</tr>
<tr>
<td>3. Bank of America</td>
<td>85.39</td>
<td>16.47</td>
<td>1,291.80</td>
<td>184.17</td>
</tr>
<tr>
<td>5. ExxonMobil</td>
<td>328.21</td>
<td>36.13</td>
<td>208.34</td>
<td>362.53</td>
</tr>
<tr>
<td>6. JPMorgan Chase</td>
<td>79.90</td>
<td>8.48</td>
<td>1,198.94</td>
<td>144.13</td>
</tr>
<tr>
<td>7. Wal-Mart Stores</td>
<td>312.43</td>
<td>11.23</td>
<td>138.17</td>
<td>188.86</td>
</tr>
<tr>
<td>8. Chevron</td>
<td>184.92</td>
<td>14.10</td>
<td>124.81</td>
<td>126.80</td>
</tr>
<tr>
<td>9. Berkshire Hathaway</td>
<td>76.33</td>
<td>6.74</td>
<td>196.71</td>
<td>133.67</td>
</tr>
<tr>
<td>10. Procter &amp; Gamble</td>
<td>61.68</td>
<td>7.79</td>
<td>136.52</td>
<td>197.12</td>
</tr>
</tbody>
</table>

Source: www.forbes.com  
*All figures are in billions of dollars.  
Rankings are based on a composite score for sales, profits, assets and market value.
Regional Cross-Border Investments Although many of the biggest multinationals invest all over the world, most invest in regions that are closest to home. The European Union, for example, conducts more direct foreign investment in western Europe than anywhere else.

In a world in which borders matter less, the line separating sales at home and those abroad becomes less important. The most appropriate way to look at patterns of direct investment is to include direct domestic sales as a part of regional sales. European firms principally invest in western Europe. American firms principally invest in the United States, Canada, Mexico, and South America. Japanese firms principally invest in Japan, South Korea, China, and Southeast Asia.

Beyond Multinationals—Alliances In addition to multinational direct investments in other countries, firms in different countries are forming alliances. These may be joint ventures or licensing deals. Indeed, many foreign governments have insisted that multinationals enter their markets through joint ventures with local firms in the hope that locals will capture some of the profits.

Most alliances have been between firms from industrialized countries. Alliances are even popular within nations like the United States. International Business Machines (IBM), for example, developed its personal computer in alliance with Microsoft (for the software), Intel (for the central processing unit), and Lotus. In the late 1980s, IBM entered into an alliance with Siemens of Germany to work on memory chips. In the 1990s, IBM entered into an alliance with Apple Computer, once its archrival. (In late 2004, IBM sold its personal computer business to a Chinese company, Lenovo Group.)

Alliances can be seen as each firm’s acceptance of its own limitations, whether they are financial, technological, or geographical. Alliances can be used to help a firm leapfrog its competitors or catch up to them. Such a strategy is particularly effective in industries that have seen rapid changes, such as software.

Summarizing How has ownership of multinationals changed in the last three decades?
The Global Village and Tolerance

Main Idea Economic globalization has the potential to promote greater tolerance of diversity within society.

Economics & You Do you speak a foreign language, drive a foreign-made car, or have friends or classmates from ethnic, cultural, or racial backgrounds different from your own? Read on to learn why it is important to embrace diversity in today’s globalized world.

One of the social results of the globalization of our world is increased immigration. America has become a truly multicultural society because of such immigration. In many cities the combined number of African Americans, Hispanics, Asians, and other minorities now constitutes a majority of the population.

In the 1980s, the Asian population in America increased more than 100 percent. In 2003, Hispanics became the largest minority group in the United States. With so many immigrants, public schools are more diverse. This diversity means that the need for tolerance and open-mindedness is more important today than it ever has been. For Americans, this includes learning one or more foreign languages and maintaining friendships with those of different ethnic, cultural, national, and/or religious backgrounds.
Globalization has also meant hiring firms from other countries to handle calls for customer service. For example, when you call with a computer problem, you may be connected with someone in India, Jamaica, or Scotland. In the same vein, many companies in Mexico send their financial information via the Internet to U.S. accounting firms for preparation of financial statements. Sometimes U.S. hospitals send digitized X-rays to physicians in India for quick diagnoses, especially during the middle of our night when it is daytime over there.

These continuing and increasing contacts with foreigners help U.S. residents understand that all global citizens have more in common than many people realize.

Identifying What is the largest minority group in the United States today?

Review

Vocabulary
1. Explain the significance of: multinationals, foreign affiliates.

Main Ideas
2. Outlining Copy the outline below, and list at least four pros and cons of multinationals.

<table>
<thead>
<tr>
<th>Effects of Multinationals</th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Pros</strong></td>
<td><strong>Cons</strong></td>
</tr>
<tr>
<td>A.</td>
<td>A.</td>
</tr>
<tr>
<td>B.</td>
<td>B.</td>
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<tr>
<td>C.</td>
<td>C.</td>
</tr>
<tr>
<td>D.</td>
<td>D.</td>
</tr>
</tbody>
</table>

Critical Thinking
3. The BIG Idea Why might an economist support the formation of economic alliances between countries?
4. Contrasting What is the difference between a multinational and an affiliate?

Applying Economics
5. Multinational Corporations Use an Internet search engine to find five multinational corporations. Make a chart that shows where each company is based, where it has affiliates, and some of the products it produces.
Geography is so twentieth century.

Check It Out! In this chapter you learned that globalization has increased dramatically over the past several decades. The following article proves that point.

When it comes to work, geography doesn’t matter anymore. Even in smaller companies, a growing number of people now operate in teams spread across continents. They use standardized information technology platforms for laptop computers, e-mail addresses, mobile phones, and intranet access. Whether you’re in Singapore or Sunnyvale, California, is irrelevant. With portable phone numbers and e-mail addresses, in fact, it can be tough to pinpoint where someone is on the planet. Meanwhile, two people on the same city block can be working in different time zones to serve a far-flung customer base. At 7 A.M., one could be ending the day while the other munches on cereal.

While the post-geographic world has made it possible for far-flung workers to collaborate like neighbors, there are challenges. Your Shanghai team members may be waking up just as the Chicago-based folks are going home—and London may need you online at 3 A.M. The result is a workday that could conceivably span 24 hours, if the limits of human biology didn’t kick in. People must learn to work to the ebb and flow of their own schedule—and reach out in new ways. Though geography may have become less relevant, the need for community never goes away.

—Reprinted from BusinessWeek

Global Matters

If you do have to travel to another country, know your manners. One Web site offers this advice for doing business in Japan:

- Refrain from discussing business until after the first few minutes of any conversation.
- Avoid discussing World War II or making jokes.
- Wait to be invited before presuming to use first names.
- Gift-giving is an important part of Japanese protocol. Present your gifts with both hands.
- If you are invited to a Japanese home, bring flowers (an uneven number), cakes, or candy. Giving four or nine of anything is considered unlucky.

Think About It

1. Identifying What technologies make global teams possible?
2. Defending Do you believe global technologies make the ways in which people work more or less efficient? Why?
Developments in technology are strongly tied to the growth of the global market. 

Foreign investment and foreign ownership of U.S. debt have grown significantly over the past few decades.

Multinationals are firms that do business in many countries. Today, there are over 60,000 multinational corporations in the world.

Citigroup is the world's largest multinational corporation.
Review Content Vocabulary

1. Write a paragraph or two explaining global integration. Use all of the following terms.
   - global integration
   - multinationals
   - telecommunications
   - foreign affiliates
   - direct foreign investment (DFI)

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. transform  
   b. transmit  
   c. recover  
   d. identical  
   e. despite  
   f. manipulate  
   g. appropriate  
   h. ethnic

2. Global communication has the power to _____ traditional societies into more modern ones strongly influenced by Western cultures.

3. The profit-making motivation of foreign-owned companies is _______ to that of U.S.-owned companies.

4. The U.S. economy has continued to grow _______ concerns about direct foreign investment.

5. One result of globalization is that people have had to learn to be more tolerant of different cultural, _______, and religious backgrounds.

6. One can _______ messages around the world in an instant using satellite communications and the Internet.

7. Some are concerned that giant multinational companies might grow powerful enough to _______ governments into doing what they want.

8. Advising caution about foreign investment is _______, but it should not keep the United States from globalizing its economy.

9. When a stock market falls dramatically, it may take months or years for it to _______.

Review the Main Ideas

Section 1 (pp. 517–521)

10. Why has improved telecommunication led to increased global integration?

11. What happened elsewhere in the world economically when the U.S. stock market crashed in 1987?

12. Why is English a popular second language for many people around the world?

13. How did the terrorist attacks of September 11, 2001, affect the American economy?

Section 2 (pp. 523–526)

14. Why do foreigners purchase United States government securities?

15. In what ways do foreign corporations indirectly influence the U.S. government?

16. What is the United States’s share of worldwide direct investment?

Section 3 (pp. 527–531)

17. People in what four countries own about half of the multinationals that exist today?

18. Why do firms in different countries form alliances with one another?

19. Fill in a graphic organizer like the one below to list some of the benefits of economic globalization for the United States.

**Benefits of Globalization**

- Transform
- Transmit
- Recover
- Identical
- Despite
- Manipulate
- Appropriate
- Ethnic

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**Graphic Organizer**

- Transform
- Transmit
- Recover
- Identical
- Despite
- Manipulate
- Appropriate
- Ethnic
Thinking Like an Economist

20. Using a chart like the one below, make a list of reasons people give for why they are concerned about direct foreign investment in the United States or foreign ownership of U.S. debt. For each reason, present a counter-argument.

<table>
<thead>
<tr>
<th>Reason for Concern About DFI</th>
<th>Counter-argument</th>
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Math Practice

21. Look back at the graph showing foreign ownership of the U.S. debt on page 525, and note what the percentage of ownership was in 2005. If that percentage decreased by 20%, what would the new percentage of ownership be?

Critical Thinking

22. **The BIG Idea** Although cheap telecommunication is widespread in industrialized nations, it is not so widespread in developing nations. What will happen to global integration as developing nations catch up to the developed nations?

23. **Explaining** A foreign company buys an American company. Explain why that company might not necessarily be run any differently from other American companies.

24. **Evaluating** What are some possible advantages and disadvantages of multinationals and alliances?

Analyzing Visuals

25. Study the cartoon on the right, and then answer the following questions.

   a. What do the musicians represent?

   b. What does the word *synchronized* mean?

   c. What is about to happen to the musicians? What does this imply about the cartoonist’s expectations for the global economy?
Debating Economic Issues

Is Globalization Good for Everyone?

Whether you see globalization as an opportunity or a threat depends on who and where you are. Those in favor define globalization as the free flow of funds and products throughout the world—investment and marketing without borders. They believe it will lead to shared global values, political unity, reduced corruption, and increased wealth. Opponents say Western capitalists are forcing their economic system and consumer culture on other countries. They blame globalization for the loss of American jobs and the widening gap between the rich and the poor. Is globalization good for all?

YES! Globalization increases everyone’s options

Under... "globalization"... our options and opportunities have multiplied. We don't have to shop at the big local company; we can turn to a foreign competitor. We don't have to work for the village's one and only employer; we can seek alternative opportunities. The world's culture is at our disposal. . . . Our ability to control our own lives is growing, and prosperity is growing with it.

Free markets and free trade and free choices transfer power to individuals at the expense of political institutions. . . . No company would import goods from abroad if we didn't buy them. If we did not send e-mails, order books, and download music every day, the Internet would wither and die. We eat bananas from Ecuador, order magazines from Britain, work for export companies selling to Germany and Russia, vacation in Thailand, and save money for retirement by investing in South America and Asia. These things are carried out by businesses only because we as individuals want them to.

—Johan Norberg, The American Enterprise Online
Debating the Issue

1. **Explaining**  How does globalization help poor workers in developing countries? What are its disadvantages for these people?

2. **Choosing Sides**  The two writers disagree about whether globalization helps everyone. Which writer do you agree with? Why?

Find Out More!

3. **Analyzing**  After making jeans in America for 150 years, Levi Strauss closed its last U.S. factory in 2003 and moved its manufacturing plants overseas. Use the Internet to find other companies who have outsourced jobs. Then write a short essay explaining why you would or would not be willing to pay higher prices for goods if it meant saving American jobs.
Reference Section

Personal Finance Handbook .................. R1
Skills Handbook ................................ R34
Databank ...................................... R60
Careers Handbook ............................ R76
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Financial Fitness:
Money and Real Life

• Can you afford a cool car?
• How can you avoid the credit trap?
• Is college for you?
• Can you become a millionaire?

Only you can answer those questions—and thousands of others. Your life is ahead of you; it’s up to you to decide how you’ll live it. Whatever goals or dreams you may have, the way you live your life will be determined, at least in part, by your relationship to money: how you get it and how you use it.

The opportunities you create for yourself are greatly affected by the money habits you form when you’re young. This handbook is designed to help you learn how to use money to meet your goals and to live the way you want to live. It can help you make intelligent decisions about money so you can get what you want and need—today and throughout your life.

1. Your Checking Account ............... R2
2. Budgeting .......................... R4
3. Saving and Investing ............... R6
4. Credit and You .................... R10
5. Your Education ..................... R16
6. Getting a Job ....................... R20
7. Paying Taxes ....................... R24
8. Renting an Apartment ............. R28
9. Buying a Car ....................... R30
10. Insurance Matters ................ R32
Your Checking Account: Check into independence

Are all banks alike? What if you bounce a check? Where do checks go?

Knowing the smart way to open and manage a checking account can help you avoid hassles—and save money.

How It Works

A checking account gives you a safer place to keep cash than a cookie jar while making it easy to pay bills and buy things.

Opening an Account To open an account, you need identification and usually a deposit (money you put into the account). Some banks offer student accounts requiring no initial deposit. The amount in your account at any given time is the balance. Putting money in or taking it out is a transaction.

To deposit a check, endorse (sign) it on the back. If you’re depositing the entire check rather than keeping some cash, write “for deposit only” and your account number below your signature. When you open an account, you’ll get a receipt for your deposit and, soon, numbered checks printed with your name, address, and account number; a check register; and a debit card. A debit card acts like an electronic check: money is taken out of your account immediately (a withdrawal or debit).

Making Withdrawals There are five ways to make withdrawals:

1. Write a paper check, or pay by check over the phone.
2. Get cash from a teller at a bank branch.
3. Use a debit card at a store or automated teller machine (ATM).
4. Use your bank’s Web site to pay a bill.
5. Authorize the bank to automatically pay recurring bills.

Keeping Good Records Record all transactions in your check register. You’ll get a monthly statement showing activity for the previous month. Compare it with your check register for errors and keep both in a file.

Help! If your debit card is lost or stolen, your liability for an unauthorized withdrawal can vary. If you notify the financial institution within two business days after learning of the loss or theft, you’re liable for only $50. If you don’t report unauthorized use that appears on your statement within 60 days after its mailing date, you could lose all the money in your account.
Which Bank, What Account?

Some banks offer better service or lower fees, or are conveniently located. Banks offer different types of accounts, some of which pay interest in exchange for having the use of your money. Before opening an account, savvy consumers ask if there’s a minimum balance requirement, how many checks can be written per month, if there are fees for writing checks, and if the account will earn interest.

Choose a traditional bank that offers some services online or a bank that exists only on the Net. If you bank online, don’t rely on the bank’s system to protect you. Install a firewall and don’t open suspicious e-mails or provide personal information to anyone who contacts you. Check your balance often to see if a thief has taken money from your account. You’re liable for only the first $50 if you report it to the bank within two days. Find more tips at www.idtheftcenter.org.

How to Write A Check

- In this example, if you spelled out “Eleven fifty” instead of “Eleven hundred fifty,” the bank would pay only $11.50—not $1,150.00. Be sure the numerals and longhand version are the same amount.

Test Your Financial Fitness

1. **Explaining** Why is it important to balance your checkbook?
2. **Determining Cause and Effect** List two reasons to avoid bouncing a check.
3. **Paraphrasing** Describe three ways to protect yourself from online theft.
Budgeting:
Take control of your cash

Did you really need that cashmere sweater or those $200 sneakers? How did you get $5,000 in debt? Getting control of what you spend—budgeting—is a skill you’ll need throughout your life.

Where Does Your Money Go?
Many people have no idea what happens to their money. It just seems to “disappear.” Here’s how to find out how where yours goes:

1. List the bills you pay every month.
2. For one month, jot down everything you buy and the price—no matter how little it costs.

At the end of the month, categorize the items you’ve listed: “Food,” “Transportation,” etc. Then break down each category; for example, “Food: School Lunches, Snacks, Restaurants.” Now you know where your money goes.

The Urge to Splurge
Advertising and peer pressure tempt us to buy things we don’t need. Which of the items you categorized above were things you needed, like gym shoes or an ink cartridge? Which ones were things you just wanted: take-out pizza or that CD you played only once? Those are impulse purchases. They don’t seem expensive when you buy them, but they can keep you from reaching larger goals like a vacation, a cool car, or college.

Think Before You Buy
Before you buy an item, ask yourself whether the item is worth the time you’ll have to work to pay for it. The better you get at saying “no” to unnecessary spending, the more money you’ll have for what’s important to you.

Creative Budgeting
Using the expenses you listed before, complete a chart like the one on the next page. Look at each expense in column 2 and think of ways to reduce it. Enter the lesser amount in column 3, your New Budget. Be sure to budget 10 to 30 percent of your income for “Savings.” (To see why, go to Saving and Investing on page R6.) Total column 3 to see if your budget matches your income. If not, you’ll need to keep trimming expenses until it does or find another source of income.
### Building Your Budget

- **Part-time Job:** $______
- **Monthly allowance:** $______
- **Total income:** $______

<table>
<thead>
<tr>
<th>Spending Category</th>
<th>Current Expenses</th>
<th>New Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Food:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>School lunches</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restaurants &amp; take-out</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Snacks</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Transportation:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Car payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gasoline</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance (estimate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Entertainment:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Movies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Music</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Games</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sports and hobbies</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Personal care:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clothes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shoes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Haircuts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accessories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cosmetics</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Savings (10–30% of income)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Utilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Phone</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internet access</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Medical/dental</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Donations to charity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Miscellaneous</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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**Autonomy** According to the American Psychological Association, neither popularity, influence, money, nor luxury contributes the most to happiness. What does? Autonomy (feeling that your activities are self-chosen), feeling that you’re effective in your activities, a sense of closeness with others, and self-esteem.

Advertising executive Gary Dahl became a millionaire by convincing people to pay $3.95 each for “Pet Rocks” in 1975. The product was simply a beach stone that cost him a penny, packaged in a box with a “Care and Training of a Pet Rock” manual.

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**Test Your Financial Fitness**

1. **Listing** List five ways you can start saving money. How much could you save in a year by cutting these costs?
2. **Defining** What is an impulse purchase? What was the last one you made?
3. **Explaining** Why is it important to live on a budget?
4. **Applying** Make a list of three ways you can re-use things you usually throw away.
Saving and Investing:
Make your money grow

Want a faster computer or a great car? How about retiring at 40? You don’t have to be old or rich to take save and invest. People with ordinary jobs and moderate incomes can build wealth—and financial freedom—just by starting young.

Saving: The Frugal Habit

Frugality is the attempt to save money instead of spending it. Why save? Because saved money grows. Here’s why it’s worth it:

1. Savings are your only safety net in financial emergencies.
2. With an early start, you can amass huge amounts of money over time.
3. Having a savings account improves your credit rating (see Credit and You on page R10).

The Secret of Compounding

Why save now? Because of a simple but very important concept: compounding. It’s the process of interest earning interest. And it takes time to kick in. If a family saves $75 a month at 5 percent interest from the day a child is born, they’ll have more than $24,000 by the time she’s ready for college. More than $9,000 of it is interest—money their money earned. If they wait until the child is seven to start, they’ll have to save almost $137 a month to get the same result.

Two key concepts make compounding work: yield and time.

Yield:

Different types of accounts offer different annual percentage rates (APR). That’s the rate you’ll get if the interest is compounded only once a year.

Example: You deposit $10,000 in an account with an APR of 5 percent. At the end of the year, your money has earned $500 ($10,000 × 5% × one year = $500). So you have $10,500.

Interest for some accounts is compounded more often: semi-annually, quarterly, monthly, daily, or even continuously. The more frequently it’s compounded, the more interest you get. That’s because interest is added to your deposit periodically and the entire amount earns, or yields, interest—the annual percentage yield (or APY).
**Example:** You deposit the same $10,000 at 5% APR, but interest is compounded twice a year. After six months, your money has earned half the annual interest ($10,000 \times 5\% \times \frac{1}{2} \text{ year} = \$250$). The bank adds that interest to your original deposit. Now the $250 also earns interest for six months. The APY is 5.0625%. So at the end of the year, you have $10,506.25 instead of $10,500. That may seem like a small change, but it can make a big difference as your balance grows over the years.

**Time:** The longer you leave your money in an account, the better compounding works—especially in an account with frequent compounding. If you left $10,000 in an account for 10 years, with interest compounded quarterly, you’d have almost $16,500—without ever adding another cent!

**Ways to Save** Your goals should determine which savings methods you choose. A savings account is ideal for “emergency funds,” since you have fast access to cash. But it also pays low interest, so you’ll want to find other ways—including investments—to get enough interest to offset the taxes you’ll pay on the interest, plus inflation.

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**SAVINGS VEHICLES AND RISKS**

- **Savings account:** Safe (FDIC-insured). Some student accounts offer no deposit requirement. Easy access to funds makes them good for emergencies, but interest is low.

- **Money market deposit account:** Safe (FDIC-insured), with easy but infrequent withdrawals. These accounts pay slightly higher interest than savings accounts, with various deposit requirements.

- **Money market mutual fund:** Relatively low risk because invested in a pool in short-term vehicles such as certificates of deposit and commercial paper. Terms are from 90 days to 13 months. Interest is comparable to money market deposit accounts.

- **Certificate of deposit (CD):** FDIC-insured time deposit with slightly higher interest than savings accounts and opening requirements as low as $250. Terms are from 3 months to 5 years with varying interest and low penalties for early withdrawal.

- **U.S. savings bond:** Safe (government-backed) and available for as little as $25. Terms vary, but after a waiting period bonds can be redeemed before maturity. Not taxed until redeemed. Most types offer interest higher than savings accounts.

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**Who Is Rich?** Looking rich and being rich are not the same. Most millionaires drive used cars, live in modest houses, and don’t wear expensive clothes. They save at least 15% of their earned income, and four out of five of them did not inherit their money.
### Common Investments

<table>
<thead>
<tr>
<th>Type of investment</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stocks</td>
<td>High earnings potential</td>
<td>High risk</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Need broker to buy and sell</td>
</tr>
<tr>
<td>Stock mutual funds</td>
<td>Some risk, but less than buying stocks individually</td>
<td>Professional investment manager</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Minimum investment usually $1,000 or more</td>
</tr>
<tr>
<td>Bonds</td>
<td>Good earnings potential</td>
<td>Federal tax on federal and corporate bond interest</td>
</tr>
<tr>
<td></td>
<td><strong>Federal:</strong> no default risk (see Ways to Save on page R7)</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Municipal:</strong> low risk, no federal tax</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Corporate:</strong> moderate risk</td>
<td></td>
</tr>
<tr>
<td>Bond mutual funds</td>
<td>Professional investment manager</td>
<td>Need broker to buy and sell</td>
</tr>
<tr>
<td></td>
<td>Less risk than individual bonds</td>
<td></td>
</tr>
</tbody>
</table>

### Investing: Not Just for the Rich

About 19 percent of students in grades 8–12 own stocks or bonds. If you think you don’t have enough money to invest now, remember the compounding principle: time is on your side. Even the spare change you keep in a jar every week, invested consistently and well, can reap big rewards in time. Investment advice can be confusing and, let’s face it, boring. A good way to learn is to join—or start—an investment club. Get information at [www.better-investing.org/youth/youth.html](http://www.better-investing.org/youth/youth.html).

All investments involve two unknowns: the possibility of making money (the return), and the risk of losing it. In choosing investments, you’re always balancing those two realities. Common investments include the following:

**Stocks** A stock is a share of a company’s assets. Say you want to start a company that sells jewelry but can’t afford to buy the beads. So you ask three friends for money. Now each of you owns one fourth of the company—one share. When you sell the jewelry, you each get a fourth of the profits. If it doesn’t sell, you all lose money. That’s the stock market, simplified.

Most investment professionals consider stocks the best way to get a fairly dependable, high return—but only if you keep them for more than ten years. Individual stocks and the stock market itself shoot up and down like a roller coaster. But over the last 50 years, the average return for stocks has been 10 percent—higher than savings vehicles and most other types of investments. Patience is the key to success.

You can buy stocks online, through a stockbroker or mutual fund company, or directly from companies that offer “Drip” (direct reinvestment) funds in which earnings are automatically reinvested in more of their stock.
To reduce your risk, you can buy stocks through a mutual fund, a pool of money from many people invested in a variety of stocks or bonds by an investment manager.

There are two ways to make money with stocks. You can sell them when their value is high; the profit is called a capital gain and is taxed as income. Or you can keep them and receive regular payments (dividends), if the company pays dividends.

**Bonds** Governments (federal, state, and local) and corporations sell bonds to raise funds for projects like schools, bridges, or business expansion. They’re borrowing your money. In return, you generally get periodic interest and a fixed amount of money at a specified time in the future (maturity date). Some types of federal bonds offer different payment plans. Maturity dates vary. Most bonds are considered less risky than stocks, and government bonds are less risky than corporate bonds, since companies sometimes lose money.

**U.S. Treasury Instruments** Treasury instruments are loans you make to the government. They include T-bills, T-notes, T-bonds, Treasury Inflation-Protected Securities (TIPS), and several series of savings bonds. (See the Savings Vehicles table on page R8). They offer various interest rates and maturity dates. Because they’re issued by the government, treasury instruments offer low risk. They can be bought directly from the government online, or through banks or brokers. Minimum investments for most are $1,000–$10,000; some savings bond minimums are much lower.

**Other Investments** A home may be the largest investment you’ll make. Real estate is considered a good investment because most properties increase in value—but not all. Other types of investments include precious metals (like gold and silver) and retirement plans.

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**Early Investing** A 16-year-old who invests $2,000 a year at 10 percent APR will have more than $2 million at age 65. By waiting until you’re 26 to begin, you’d have less than $803,000.

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**Test Your Financial Fitness**

1. **Explaining** Look at the budget you prepared on page R5, and see if you can increase the amount you’re saving. If so, what type of savings vehicle or investment will you use, and why?
2. **Defining** What is the difference between APR and APY?
3. **Summarizing** How can you make buying stocks less risky?
4. **Applying** In the library or on the Internet, research an investment you think you’d like to make. Write down your reasons.
Credit and You: Use it, don't abuse it

How can you buy a hot new car if you don't have $25,000? Can you avoid the credit card trap? Whenever you buy something but don't have the cash, you're using credit. Mastering the wise use of credit gives you a head start on financial fitness.

Are You Creditworthy?

“Credit” means borrowing someone else’s money. In exchange for the loan, you’ll have to pay back more than you borrow. That’s called interest. It’s a percentage of the borrowed amount.

Who Decides? Lenders decide whether to lend you money and how much interest to charge by looking at three things:

1. Can you pay them back? Add your monthly income to your bank account balances to find your total assets. Then total your monthly expenses, including debts (obligations). Compare the two to see if you’re able to take on more debt.

   YOUR CAPACITY TO REPAY DEBT

   Monthly income + Checking account + Savings account = Your assets

   Compared to

   Monthly expenses + Total debt = Your obligations

2. Do you have a good credit rating? Lenders want to know if you’ve repaid previous debts on time.

3. Do you have collateral? Collateral is used mostly to buy homes or cars. If you don’t make the payments, the lender takes the property.

Your Credit Score Like your shadow, your credit score, or credit rating, follows you throughout your life. It’s a number from 300 to 900 that shows how responsible you’ve been with your finances—recently and in the past. The higher your score is, the more likely you are to get credit and a low interest rate.

Credit scores are assigned by three credit bureaus—Equifax, Experian, and TransUnion—that track each person’s financial history and create credit reports. Check yours at least once a year to be sure it contains no incorrect information.

Check Your Credit You can get one free report per year from each credit bureau. Call 877-322-8228; write to Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281; or go to www.annualcreditreport.com.
Credit Cards

When you use a credit card, you’re borrowing money that must be paid back—plus interest. Card issuers set a limit on the total amount you can spend. Smart borrowers avoid reaching that limit because it lowers their credit score.

Once you’ve established credit, you’ll get offers for many cards. To avoid the temptation to rack up debt, keep no more than two or three. Choose those with the lowest annual percentage rates (APR)—not just low introductory rates that bounce up later. Be sure to read the fine print on the contracts—all of it.

The Price vs. the Real Cost

The longer it takes you to pay off your credit card balance (the total amount you owe), the more the items you bought with the card actually cost. That’s because card issuers make their profits by charging interest—from 1 to 25 percent or more—on the amount still owed.

Example: If you pay cash for a pair of $100 sneakers, they cost $100. If you use a credit card at an interest rate of 18.9% and take a year to pay it off, they cost $118.90 or more, depending on how the interest is calculated.

The Credit Card Trap

Every month, you’ll get a statement listing everything you bought in the previous month, payments you made, and the balance. You are usually allowed to pay less than the total balance as long as you make at least the “minimum payment due” listed on the statement. This is how many people fall into the credit trap: they make only the minimum payment, racking up more debt month after month.
Other Sources of Credit

There are a number of ways to borrow money besides credit cards. These include relatives and friends, as well as retail stores and financial institutions, such as banks, credit unions, and savings and loan associations.

Retail Stores  Most department stores and other retailers let customers with good credit buy merchandise from their stores with one of three types of credit:

- **Installment sales credit:** Major items like refrigerators are often bought by making equal payments, which include interest and service charges, over a set period of time.
- **Regular charge accounts:** You can buy goods or services within a set dollar limit by agreeing to pay off the balance in the future. Interest is charged only if the balance is not paid in 30 days.
- **Revolving credit:** You usually make no deposit but can buy items on credit on an ongoing basis, up to a certain dollar limit. If you repay the balance by a certain date, some stores charge no interest; most charge interest on each month’s unpaid balance. Credit cards are also a type of revolving, or open-ended, credit.

Service providers  Your agreements with providers of services (electricity, cell phone, Internet, etc.) are credit arrangements. The history of your payments to them often appears on credit reports—especially if you pay late.
Financial Institutions  Commercial banks, savings banks, credit unions, finance companies, and some insurance companies lend money, with varying interest rates and fees. Shop and compare costs before borrowing. Some loans require a single, lump-sum payment on a specific date; others accept monthly payments for either a set or indefinite period of time.

Comparing Costs
As with credit cards, the length of time it takes you to repay the balance of a loan from other creditors affects the total amount you pay. You can see in the table below that when you take longer to pay off a loan, you pay less each month, but your total cost is higher. That is because interest gets compounded over a longer period of time.

<table>
<thead>
<tr>
<th>COSTS OF 3- AND 5-YEAR INSTALLMENT LOANS</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000 loan at 12% interest compounded annually</td>
</tr>
<tr>
<td>Number of monthly payments</td>
</tr>
<tr>
<td>Amount of each payment</td>
</tr>
<tr>
<td>Total interest paid</td>
</tr>
</tbody>
</table>

The annual percentage rate (APR) of the loan also affects the total amount you pay. Be sure to check it before signing any loan agreement.

<table>
<thead>
<tr>
<th>APR COMPARISON</th>
</tr>
</thead>
<tbody>
<tr>
<td>5-year Loan of $8,000</td>
</tr>
<tr>
<td>APR</td>
</tr>
<tr>
<td>11%</td>
</tr>
<tr>
<td>Monthly payment</td>
</tr>
<tr>
<td>Total interest to be paid</td>
</tr>
<tr>
<td>Total cost</td>
</tr>
</tbody>
</table>
Identity Theft

Criminals could steal your name, social security number, date of birth, and other private information—and use it to run up debts in your name: credit cards, wireless phone accounts, or loans. Here are some tips to help protect your identity; find more at www.idtheftcenter.org.

- Be careful who sees your personal information. Never provide it on the Internet or by phone to anyone who contacts you. Banks don’t request private information by e-mail.
- Thieves sort through people’s trash and mailboxes. Shred statements that include account numbers and any unused offers of credit cards you receive in the mail.
- Always know where your cards are. When you buy something with a card, watch to see that it’s not copied and get it back as quickly as possible.
- Check your credit report periodically for accuracy.
- Report lost or stolen credit cards immediately to the fraud department of a credit bureau. You’re liable for only the first $50 after your report.
- Do business only with companies that will provide their name, street address, and phone number.
- Don’t use the links in an e-mail to get to any Web page. Type the Web address in your browser window. A secure site begins with “https://” rather than “http://”.

▲ Shredding old financial documents helps guard against identity theft.
**CREDIT BASICS**

**Annual percentage rate (APR):** The percentage of interest you are charged for every year you owe money. A fixed APR will stay the same; a variable APR will rise and fall with changes in national economic indicators.

**Compounding:** The process of charging interest on the amount of interest still owed. This interest is added to the stated interest rate because it’s money you owe but have not yet paid.

**Example:** If the stated APR on a $10,000 loan is 10%, you’d expect to pay $1,000 in interest per year (10% of $10,000). But since lenders compound interest, you may pay an extra $47 on the same $10,000 loan—for a total interest of $1,047. Some lenders compound interest more often—even daily. The more often interest is compounded, the more you will owe.

**Delinquent payment:** A payment that is 30 days or more past due. This is not the same as a late payment, which is one received after the due date but before it’s 30 days past due. If a car payment due on the first of the month is received on the 20th, for example, it’s late and you’ll pay a late charge. But it’s not delinquent and won’t appear on your credit report.

**Grace period:** A period of time after you buy something on credit during which some creditors charge no interest if you pay the balance before the due date.

**Finance charge:** The total cost of credit. In addition to interest, some companies charge fees for annual membership, cash advances, services, transactions, and exceeding the credit limit.

**Introductory rate:** A lower rate of interest offered by some credit card companies to persuade consumers to apply for their card. After an initial period, the APR you’re charged increases. It’s important to read the fine print on the offer to find out when the APR increases and whether the low rate applies only to balances you transfer from another credit card, to new purchases, or to both. You also need to know how long you have to transfer balances; some cards feature a fixed APR on balance transfers for the life of the card; others for only 45 days to six months.

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**A Big Difference** Your credit score makes a big difference in the interest rates lenders charge. For example, a person with a credit score of 720 or above applying for a 3-year loan to buy an $18,000 car may pay 7.258% interest. The same dealer might charge a person with a credit score between 500 and 559 a rate of 15.294% for the same loan. At the end of the 3 years, the first applicant would have paid $2,085 in interest; the applicant with the low credit score would have paid $4,557.

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**Test Your Financial Fitness**

1. **Summarizing** Why is a good credit score important?
2. **Identifying** What are two ways to establish good credit?
3. **Listing** List two ways to avoid paying interest when you buy something.
4. **Applying** Analyze three credit card offers your family has received in the mail or that you have seen advertised. Which one offers the best deal? Why?
Your Education: Jump-start your future

Is college for you? Which one? How can you pay for it? Whether you plan to attend college or enroll in vocational training after high school, don’t let rising costs keep you from realizing your dreams.

Why Go to College?

A college education enriches a life in ways that can’t be measured in dollars. But there’s a practical reason to continue your education beyond high school, too: what you learn usually determines what you earn. Compared to workers with only high-school educations, those with bachelor’s degrees have greater lifelong earning power and are less likely to be unemployed.

<table>
<thead>
<tr>
<th>Unemployment and Earnings</th>
<th>Education Level</th>
<th>Unemployment Rate</th>
<th>Median Annual Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Males</td>
</tr>
<tr>
<td>No high school diploma</td>
<td>8.8%</td>
<td>$19,802</td>
<td>$10,613</td>
</tr>
<tr>
<td>High school diploma/GED</td>
<td>5.5%</td>
<td>$27,526</td>
<td>$15,972</td>
</tr>
<tr>
<td>Bachelor’s degree (4 years)</td>
<td>3.3%</td>
<td>$55,188</td>
<td>$34,292</td>
</tr>
</tbody>
</table>


Choosing the Right School

Some schools are better at certain fields of study than others. Costs, too, vary widely from school to school. Consider these factors when choosing a college or vocational school:

• Your goals: Can you get the educational experience you want at a public school? If not, don’t rule out a private school because of cost; some are generous with financial aid. Another option is to start out at an inexpensive community college and transfer to a four-year school.

• Income potential: If you choose a career with high income potential—like medicine or computer engineering—you can afford to take on a higher debt at an expensive school.

• Location: Out-of-state students pay a surcharge—usually thousands of dollars a year—to attend public universities. Costs also vary in different parts of the country.

College-degreed workers earn an average of 62 percent more than those with high-school educations—roughly $2 million more overall during their working years.
Financial Aid Basics

Tuition is the amount a school charges for instruction. This does not include room, food, books, or other fees. In recent years, the cost of college tuition has risen faster than incomes or inflation. Few parents can afford the full cost of educating their children, and so most students need financial aid. The good news is that most students qualify for some type of financial aid. It takes research to find it, so the sooner you start looking, the better. How much aid you receive depends on these criteria:

- income—yours and your parents’ or guardians’
- family assets and expenses
- number of college students in your family
- amount of aid available at the school
- number of students applying for aid and their financial need compared with yours

<table>
<thead>
<tr>
<th>Type of Institution</th>
<th>Cost and tuition and fees</th>
<th>Total cost</th>
<th>Percentage of students qualifying for financial aid</th>
<th>Average aid amount (loans and grants)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Four-year private</td>
<td>$21,235</td>
<td>$29,026</td>
<td>76%</td>
<td>$11,600</td>
</tr>
<tr>
<td>Four-year public</td>
<td>$5,491</td>
<td>$12,127*</td>
<td>62%</td>
<td>$6,200</td>
</tr>
</tbody>
</table>

*Average annual costs at two-year public community colleges are about half those of four-year public colleges.

THE COST OF EDUCATION

\[
\text{Total Cost} = \text{tuition, board, books, fees, living expenses} \\
\text{Total Aid} = \text{loans, scholarships, grants, work-study} \\
\text{What you owe} = \text{Total Cost} - \text{Total Aid}
\]

Types of Aid Available Apply for all types of financial aid for which you may be qualified, including:

Scholarships and grants: Both are outright gifts you don’t have to pay back. Most scholarships are based on academic, athletic, or artistic ability. Many companies offer them to employees’ children, and some states provide them to residents; for example, Georgia guarantees free tuition to drug-free students with at least a B average.
Some grants, such as federal Pell grants and Supplemental Educational Opportunity grants, are awarded for “exceptional financial need.” Others are given to students belonging to a certain ethnic group, club, or civic organization. The armed forces offer aid in return for military service after graduation.

**Work-study programs:** Many colleges offer federally funded, on-campus jobs to students receiving financial aid.

**Loans:** More than half of all financial aid is in the form of loans—which *must* be repaid. Regardless of your income, you probably qualify for one of these loans:

- **Government loans:** The U.S. Department of Education (DOE) offers low-interest loans to students and parents. Some are subsidized (the government pays the interest until you’re out of school) and are based on need; others are unsubsidized (interest accrues while you’re in school) and are not need based. In order of desirability, they are
  - subsidized Perkins Loan
  - subsidized Stafford or Direct Loan
  - unsubsidized Stafford or Direct Loan
  - unsubsidized Parent Loans for Undergraduate Students (PLUS)
- **Private and college-sponsored loans:** Private loans are available from banks and other financial institutions. Interest rates are generally higher than those of federal loans.

**Aid Application 1-2-3** Once you’ve been accepted at several schools, follow this loan application process:

1. **Gather up documents.** You’ll need proof of income, such as tax returns, W-2 forms, pay stubs; mortgage statements; and proof of any unusual financial hardships in the family, such as high medical expenses or unemployment.

2. **Find aid sources.** Use the Internet to find grants and scholarships, then loans. Be sure to check deadlines.

3. **Fill out and send in applications.** The first form to complete is the Free Application for Federal Student Aid (FAFSA), available from your high school, library, or DOE’s Web site. It’s needed for any type of government aid. DOE will send you a number called an *Expected Family Contribution* (EFC), which is an amount computed according to a formula established by law. Colleges use it to determine the amounts of grants, loans, and work-study awards.
Payback  You don’t begin repaying some government loans until after you’re out of school. Other loans, such as PLUS loans, require you to begin making payments within 60 days after you receive the funds. Since unsubsidized loans accrue (accumulate) interest while you’re still in school, you’ll want to pay those off first. For some loans, you can repay just the interest for a period of time or start with smaller payments that increase as your income presumably increases. Some lenders even tie payment amounts to rises and drops in your income level.

Graduates who take teaching jobs in certain schools; who volunteer with the Peace Corps, Americorps, or VISTA; or who serve in the military may have their federal loans deferred, partially repaid, or even canceled.

It’s important to repay your loan on schedule to avoid penalties and damage to your credit, as well as to reduce the amount of interest you pay. Some lenders lower the principal or the interest rate if you make on-time payments. Your lender or the school’s financial aid office can help you establish a workable repayment plan.

Test Your Financial Fitness

1. **Stating** How much more money will the average college graduate earn per year than someone with only a high school diploma?

2. **Listing** List four things that are important to you in choosing a college or vocational school. Using the Internet or library resources, find three schools that meet your criteria.

3. **Applying** Choose one of the schools you identified above and calculate how much it would cost to attend that school for one year. Then find two types of financial aid for which you might qualify.
Getting a Job: Make it work for you

Where are the jobs? What are your skills? Do you need a resume? Whether you’re searching for a summer job or planning to enter the labor market right after high school, looking for work is hard work. Knowing where to look and how to present yourself can help you land a better job.

The Right Job

Besides earning money and learning good work habits, use your first few jobs to find out what tasks you like to do—and what you don’t. Take the time to explore what interests you.

One good method is the “informational interview.” Many businesspeople who may not have current job openings are willing to chat briefly with young job seekers. Call and ask if they have a few minutes to give you information about their field. Don’t ask about job openings. Ask how they got their start in the field or what a typical day is like. Leave a resume and ask for names of others who might be helpful. You’ll gain interviewing experience, contacts, and possibly a job lead. Always mail a handwritten thank-you note.

Finding Openings

The best way to find a job is to ask family, friends, and acquaintances for leads. It’s called networking. Everyone you meet is a potential source of information about a job—now or in the future. Other resources include:

- “Help Wanted” Signs: Walk around town or the mall and apply in person. Dress appropriately and be ready for an on-the-spot interview and application.
- Newspapers and the Internet: Your local newspaper carries help-wanted ads every day. On the Internet, you can find job postings and post your resume.
- Placement Agencies: Free state-run employment services match qualifications with available jobs. Private placement companies charge applicants or employers; ask who pays before signing up.
- Start Your Own Business: Teenagers start businesses every day. Not all teen businesses are financially successful, but they all provide invaluable experience that impresses college admissions officers and potential employers.
Getting in the Door

For some jobs, like retail sales, you’ll see a sign in the window and can simply walk in and complete an application. But most employers expect you to send a resume and cover letter first.

Your Resume: A resume is a document that summarizes your experience, skills, and education. Its purpose is to present you in the best possible light so that employers will contact you for an interview. You’ll need more than one resume, since an effective one focuses on skills related to a specific job. These tips can help you get started:

1. Make a list of everything you’ve accomplished in your life. You can use it to identify skills that relate to various jobs, now and in the future.

For every job opening, employers receive about 500 resumes and spend about 5 seconds glancing at each one.

John D. Smith
123 Main Street
Pasadena, CA 91101
(626) 555-7345
e-mail: jdsmith@myaddress.com

OBJECTIVE
A challenging part-time sales position in the auto industry.

EXPERIENCE
6/2007 to present
Bagger, Star Market, Pasadena, CA
Bag groceries after school, weekends and summers
Received employee of the month twice

1–5/2006
Team Leader, Enterprise Project,
Pasadena High School, Pasadena, CA
Working with three other students, manufactured and sold $460 worth of plastic CD travel cases

Office Assistant, Pasadena High School, Pasadena, CA
Assisted secretary after school by correctly filing student records, copying and distributing teaching materials

EDUCATION
Pasadena High School, will graduate in (month, year)

SKILLS
Speak Spanish fluently
Proficient in Microsoft Word, Excel and internet research
Cash register experience

ACTIVITIES
Oakdale Community Health Clinic, volunteer
National Honor Society
2. Get a description of the job you want from the company’s Web site, ad, or human resources department. You can also check your local library for *The Dictionary of Occupational Titles* or the *Occupational Outlook Handbook* (also at http://stats.bls.gov/oco/oco1002.htm).

3. From your list of accomplishments, select those that match this job and list them in the “Experience” section of your resume (see the sample on the previous page for formatting). Be brief and use active verbs like organized, developed, or implemented. If you can truthfully claim results, do so: “raised $1,700” or “reduced filing errors by half.”

4. Employers often toss resumes with typos or misspellings, so ask several people to proofread yours.

**The Cover Letter:** Your resume should be accompanied by a letter typed in a format similar to the sample below. First, state why you are interested in the company and where you heard about the opening. In the next two paragraphs (three at most), “sell” yourself: How will your skills be valuable to the employer? If an e-mailed resume was requested, type the cover letter in the e-mail itself.

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**Cover Letter**

**John D. Smith**
123 Main Street
Pasadena, CA 91101
(Date)

Mrs. Helen Jones, Manager  
Sales and Marketing  
ABC Company  
345 Central Avenue  
Pasadena, CA 91101

Dear Mrs. Jones:

I am an experienced sales person responding to your Pasadena Press ad for a part time sales assistant.

ABC Company interests me because of its reputation as an aggressive marketer of high-quality auto parts. I also have a personal interest in cars and helped restore a 1957 Thunderbird last summer.

I believe my skills could be useful to you in several areas:
• Successful sales experience (CD travel cases)  
• Ability to track accurately (class treasurer for two years)  
• Excellent clerical skill: organizing, filing, photocopying

I hope you will contact me at (626) 555-7345. I look forward to talking with you.

Sincerely,

John Smith  
John Smith  
Enclosure

---

Figure out what the employer needs and mention your skills that meet those needs.
The Job Interview

Appearance is important, so dress appropriately for all interviews. Be prepared to answer questions like “Why do you want to work here?” Interviewers often ask this to see if you’ve researched the company’s products, financial status, etc. You can request brochures from the company’s human resource department or find this information on the Internet. Be ready to explain how your skills qualify you for the job.

**Example:** “Although I don’t have professional sales experience, I believe the skills I demonstrated selling school raffle tickets will be useful to you. According to the product vendor, my aggressive selling efforts increased sales by 22 percent.”

Before you leave, hand the interviewer a typed sheet listing three references: names, titles, companies, and phone numbers. Send a brief thank-you letter; summarize why you’re right for the job and include your daytime phone number.

**Test Your Financial Fitness**

1. **Summarizing** What is the purpose of a resumé?
2. **Listing** List ten of your accomplishments that you think demonstrate skills an employer might want.
3. **Applying** Write a resumé applying for a job you would like to have. In the “Experience” section, incorporate some of the accomplishments you listed.
4. **Analyzing** List four questions an employer might ask you during an interview and the answers you would give.
Paying Taxes: Simplify the annual event

Who pays taxes? How do you file a return? If you have an income or buy anything, you’ll pay taxes, regardless of your age. Being organized can make the process easier and maybe save you some money.

What Taxes?
The largest chunk of tax money goes to the federal government to fund programs such as the military, retirement security, space exploration, aid to foreign countries, and disaster recovery. When you see news reports about arguments in Congress over the budget, they’re arguing about how to spend your tax dollars. States, cities, and other entities also assess taxes for various purposes.

Federal Income Tax Money you earn is taxable, including wages, tips, interest earned by bank accounts, and profits from the sale of property, like cars or stocks. Every year, the Internal Revenue Service (IRS) sets a taxable minimum income. If you earn more than that, it’s taxed—even income from self-employment like babysitting or mowing lawns.

The IRS is the agency within the U.S. Treasury Department that administers tax laws and provides forms and advice. The IRS also has the power to ensure that people pay what they owe. It can assess penalties; charge interest on unpaid tax; confiscate wages, bank accounts, or property; and even imprison debtors for nonpayment. It’s to your advantage to learn how to be a responsible taxpayer.

Other Taxes States, cities, and some school districts assess income taxes to pay for schools, fire protection, police, highways, and similar services. You’ll file tax forms (returns) for those at the same time as you file your federal return. In most states, sales tax is added to the price of products sold in the state, including items bought online. Some states also assess this tax for online purchases when the seller does not have a “brick and mortar” store in that state. Then there are use (excise) taxes on things like gasoline, guns, gambling, tobacco, alcohol, and airline tickets. Finally, property owners pay taxes based on the value of their house or other real estate.
**Withholding** If you haven’t received your first paycheck yet, it will be an eye-opener. Employers are required by law to deduct—or “withhold”—a certain percentage of wages for taxes and other payments. These are listed on your pay stubs and include:

- **Federal taxes:** Your employer will withhold a part of your pay based on a table from the IRS. The more you earn, the higher the amount withheld.
- **State and city taxes:** The amount varies from state to state and from city to city. If you live in one city and work in another, your employer will withhold the tax for the city where you work. You may have to pay a separate income tax to the city where you live.
- **Social Security:** The Social Security system provides a financial safety net for retirees and disabled citizens who contributed to the system throughout their working lives. Your employer matches your contribution.
- **Medicare:** Everyone who receives Social Security benefits automatically receives Medicare Part A benefits, which partially cover stays in hospitals and skilled nursing facilities. (Other Medicare benefits must be purchased after you reach age 65.) Your employer matches this contribution as well.
- **Optional withholdings:** You may decide to have your employer deduct more money. For example, you might get health insurance through your work. (See **Insurance Matters** on page R32.) Many employers also offer automatic savings plans and match a part of your contributions. (see **Saving and Investing** on page R6.)
Four kinds of paperwork are used in the tax process: a form you fill out when you’re hired by a company (W-4), documentation of your income (W-2), your tax return, and records you’ll need to complete the return.

W-4 Form When you start a job, you get a W-4 form on which you tell the employer how much money to withhold for federal income taxes. You choose the number of exemptions by asking yourself: Do I want to have the government keep the money for a year to make sure I don’t spend it before tax time? Or, would I rather invest the money and make the payment in April? If more money is withheld than you owe, you’ll get a refund, which makes tax season more pleasant. But your money is with the government instead of earning interest in a bank account or investment.

W-2 Form Every January, your employer(s) will send you a W-2 form listing your wages and withholdings for the previous year. If you don’t receive yours by mid-February, call the employer. You’ll attach this form to your tax return to prove your income.

Tax Return Every year, you’ll complete a paper or online form telling the IRS how much tax you still owe or how much you believe should be refunded to you. If your income is below a certain level set annually by the IRS, you don’t have to file a return, but you should anyway. It’s the only way to get your refund. These guidelines may make it easier:

- **Forms:** The IRS will mail you a form and instructions. Free forms are also available at post offices, banks, libraries, and on the IRS Web site at [www.irs.gov](http://www.irs.gov). Be sure your name and Social Security number are correct.
- **Deadline:** File any time between January 1 and April 15. If you file after April 15, you’ll be charged a penalty and, if money is owed, interest on the amount owed.

**INCOME TAX TERMS**

- **Earned income:** Wages, tips, and taxable scholarship and fellowship grants. You’ll need to total these amounts to calculate your taxes.
- **Unearned income:** Interest (from bank accounts, stocks, etc.) and dividends or capital gains from stocks.
- **Gross income:** The total of earned and unearned income.
- **Adjusted gross income:** Gross income minus deductions. This is the figure used to calculate the amount of your federal income tax.
• **Deductions:** The amount you pay is a percentage of your income minus any eligible deductions. These are expenses that meet IRS guidelines, like donations to charity and interest on college loans.

• **Preparing your return:** Whether you’re filing a paper or electronic return, you’ll have to decide several things:

  1. What status to file under. For now, select “single.”
  2. Whether you want to take the standard deduction or list (itemize) your eligible deductions separately. If you choose the standard deduction, you can use a simple 1040EZ form. Or, you can try to lower the amount you owe by itemizing deductions on a 1040 form. (More complicated taxes use other forms.) With this form, you may need help from a tax preparer, because tax regulations are complicated and change frequently. The IRS offers free advice by phone at 800-829-1040 or on its Web site. Some nonprofit organizations also offer free services to low-income taxpayers.

**Your Records** You have two choices for tax recordkeeping: you can wait until tax time and search for documentation, or start a file in January and keep handy the papers you’ll need to file a return the next year. Here’s what tax experts recommend keeping for four to seven years:

### TAX RECORDS
- Pay stubs and W-2 forms
- Bank statements
- Receipts for major purchases and charitable donations
- Records of insurance and medical payments
- Proof of any theft losses: value, date missing, proof of ownership

**Test Your Financial Fitness**

1. **Stating** Who is responsible for paying income taxes?
2. **Explaining** Why do young workers have to contribute to the Social Security system?
3. **Defining** What is “adjusted gross income”?
4. **Locating** How can you find out how much money was withheld from your pay?
5. **Listing** List three forms you need to file your income tax.
Renting an Apartment:  
Know what to look for

How much rent should you pay? How do you find the best deal? What if your roommate moves out? Moving to a new apartment can be exciting. Finding and renting one takes work. Making good decisions and meeting your responsibilities as a tenant can make it easier—and avoid money problems later on.

The Rental Process

Before you begin searching for an apartment, first consider how you’ll pay for it. Rent is only the beginning. Tenants usually pay for heat, air conditioning, and electricity, and sometimes water and garbage pick-up. Many landlords expect the first and last months’ rent in advance, plus a security deposit they hold until tenants move. If you damage the property, your deposit pays for repairs. Any remainder should be returned to you, sometimes with interest, depending on local laws. If you own expensive items, you may want to add the cost of renter’s insurance. Remember: rent plus utilities should generally equal no more than one-fourth of your monthly income.

Finding a Home Once you know how much you can afford, ask yourself:
• How close to school or a job do I want to live?
• Will I have roommates?
• How many rooms do I need?
• What else is important to me: Security? Noise level? Storage? Laundry facilities?

Begin your search with friends, newspaper ads, the Internet, bulletin boards, and/or rental agencies. Make appointments to view several apartments and be prepared to provide:
• identification
• social security number
• income amount and employer’s name and phone number
• contact numbers for references (current or previous landlords, teachers, coaches, or employers) who can vouch for your character
Signing a Lease

You’ll be required to sign a lease or a rental agreement. This is a binding legal contract, so read it—fine print and all—before signing. A lease requires the tenant to pay rent for the number of months listed—even if the tenant moves before the lease ends. Rental agreements are from month to month.

The Walk-Through  Before signing anything, “walk through” the apartment with the landlord and note its condition. To safeguard your deposit, make sure any damages are listed on the lease. Take dated photos before you move in and when you move out.

The Right Roommates  If you plan to share an apartment with roommates, be sure that they can afford the apartment and that they sign the lease to ensure equal legal responsibility. Make it clear that if they move before the lease ends, they’re responsible for either paying their share of the rent until the lease ends or for finding replacement roommates. Agree on house rules up front: overnight guests, parties, chores, etc.

Rights and Responsibilities  Your apartment is your home, but it belongs to the property owner. Landlords must keep it structurally safe and sanitary, and provide access to heat, water, and electricity. They can enter your apartment only to make repairs or show it to prospective tenants. In some states, they must give you advance notice. Prospective landlords can check references, employment, and credit, but it is against the law to discriminate on the basis of race, national origin, religion, gender, familial status, or disability. A local tenants’ union can provide information and advice.

You’re responsible for paying rent on time, keeping the apartment clean and in good condition, following the terms of the lease, and being considerate of neighbors. Remember: being a responsible tenant makes your new landlord a good reference for your next one.

Test Your Financial Fitness

1. **Explaining**  What are two reasons for taking good care of a landlord’s property?

2. **Listing**  What costs are involved in renting an apartment?

3. **Applying**  List four factors that would affect your choice of an apartment, in order of importance to you. Then explain why they’re important.
Buying a Car: 
Drive a good deal

Is a cool car in your future? Where will you get the money? Picture yourself in the car of your dreams. Wait: Now picture yourself under a mountain of debt. Before you rush to a Ferrari dealer, do the homework that can help you get a good deal on a vehicle that meets your needs now—and down the road.

Choosing Your Car

The most important step in the car-buying process is figuring out how much you can afford. Do this before deciding which car you want. In general, car payments should be less than 15 percent of your monthly income.

Do the Research  Check the Internet or consumer publications for comparisons of:

• Safety: Is the car likely to protect you in a crash or poor road conditions, and avoid rolling over? Also find unbiased reviews at www.nhtsa.dot.gov.
• Performance: The number of miles per gallon of gasoline (fuel efficiency) and the impact a car makes on the environment (emissions) vary with the type of car. You can check both at www.fueleconomy.gov. High gas prices alone make it essential to check mileage. Hybrid cars are designed to use less gas and pollute less by running on a combination of gas and electricity, but they cost more up front than gasoline-powered cars.
• Repairs: Consumer publications list which vehicles require fewer repairs and cost less to fix.

Compare Financing  Dealers make most of their profit on loans, not car sales. Before discussing financing with a dealer, research loans at banks and other financial institutions. Also check your credit score, since it determines whether you’ll get a loan and how much interest you’ll pay. (See Credit and You on page R10.) If you’re applying for credit at more than one place, do it within a 14-day period. Otherwise, your credit rating will drop because of “too many inquiries.”

Every car has a “pink slip,” or title—a document that proves ownership. You won’t get the pink slip until you’ve made all the payments. Meanwhile, the seller gives you a receipt you’ll need to register your car and buy license tags.
Getting a Deal

A new car is exciting, offers warranties, and requires fewer repairs. But a new car depreciates (loses value) the minute you drive it off the lot. Used cars depreciate more slowly and cost a lot less to begin with. Some even offer limited warranties.

New Cars  A cool head and a game plan can save you thousands of dollars. Here are some tips:
1. Take your time. Don’t let “special offers” or high-pressure sales tactics rush you into buying on your first visit.
2. Find the fair price. On the Internet, find the factory invoice price, which is the price the dealer paid for the car. This is not the “sticker” price on the car’s window (a higher Manufacturer’s Suggested Retail Price, or MSRP). Offer to pay that price plus a fair profit, usually 3 to 5 percent.
3. Get bids. Ask five dealers for written bids. Those bids are your bargaining edge.

Used Cars  Check the Internet or newspapers for ads. If you’re buying from a dealer, ask for names and phone numbers of previous customers. Contact them or the Better Business Bureau for any complaints against the dealer. Weed out the “lemons” with these tips:
- Drive the car, noticing odd noises and how it handles.
- Look at the title to see if the car was “salvaged.” That means an insurer declared it a “total loss”; it probably has structural damage that could affect safety and performance.
- Have a mechanic you trust or the American Automobile Association (AAA) test the car. If the seller won’t allow testing, don’t buy the car.
- Ask to see receipts for recent repairs. Also get the vehicle identification number (VIN) (usually on the dash). At the CARFAX Web site, check the car’s history.

High Cost of Driving
The average annual cost of driving a new car in the United States is more than 56 cents per mile, including gas, oil, maintenance, tires, insurance, licenses, registration, vehicle depreciation, and finance charges. That’s $8,410 a year!

Test Your Financial Fitness

1. **Explaining**  What is the most important thing to consider when choosing a car? List three other important factors.
2. **Listing**  List three things you can do to avoid getting a “lemon” when you buy a used car.
3. **Describing**  Describe the process a smart car buyer would use before visiting a car dealer.
4. **Defining**  What is the difference between the retail price and the factory invoice price?
Insurance Matters:
Protect yourself

Is your car legal? Who pays if you get sick or robbed? Nobody enjoys thinking about—or paying for—insurance. If you have an emergency, you’ll be glad you did.

How It Works

Insurance is like a life raft. You pay an insurance company monthly or quarterly premiums. Then, if something bad happens, such as a traffic accident, an illness, or an apartment fire, insurance helps you stay afloat financially. If nothing bad happens, the company keeps the money.

A document detailing what your insurance covers is a policy. Most policies require a deductible, an amount you have to pay before the insurance kicks in.

**Example:** You chose car insurance with a $1,000 deductible and you’re involved in an accident. You’ll have to pay the first $1,000 to fix the car. The insurance company will pay the rest, up to the amount you’ve purchased. If you had chosen a $500 deductible, you’d pay only the first $500, but your premiums would be higher.

**Types of Car Insurance**

**Collision:** Damage to your car, regardless of who caused the accident.

**Comprehensive:** Damage to your car not caused by an accident, such as theft, vandalism, and natural disasters.

**Liability:** Bodily injury and property damage to others, plus legal costs. State laws determine how much coverage you must have.

**Medical:** Medical expenses for everyone injured, regardless of fault.

**Personal injury protection:** Medical expenses for the insured driver, regardless of fault.

**Uninsured motorist:** Damage to your car in an accident caused by a driver with no liability insurance.

**Underinsured motorist:** Damage to your car in an accident caused by someone with insufficient liability insurance.

**Rental reimbursement:** Car rental if your vehicle cannot be driven after an accident.
Types of Insurance

Some types of insurance are useful to you now, but most can wait until you’re out of school and have more responsibilities.

Auto It’s illegal to drive in most states without basic liability insurance to cover property damage and injuries to others; some also require personal injury coverage for the driver. But you may want to buy more insurance than the law requires. Teenage drivers are involved in four times as many crashes as other age groups and are three times more likely to die in a traffic accident. Auto insurance helps pay the costs of injuries, car and property damage, and lawsuits.

Health Even if you’re healthy, health insurance is a good idea at any age. It pays for hospitalization, surgery, exams, and other medical costs. Some employers pay part of the cost for employees and their families. Health insurance has deductibles and most plans require a small payment (co-payment, or “co-pay”) whenever you visit a doctor’s office.

Property What would it cost to replace everything you own: computer, TV, clothes, bicycle? If it’s more than you could afford, it should be insured against theft, fire, and other dangers. Renters insurance covers the contents of rented property and injury to visitors. Homeowners insurance covers a house, its contents, and visitor injuries. Separate insurance is needed for flood or earthquake damage.

Other Insurance Life insurance provides financial support to loved ones when a person dies. Some types of life insurance offer lending or retirement income features. Disability insurance partially replaces income if you can’t work because of illness or injury. Long-term care insurance pays for care in nursing homes, assisted living facilities, or private homes when an elderly or disabled person can’t manage daily tasks.

Test Yourself

1. **Stating** What type of insurance covers a stolen car?
2. **Determining Cause and Effect** Why do you think most states require drivers to have liability insurance, but not collision or comprehensive?
3. **Defining** What is a deductible?
4. **Listing** What two disasters are not covered by renters or homeowners insurance?
5. **Naming** Name three ways to cut the cost of car insurance.

**INSURANCE TIPS**

- Find out if the policy covers the amount it would cost you to replace the item (replacement cost), or only the amount the item was worth before it was damaged, lost, or stolen (actual cash value, or ACV).
- Read the fine print before signing a policy.
- Document your property with photos and keep receipts.
- To lower insurance costs:
  - Shop to get the lowest premium.
  - Maintain good credit.
  - Drive a low-profile car, not one that’s flashy or expensive to repair.
  - Drive safely and ask about discounts for “good students,” nonsmokers, nondrinkers, and good drivers.
  - Get an education: some insurers charge less to customers with higher educational levels.
  - If your car is worth less than $1,000, consider dropping collision and comprehensive coverage—but not liability.
  - Install safety and anti-theft devices (airbags, alarms).
  - Buy several types of insurance from the same company to qualify for a multiple-policy discount.
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Identifying the Main Idea

Why Learn This Skill?
Finding the main idea in a reading passage will help you see the “big picture” by organizing information and assessing the most important concepts to remember.

Learning the Skill
Follow these steps when trying to identify the main idea:
• Determine the setting of the passage.
• As you read the material, ask: What is the purpose of this passage?
• Skim the material to identify its general subject. Look at headings and subheadings.
• Identify any details that support a larger idea or issue.
• Identify the central issue. Ask: What part of the selection conveys the main idea?

Practicing the Skill
Read the excerpt below and answer the questions that follow.

Industrial robots can’t speak English or Chinese, but they can communicate very well with their controllers—something they do 24/7, with no vacations and no health care. They don’t receive a pension after they’re retired, either. Instead, they get recycled or remanufactured and go to work again.

The average wage for a U.S. warehouse or distribution worker is around $15 per hour (plus benefits). The average wage for this same work in China is about $3 per hour. The average wage for a skilled UAW U.S. automobile worker is $25 to $30 per hour, plus the staggering costs of health care coverage and retirement.

The average cost per hour to operate an industrial robot is 30 cents per hour according to Ron Potter, director of robotic technologies of Factory Automation Systems.


1. Where did this article appear?
2. When was it written?
3. What is the main idea of this article?
4. What additional details support the main idea?

Applying the Skill
Bring to class an article from a newspaper, magazine, real-estate buying guide, or other publication. Identify the main idea, and explain why it is important.
Determining Cause and Effect

Why Learn This Skill?
Determining cause and effect involves considering why an event occurred. A cause is the action or situation that produces an event. What happens as a result of a cause is an effect.

Learning the Skill
To identify cause-and-effect relationships, follow these steps:
• Identify two or more events or developments.
• Decide whether one event caused the other. Look for “clue words” such as because, led to, brought about, produced, as a result of, so that, since, and therefore.
• Look for logical relationships between events, such as “She overslept, and then she missed her bus.”
• Identify the outcomes of events. Remember that some effects have more than one cause, and some causes lead to more than one effect. Also, an effect can become the cause of yet another effect.

Practicing the Skill
The classic cause-and-effect relationship in economics is between price and quantity demanded/quantity supplied. As a price for a good rises, the quantity demanded goes down and the quantity supplied rises.

1. Look at the photo above. What might cause a store to have a big sale on plasma televisions? What is the effect on consumers?

2. Now look at the demand curve for plasma televisions below. If the price is $5,000, how many will be demanded per year? If the price drops to $1,000, how many will be demanded per year?

Demand Curve for Plasma Televisions

Applying the Skill
In your local newspaper, read an article describing a current event. Determine at least one cause and one effect of that event.
Making Generalizations

Why Learn This Skill?
Generalizations are judgments that are usually true, based on the facts at hand. If you say, “We have a great soccer team,” you are making a generalization. If you also say that your team is undefeated, you are providing evidence to support your generalization. Generalizations are useful in the study of economics because they help economists see trends. Examples include the generalizations that men earn more than women and that prices go down when there is more competition. There are exceptions to both of these statements, but they are generally true.

Learning the Skill
To learn how to make a valid generalization, follow these steps:
- Identify the subject matter.
- Collect factual information and examples relevant to the topic.
- Identify similarities among these facts.
- Use these similarities to form some general ideas about the subject.

Practicing the Skill
Read the excerpt, then identify whether each generalization that follows is valid or invalid. Explain your answers.

Few times in a young person’s life are as stressful as the first year out of college. If all goes well, you land a dream job in your chosen profession. But now everything hangs in the balance. Do well in your rookie job and it could put your career into overdrive. Your employer may shower you with promotions, pay raises, and increased responsibility, and you’ll be able to leapfrog ahead of the competition in your next position. Do poorly, and you may be sent down to the minors.

The good news: Barring any serious infractions, relatively few people get completely sidetracked in their first year on the job, as most employers allow for a learning curve. The bad news is the reputation you make for yourself will be yours for a good long time—the corporate equivalent of your permanent academic record—coloring the way people see you for many years.

—BusinessWeek Online, September 18, 2006

1. The first year out of college is one of the most stressful times in a person’s life.
2. All young workers who do well in their first year will have successful careers.
3. Most employers will tolerate a few rookie mistakes.
4. A young employee can never recover from a bad reputation.

Applying the Skill
Read at least three editorials in your local newspaper. Then make a generalization about each editorial.
Distinguishing Fact from Opinion

Why Learn This Skill?
Distinguishing fact from opinion can help you make reasonable judgments about what others say and write. Facts can be proved by evidence such as records, documents, or historical sources. Opinions are based on people’s differing values and beliefs.

Learning the Skill
To learn how to identify facts and opinions, follow these steps:
• Read or listen to the information carefully. Identify the facts. Ask: Can these statements be proved? Where would I find information to verify them?
• If a statement can be proved by information from a reliable source, it is factual.
• Identify opinions by looking for statements of feelings or beliefs. They may contain words like should, would, could, best, greatest, all, every, or always.

Practicing the Skill
Read the excerpt and answer the questions that follow.

Office architects are envisioning improved cubicles—newbicles?—that feel private yet collegial, personal yet interchangeable, smaller yet somehow more spacious. Employing advanced materials, tomorrow’s technology, and the fruits of sociological research, designers are fitting the future workplace to workers who are increasingly mobile and global. . . .

The father of the cubicle never meant to wreak such bleakness on the American office. We know this from the delightfully delusional name Robert Propst gave his invention: the Action Office. Back then, in 1968, most office workers toiled in open bull pens. Propst’s pod offered at least as much privacy as they had in a toilet stall, albeit without the door. Corporate America, which is run by people whose offices have doors, has snapped up more than $5 billion worth of the units from maker Herman Miller. Today 70% of U.S. office workers sit in cubicles, which have long transcended mere office furniture to become a pop-cultural icon (thank you, Dilbert).

—Time, July 9, 2006

1. What are three factual statements in the passage?
2. Which statements are opinions? Explain.

Applying the Skill
Watch a television interview, and then list three facts and three opinions that you hear.
Formulating Questions

Why Learn This Skill?
Asking questions helps you to process information and understand what you read.

Learning the Skill
Follow these steps to formulate questions as you read:
• Think about questions you have. 
  Often you can find the answers in the next paragraph or section.
• Ask who, what, when, where, why, and how about the main ideas, people, places, and events.
• Reread to find answers to your questions.

Practicing the Skill
Read the second excerpt about Hello Kitty. Then, using a chart like the one below, ask questions about the excerpt and reread the selection to find the answers.

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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<tbody>
<tr>
<td>Who?</td>
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</tbody>
</table>

The business mind behind [Hello Kitty] is Shintaro Tsuji, the founder, president, and CEO of Sanrio. In Japan, Tsuji is considered the closest thing the country has to a Walt Disney. He turned Sanrio, founded in 1960 as a small trinket maker, into a nearly $1 billion character-goods purveyor and theme park operator. Hello Kitty came on the scene in 1974 and appealed primarily to Japanese girls age 5 to 15.

Today, the fabulous feline is embraced by Parisian fashion houses, U.S. pop divas such as Mariah Carey and Christina Aguilera, and legions of fashion-conscious women in rich world markets.

—BusinessWeek, June 23, 2006

Applying the Skill
Select any section of this textbook to read or reread. Make a questioning chart to help you ask and answer five or more questions about the section as you read.
Analyzing Information

Why Learn This Skill?
The ability to analyze information is important in deciding what you think about a subject. For example, you need to analyze the effects of international free trade versus the effects of trade restrictions to decide where you stand on the issue of U.S. trade policy.

Learning the Skill
To analyze information, use the following steps:
• Identify the topic that is being discussed.
• Examine how the information is organized. What are the main points?
• Summarize the information in your own words, and then make a statement of your own based on your understanding of the topic and on what you already know.

Practicing the Skill
Read the excerpt and answer the questions that follow.

In May, the U.S. Mint informed Congress that the cost of making a penny and a nickel will soon exceed the actual value of each coin. . . . The U.S. mint estimates that by the end of the fiscal year, the cost of producing one penny will come to around 1.23 cents. . . . The news revived efforts to take the penny out of circulation. On July 18, Representative Jim Kolbe (R., Ariz.) introduced the Currency Overhaul for an Industrious Nation (COIN) Act that calls for the modernization of America’s currency system. The bill includes implementing a rounding system for cash transactions that would eliminate the penny, increasing the production and circulation of the golden dollar while phasing out the dollar bill, and studying whether a change in the composition of coins to include less expensive metals would be worthwhile.

—BusinessWeek, July 19, 2006

1. What topic is being discussed?
2. What are the main points of this excerpt?
3. Summarize the information in this excerpt, and then provide your analysis based on this information and what you already know about the subject.

Applying the Skill
Select an issue in economics that is currently in the news, such as Social Security, oil prices, the national debt, or taxation. Read an article or watch a news segment about the issue. Analyze the information and make a brief statement of your own about the topic. Explain your thinking.
Evaluating Information

Why Learn This Skill?
We live in an information age. The amount of information available can be overwhelming, and it is sometimes difficult to know when information is true and useful. You need to evaluate what you read and hear to determine the reliability of the information presented.

Learning the Skill
When evaluating information to determine its reliability, ask yourself the following questions as you read:

- Is there bias? In other words, does the source unfairly present just one point of view, ignoring any arguments against it?
- Is the information published in a credible, reliable publication?
- Is the author or speaker identified? Is he or she an authority on the subject?
- Is the information up-to-date?
- Is the information backed up by facts and other sources? Does it seem to be accurate?
- Is it well-written and well-edited? Writing that has errors in spelling, grammar, and punctuation is likely to be careless in other ways as well.

Practicing the Skill
Look at the following statements about oil prices. Rank them in order of most reliable to least reliable, and then explain why you ranked them as you did.

“Oil prices are so high, becuz big oil companies are tryng to gouge us. Greedy oil executives, are driven up prices to get richer.”
—published on an individual’s blog on the Internet

“It’s certainly clear that high oil prices aren’t dulling demand for energy products. According to the Energy Dept.’s Energy Information Administration (EIA), U.S. demand for gasoline in June was 9.5 million barrels per day, a record.”
—BusinessWeek, July 7, 2006

“The single biggest factor in the inflation rate last year was from one cause: the skyrocketing prices of OPEC oil. We must take whatever actions are necessary to reduce our dependence on foreign oil—and at the same time reduce inflation.”
—President Jimmy Carter, January 23, 1980

Applying the Skill
Find an advertisement that contains text and bring it to class. In a brief oral presentation, tell the class whether the information in the advertisement is reliable or unreliable and why.
Making Inferences

**Why Learn This Skill?**
To infer means to evaluate information and arrive at a conclusion. When you make inferences, you “read between the lines,” or use clues to figure something out that is not stated directly in the text.

**Learning the Skill**
Follow these steps to make inferences:
- Read carefully for stated facts and ideas.
- Summarize the information and list important facts.
- Apply related information that you may already know.
- Use your knowledge and insight to develop some logical conclusions.

**Practicing the Skill**
Read the passage and answer the questions that follow.

**Applying the Skill**
Look over the headlines in today’s Business and Finance section in your local newspaper. What can you infer about what economic issues are important in your community, the nation, and the world right now? Skim an article. Can you tell how the writer feels about the topic? How?

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**USA Today, September 11, 2006**

1. What facts are presented in the passage?
2. What can you infer about the importance of educating Panda Express customers about Chinese food? Explain.
3. Can you also infer that there is currently no national Chinese fast-food chain? Explain.

Texans know their barbecue. But lots of them apparently don’t know their Chinese food. The top question at the 10 Panda Express stores opened in Texas this year is “What's orange chicken?”

Andrew and Peggy Cherng, the husband-and-wife team who created Panda Express, know that answering that question and many others about their menu is part of the diner-education process that has turned a one-store eatery inside a California mall into an 820-store Chinese food empire. Orange chicken, a lightly sweetened fried chicken dish, is their best seller but not as familiar in Texas as fajitas and hamburgers.

If they get their way, it will be. And not just on the coasts. The two are well on their way to cracking a frontier in fast food: creating a national Chinese fast-food chain.

—USA Today, September 11, 2006
Comparing and Contrasting

**Why Learn This Skill?**
When you make comparisons, you determine similarities among ideas, objects, or events. When you contrast, you are noting differences between ideas, objects, or events. Comparing and contrasting are important skills because they help you choose among several possible alternatives.

**Learning the Skill**
To learn how to compare and contrast, follow these steps:
- Identify or decide what two or more items will be compared and/or contrasted.
- To compare, determine a common area or areas in which comparisons can be drawn. Look for similarities within these areas.
- To contrast, look for areas that are different. These areas set the items apart from each other.

**Practicing the Skill**
Study the advertisements for two computers at the bottom of the page, and then answer the questions that follow.
1. How are these products similar?
2. How are they different?
3. Which of these two computers would you choose? Why?

**Applying the Skill**
Survey your classmates about an issue in the news. Summarize the opinions and write a paragraph or two comparing and contrasting the different opinions.
Detecting Bias

Why Learn This Skill?
Most people have a point of view, or bias. This bias influences the way they interpret and write about events. Recognizing bias helps you judge the accuracy of what you hear or read.

Learning the Skill
Follow these steps to learn how to recognize bias:
• Examine the author’s identity, especially his or her views and particular interests.
• Identify statements of fact.
• Identify any expressions of opinion or emotion. Look for words that have positive or negative overtones for clues about the author’s feelings on a topic.
• Determine the author’s point of view.
• Determine how the author’s point of view is reflected in the work.

Practicing the Skill
Read the passage and answer the questions that follow.

Sometime in October the U.S. will join China and India in the very small club of countries with at least 300 million residents. This really is a big deal, like hitting 700 home runs in baseball. No other country is expected to reach the 300 million mark for at least 30 more years. . . .

But here are a couple of questions for you to ponder as the U.S. gets closer to the big 300:
Is it coincidence that the three countries with the largest populations also have the most dynamic economies in the world? And is it coincidence that the most innovative major industrialized country, the U.S., also has the fastest growing population and the most young people?
No coincidence at all, as it turns out.
—BusinessWeek, September 5, 2006

1. What statements of fact are presented in this passage?
2. What opinions are stated?
3. What is the purpose of this passage?
4. What evidence of bias do you find?
Does the author think it is a good thing or a bad thing that the United States is hitting this population milestone?

Applying the Skill
Find an editorial in the newspaper that deals with a topic of specific interest to you. Apply the steps for recognizing bias to the editorial. Write a paragraph summarizing your findings.
Synthesizing Information

Why Learn This Skill?
Synthesizing information involves combining information from two or more sources. Information gained from one source often sheds new light upon other information.

Learning the Skill
Follow these steps to learn how to synthesize information:
• Analyze each source separately to understand its meaning.
• Determine what information each source adds to the subject.
• Identify points of agreement and disagreement between the sources. Ask: Can Source A give me new information or new ways of thinking about Source B?
• Find relationships between the information in the sources.

Practicing the Skill
Read the passages and answer the questions that follow.

Source A “The flat tax. In the eyes of many fiscal conservatives, it’s the Holy Grail of public policy: One low income tax rate paid by all but the poorest wage-earners, who are exempt. No loopholes for the rich to exploit. No graduated rates that take a higher percentage of income from people who work hard to earn more. No need for a huge bureaucracy to police fiendishly complex tax laws.”

—BusinessWeek, September 26, 2005

Source B “Under Steve Forbes’ plan the flat [income tax] rate would be 17%. All families would get generous personal exemptions, so that a family of four would not pay taxes until its income exceeded $46,000. To encourage growth, the Forbes plan exempts income that is saved and invested. Which means that the Forbes plan is really a consumption tax. It taxes people based on what they take out of the system, not on what they put in.”

—Forbes, September 29, 2005

1. What is the main subject of each source?
2. Does Source B support or contradict Source A? Explain.
3. Summarize what you learned from both sources.

Applying the Skill
Find two sources of information on banking practices. What are the main ideas in each? How does each add to your understanding of the topic?
Drawing Conclusions

Why Learn This Skill?
A conclusion is a logical understanding that you reach based on details or facts that you read or hear. When you draw conclusions, you use stated information to figure out ideas that are unstated.

Learning the Skill
Follow these steps to draw conclusions:
• Read carefully for stated facts and ideas.
• Summarize the information and list important facts.
• Apply related information that you may already know.
• Use your knowledge and insight to develop some logical conclusions.

Practicing the Skill
Read the passage and answer the questions that follow.

In the automotive business these days, big is out and small is in. Sales of large sport-utility vehicles are down 45%. Small-car sales have increased 70%. Of course, having suffered from $3-plus-a-gallon gasoline for longer, the rest of the world has been thinking small for years. And there is no production car smaller than the Smart Car from DaimlerChrysler.

But can a car that is just slightly more than 8 feet long and 5 feet high with 15-inch wheels co-exist with the mastodons that rule the American road? . . . Only time will tell.

—BusinessWeek, August 24, 2006

1. What topic is the writer describing?
2. What facts are given in the selection?
3. What do you already know about the subject?
4. What conclusion can you draw about why small-car sales are increasing while sales of large sport-utility vehicles are decreasing?

Applying the Skill
Read one of the “People & Perspectives” features about a prominent economist or entrepreneur in this text. Using the information in the profile, what can you figure out about the life of the person described? Draw three conclusions about this famous person’s life and ideas.
Making Predictions

Why Learn This Skill?
Predicting future events can be difficult and sometimes risky. The more information you have, however, the more accurate your predictions will be. Making good predictions will help you understand what you read.

Learning the Skill
To help you make predictions, follow these steps:
• Gather information about the decision or action.
• Use your knowledge of history and human behavior to identify what consequences could result.
• Analyze each of the consequences by asking: How likely is it that this will occur?

Practicing the Skill
Read the passage and answer the questions that follow.

Google and Yahoo! have been raking in the cash for years, as large advertisers shift more spending to online media. But judging by recent earnings figures from the Internet leaders, the trend is just hitting its stride. . . .

Driving this breakneck growth [in Internet advertising] is the companies’ ability to draw advertising dollars onto the Internet—and away from other media. In 2002, 2.5% of U.S. ad dollars were spent online. The figure is expected to reach 4.6% this year [2005] and 7.5% by 2009, according to researcher eMarketer.

—BusinessWeek, October 21, 2005

1. What trend does the passage describe?
2. Do you think this trend is likely to continue?
3. On what do you base this prediction?
4. What are three possible consequences of this trend?

Applying the Skill
Analyze three articles in the business section of a newspaper. Predict three consequences of the actions in the articles. On what do you base your predictions?
Problems and Solutions

Why Learn This Skill?
Suppose you are not doing well in basketball. You wonder why you cannot do better since you always go to practice, try your best, and pay attention to the coach’s instructions. In order to improve a situation such as this one, you need to identify a specific problem and then take actions to solve it.

Learning the Skill
Follow these steps to help you through the problem-solving process:
• Identify the problem.
• Gather information.
• List possible solutions.
• Consider the advantages and disadvantages of each solution.
• Choose the best solution to your problem and carry it out.
• Evaluate the effectiveness of the solution.

Practicing the Skill
Read the selection and answer the questions that follow.

The soaring price of cement is having a disproportionate effect on lower-middle to middle-income families. Why? Because the denser housing that tends to get built for them uses lots of concrete, which is made from cement, sand, gravel, and water. Designs with lots of concrete are becoming so expensive to build that they’re getting out of the potential buyers’ price range, says Tim Sullivan, president of Sullivan Group Real Estate Advisors.

[Sullivan says] that because of the high price of cement and concrete products, builders are putting more of their efforts into homes that are built primarily of lumber. These are single-family homes or town homes that tend to be aimed at higher-income families. Tall condo and apartment buildings made of concrete are so expensive to build that these days they’re aimed almost exclusively at wealthier buyers.

—BusinessWeek Online, June 9, 2006

1. What problem does the writer present in this selection?
2. What options are available to solve this problem? Can you think of any other options?
3. Explain the solution that was implemented according to the selection.
4. Evaluate the solution described in the passage. Was it successful? How do you determine this?

Applying the Skill
Select an economic problem that needs to be solved. The problem can be anything from how you plan to pay for an upcoming expense to how the United States might solve the problem of funding Social Security long-term. Create a simple presentation in which you identify the problem, list options with their advantages and disadvantages, choose a solution, and evaluate the chosen solution.
Using Line Graphs

Why Learn This Skill?
A graph, like a picture, may present information in a more concise way than words. Line graphs are drawings that compare numerical values. They often are used to compare changes over time or differences between places, groups of items, or other related events.

Learning the Skill
Follow these steps to learn how to understand and use line graphs. Then answer the questions below.

1. Read the title of the graph. This should tell you what to expect or look for.

2. Note the information on the left side of the graph—the vertical axis. The information being compared usually appears on this axis.

3. Note the information along the bottom of the graph—the horizontal axis. Time often appears along this axis.

4. Determine what the line(s) or curve(s) symbolizes.

5. Select a point on the line, then note the date below this point on the horizontal axis and the quantity measured on the vertical axis.

6. Analyze the movement of the line (whether increasing or decreasing over time) or compare lines (if more than one is on the graph) to determine the point being made.

Practicing the Skill
1. About how many people in wholesale and retail businesses were self-employed in 2003? In 2004?
2. How many more people were self-employed professionals in 2003 than in 2001?

Applying the Skill to Economics
1. What trends are shown on the graph?
2. What economic forces might have influenced the changes shown on the graph?
3. What kinds of jobs do you think are represented in each category shown?
Using Bar and Circle Graphs

Why Learn This Skill?

Bar graphs are often used to show changes over time or to compare quantities between similar categories of information. Circle graphs usually show the relationship of parts to a whole.

Learning the Skill

Follow these steps to learn how to understand and use bar graphs.

1. Read the title and labels. They tell you the topic, what is being compared, and how it is counted or measured.

2. Examine a bar on the graph. Note the date below the bar on the horizontal axis and the quantity measured on the vertical axis.

3. Analyze the change over time or compare bars to determine the point being made.

Learning the Skill

Follow these steps to learn how to understand and use circle graphs.

1. Examine the title to determine the subject.

2. Read the legend to see what each segment represents.

3. Compare the relative sizes of the circle segments, thus analyzing the relationship of the parts to the whole.

Practicing the Skill

1. In the bar graph, what year had the lowest spending on air travel?
2. According to the circle graph, what percentage of high school dropouts are employed?

Applying the Skill to Economics

1. Using the bar graph, what projection could you make about the future of air transportation?
2. Based on the circle graph, what can you tell about the employment chances of high-school dropouts?
Using Tables and Charts

Why Learn This Skill?
Tables and charts are often used to show comparisons between similar categories of information. Tables usually compare statistical or numerical data. Tabular data is presented in columns and rows. Charts often show a wider variety of information than tables.

Learning the Skill
Follow these steps to learn how to understand and use tables. Then answer the questions below.

1. Read the title of the table to learn what content is being presented.
   - **Number of Full-Time Workers by Age and Gender (in thousands)**

2. Read the headings in the top row. They define the groups or categories of information to be compared.

3. Examine the labels in the left-hand column. They describe ranges or subgroups and are often organized chronologically or alphabetically.

4. Note the source of the data. It may tell you about the reliability of the information in the table.

5. Compare the data presented in the other columns. This is the body of the table.

<table>
<thead>
<tr>
<th>Age</th>
<th>Total</th>
<th>%</th>
<th>Male</th>
<th>%</th>
<th>Female</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>16 to 19 years old</td>
<td>580,704</td>
<td>4.7</td>
<td>288,653</td>
<td>4.5</td>
<td>291,099</td>
<td>4.9</td>
</tr>
<tr>
<td>20 to 24 years old</td>
<td>1,334,383</td>
<td>10.8</td>
<td>699,181</td>
<td>10.9</td>
<td>635,666</td>
<td>10.7</td>
</tr>
<tr>
<td>25 to 34 years old</td>
<td>2,817,031</td>
<td>22.8</td>
<td>1,539,480</td>
<td>24.0</td>
<td>1,283,213</td>
<td>21.6</td>
</tr>
<tr>
<td>35 to 44 years old</td>
<td>3,051,784</td>
<td>24.7</td>
<td>1,603,625</td>
<td>25.0</td>
<td>1,443,614</td>
<td>24.3</td>
</tr>
<tr>
<td>45 to 54 years old</td>
<td>2,804,676</td>
<td>22.7</td>
<td>1,404,776</td>
<td>21.9</td>
<td>1,402,029</td>
<td>23.6</td>
</tr>
<tr>
<td>55 to 64 years old</td>
<td>1,420,871</td>
<td>11.5</td>
<td>712,010</td>
<td>11.1</td>
<td>712,896</td>
<td>12.0</td>
</tr>
<tr>
<td>65 years and older</td>
<td>345,951</td>
<td>2.8</td>
<td>173,192</td>
<td>2.7</td>
<td>178,224</td>
<td>3.0</td>
</tr>
</tbody>
</table>


Practicing the Skill
1. What age group has the most workers?
2. What age group has the smallest percentage of female full-time workers?
3. Which age groups have a higher percentage of male than female full-time workers?

Applying the Skill to Economics
1. What age-related trends do you notice in this table?
2. What conclusions could you draw from this data about the peak working years for most U.S. workers?
3. At what age do people apparently begin to retire from full-time work?
Sequencing Events

Why Learn This Skill?
Sequencing involves placing facts in the order in which they occurred. Sequencing helps you deal with large quantities of information in an understandable way. In economics, sequencing can help economists understand cause-and-effect relationships between events. This in turn helps analysts to predict outcomes of various events or policies.

Learning the Skill
To sequence events, follow these steps:
- Look for dates or clue words that provide you with chronological order: in 2007, the late 1990s, first, then, finally, after the Great Depression, and so on.
- Arrange facts in the order in which they occurred.
- You might use an organizational tool such as a time line to sequence events so that it is easy to see a chronology as well as any cause-and-effect relationships that occur between events.

Practicing the Skill
Read the passage and answer the questions that follow.

At about eight in the morning on June 16, a young man named Remi Frazier from Fort Collins, Colo., sat down on a bench in Manhattan’s Columbus Circle, glued a cell phone to his ear, and spread a New York City map across his lap. By early afternoon he had launched an unlikely entrepreneurial project—to make $1 million within one month, using only a cell phone, a digital video camera, and a $100 bill. His self-imposed set of rules also meant he had made no advance contact with anyone in the city.

To achieve his goal, Frazier, 27, planned to build a volunteer network of business consultants, conceptualize and design a product, conduct market research for that product, and finally manufacture and sell it on a wide scale. He would have 30 days to complete what a startup usually takes years to do.

—BusinessWeek, June 30, 2006

1. What dates or clue words in this passage can help you determine the sequence of events being described?
2. Fill in a time line such as the one below to show the sequence of events described in the selection.

Applying the Skill to Economics
Find a newspaper or magazine article about a local business. Sequence the information presented in the article in a time line or chart.
Comparing Data

Why Learn This Skill?
Economists compare data in order to identify economic trends, draw conclusions about the relationships of sets of economic information, analyze the effectiveness of economic programs, or perform other types of analysis. It is often easiest to compare data that is organized in charts, tables, or graphs.

Learning the Skill
Follow these steps to compare and contrast data:
• Look at each set of data separately to understand what each one means on its own.
• Look for relationships among the sets of data. Ask yourself: How are these sets of information connected to each other?
• Note similarities and differences among the sets of data.
• Draw conclusions about what the sets of data, taken together, might mean.

Practicing the Skill
Compare the data in the charts at the bottom of the page, and then answer the questions below.
1. Look at the left graph. What was the overall trend in manufacturing employment from 1996 to 2005?
2. Look at the right graph. What was the overall trend in professional and business employment during the same period?
3. How are the data in the two charts related?
4. What conclusions can you draw about the two areas of employment?

Applying the Skill to Economics
Look in a world almanac or on the Internet to find two sets of data about an economic topic of your choice. Compare the data and draw at least two conclusions based on your analysis. Share your conclusions with a partner.
Understanding Percentages

Why Learn This Skill?
If you shop, you probably like seeing the word percent, as in “30 percent off.” Stores often advertise sale prices as a percent of regular prices. Percent means “parts per hundred.” So, 30 percent means the same thing as 30/100 or 0.30. Expressing change as a percentage allows you to analyze the relative size of the change.

Learning the Skill
Follow these steps to learn how to calculate and use percentages. Then answer the questions below.

1. Suppose a pair of shoes is on sale for 30 percent off the regular price. Calculate the discount by multiplying the original price by the sale percentage. Change percent to a decimal before you multiply.

2. Find the sale price by subtracting the discount from the regular price.

3. Or, figure the sale price by multiplying the regular price by the percent you will pay. (Subtract the sale percentage from 100 to get the percent you will pay.) Change percent to a decimal before you multiply.

4. Calculate an increase in sales by subtracting the quantity sold last year from the quantity sold this year.

5. Determine the percentage change by dividing the arithmetic difference by the original quantity. Multiply by 100 to change the decimal to percent.

Calculating Percent

<table>
<thead>
<tr>
<th>Regular price of shoes</th>
<th>$57.00</th>
<th>Regular price</th>
<th>$57.00</th>
<th>$57.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>$17.10</td>
<td>Discount</td>
<td>$17.10</td>
<td>0.30</td>
</tr>
<tr>
<td>Discount</td>
<td></td>
<td>Sale price</td>
<td>$39.90</td>
<td></td>
</tr>
</tbody>
</table>

Arithmetic Change vs. Percentage Change

<table>
<thead>
<tr>
<th>Arithmetic change</th>
<th>1.6 billion pounds of butter sold this year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>− 1.5 billion pounds of butter sold last year</td>
</tr>
<tr>
<td></td>
<td>0.1 billion pounds</td>
</tr>
<tr>
<td>Percentage change</td>
<td>0.67 × 100 = 67%</td>
</tr>
</tbody>
</table>

Practicing the Skill

1. A store advertises a shirt at 25 percent off the original price of $44. What is the sale price?

2. What is the percentage increase in high school enrollment from 1,165 students to 1,320?

Applying the Skill to Economics

The total number of digital single music tracks downloaded online or to mobile phones rose to 470 million units in 2005, up from 160 million in 2004. What was the percentage change of single-track downloads from 2004 to 2005?
Determining Averages

Why Learn This Skill?
The most commonly used summary statistic is the average. There are two ways to compute the average: by using the mean or the median. The mean is the average of a series of items. When your teacher computes the class average, he or she is really computing the mean. Sometimes using the mean to interpret statistics is misleading, however. This is especially true if one or two numbers in the series are much higher or lower than the others. The median can be more accurate. The median is the midpoint in any series of numbers arranged in order.

Learning the Skill
Follow these steps to learn how to determine and use averages.

1. Suppose you want to find the mean weekly salary for a group of teenagers. First, add all the earnings together.

2. Divide the sum by the number of students to find the mean.

3. Locate the median by finding the midpoint in the series ($41). Compare the mean with the median. Determine which is the more useful statistic.

4. Suppose you want to calculate the median for the four highest-paid students. First, arrange the numbers in order, from least to greatest.

5. When an even number of figures is in the series, the median is the mean of the two middle numbers. Follow steps 1 and 2 to find the mean.

Practicing the Skill
1. What is the mean salary for the four lowest-paid students?
2. What is the median salary for the four lowest-paid students?

Applying the Skill to Economics
Average Monthly Rent: 2005

<table>
<thead>
<tr>
<th>City</th>
<th>Rent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miami, FL</td>
<td>$971</td>
</tr>
<tr>
<td>Dallas, TX</td>
<td>$709</td>
</tr>
<tr>
<td>Boston, MA</td>
<td>$1,216</td>
</tr>
<tr>
<td>Los Angeles, CA</td>
<td>$1,330</td>
</tr>
</tbody>
</table>

1. What is the mean monthly rent for these four cities?
2. What is the median monthly rent?
Understanding Nominal and Real Values

Why Learn This Skill?
The rise in the economy’s average price level is called inflation. To make comparisons between the prices of things in the past and those of today, you have to make the distinction between nominal, or current, and real, or adjusted for inflation, values. You can use the consumer price index (CPI), an index of average prices for consumer goods, to calculate real values. Then you can accurately compare changes in income and prices over time.

Learning the Skill
Follow these steps to learn how to calculate nominal and approximate real values when price changes are small.

1. Suppose a family sells a house after living there for 10 years. To calculate whether they made any profit from the sale, they need to know the real sale price of their house. First, find the nominal price increase.

<table>
<thead>
<tr>
<th>Purchase price of house in 1995: $75,000</th>
<th>Sale price of house in 2005: $150,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 150,000</td>
<td>$75,000</td>
</tr>
<tr>
<td>— 75,000</td>
<td>$75,000</td>
</tr>
<tr>
<td>$ 75,000</td>
<td></td>
</tr>
</tbody>
</table>

2. Calculate the nominal percentage increase in price. Divide the amount of increase by the original price and multiply by 100 to express the answer as a percent.

\[
\text{Percentage Increase in Price} = \left( \frac{\text{Increase}}{\text{Original Price}} \right) \times 100
\]

3. Determine the percentage increase in the consumer price index. First find the actual change in CPI. Then divide the amount of increase by the original CPI and multiply by 100.

\[
\text{Percentage Increase in CPI} = \left( \frac{\text{Change in CPI}}{\text{Original CPI}} \right) \times 100
\]

4. Determine the percentage increase in real price. Subtract the percentage increase in CPI from the percentage increase in nominal price. Evaluate the sales in real values.

5. Suppose that last year you earned $10 per hour. You receive a 5 percent raise. The CPI is 3 percent higher than last year’s CPI, which means there is a 3 percent inflation rate.

6. Calculate the real salary increase by subtracting the inflation rate from the nominal raise.

Practicing the Skill
1. What was the nominal price increase on the sale of the house?
2. How much money, in real dollars, was made on the house?
3. How much was the real value of the raise?

Applying the Skill to Economics
From 2004 to 2005, the cost of employer health insurance premiums increased by 9.2 percent—nearly three times the rate of inflation. Based on this information, what was the inflation rate that year? How could you adjust the cost of health insurance for inflation?
Understanding Interest Rates

Why Learn This Skill?
When you deposit money in a savings account, the bank pays you interest for the use of your money. The amount of interest is expressed as a percent, such as 6 percent, for a time period, such as per year. Two types of interest exist: simple and compound. Simple interest is figured only on the principal, or original deposit, not on any interest earned. Compound interest is paid on the principal plus any interest that has been earned.

Learning the Skill
Follow these steps to learn how to understand and calculate interest rates.

1. Suppose you deposit $100 in a savings account that earns 6 percent simple interest per year. Get ready to figure your earnings by converting 6 percent to a decimal.

\[ 6\% = 0.06 \]

\[ \$100 \times 0.06 = 6 \]

\[ \$100 + 6 = 106 \]

\[ \$112 \]

2. To calculate the simple interest earned, multiply the principal by the interest rate.

3. Calculate the account balance for the first two years, assuming the bank pays the same interest rate each year. Add the principal, the first year’s interest, and the second year’s interest.

\[ \$112 \]

4. Suppose you deposit $100 in a savings account that earns 6 percent compound interest per year. Calculate the interest earned the first year.

\[ \$100 \times 0.06 = 6 \]

\[ \$106 + 6 = 106.00 \]

\[ \$112.00 \]

5. Find the bank balance for the end of the first year. Add the principal and first year’s interest.

\[ \$100 + 6 = 106 \]

\[ \$106 + 6.00 = 112.00 \]

6. Determine the interest earned in the second year. Multiply the new balance by the interest rate.

\[ \$106 \times 0.06 = 6.36 \]

\[ \$112.36 \]

7. Figure the total bank balance after two years. Add the second year’s interest to the first year’s balance.

\[ \$112.36 \]

Practicing the Skill
1. What would be the difference in earnings between simple and compound interest if your initial balance was $1,000 rather than $100?
2. What would be the difference in earnings between simple and compound interest on your $100 savings after five years?

Applying the Skill to Economics
1. What would be the impact of compounding interest on a daily basis rather than an annual basis?
2. Banks often pay higher rates of interest on money you agree to keep in the bank for longer periods of time. Explain why this might be.
Interpreting Political Cartoons

Why Learn This Skill?
Political cartoonists use art to express opinions. Their work appears in newspapers, magazines, books, and on the Internet. Political cartoons usually focus on public figures, political events, or economic or social conditions. They can give you a summary of an event or circumstance and the artist’s opinion in a quick, entertaining manner.

Learning the Skill
To interpret a political cartoon, follow these steps:

1. Read the title, caption, or conversation balloons. They help you identify the subject of the cartoon.
2. Identify the characters or people shown. They may be caricatures, or unrealistic drawings that exaggerate the characters’ physical features.
3. Identify any symbols shown. Symbols are things that stand for something else. Commonly recognized symbols may not be labeled. Unusual symbolism will be labeled.
4. Examine the actions in the cartoon—what is happening and why?
5. Identify the cartoonist’s purpose. What statement or idea is he or she trying to get across? Decide if the cartoonist wants to persuade, criticize or just make people think.

Practicing the Skill
1. What is “cow tipping”? What does this imply about the U.S. economy as it is pictured in the cartoon?
2. What does the rhinoceros represent? Why might the cartoonist have chosen this particular symbol?
3. What overall message do you think the cartoonist is trying to send?

Applying the Skill to Economics
Bring a newspaper or business magazine to class. With a partner, analyze the message in each political cartoon that you find.
Reading Stock Market Reports

Why Learn This Skill?
A stock market report alphabetically lists stocks and provides information about stock prices and trades. Every business day, shares of stock are bought and sold. At the beginning of each trading day, stocks open at the same prices they closed at the day before. Prices generally go up and down throughout the day as the conditions of supply and demand change. At the end of the day, each stock’s closing price is recorded.

Learning the Skill
Follow these steps to learn how to understand and use the financial page.

1. Locate the stock in the alphabetical list. Names are abbreviated.
2. Examine the stock’s history over the last 52 weeks. The high and low prices for one share of stock appear.
3. Note the ticker symbol, or computer code, for the stock.
4. Evaluate the annual dividend. Stockholders receive this dividend, or payment, for each share of stock they own.
5. Review the yield. The yield is the return on investment per share of stock. It is calculated by dividing the dividend by the closing price.
6. Read the price/earnings ratio. Lower price/earnings ratios generally mean more earnings per share.
7. Note the volume, or number of shares of stock, traded that day. The number given represents hundreds of shares.
8. Examine the day’s high, low, and closing stock price.
9. Examine how the day’s closing stock price compares with the prior business day’s closing price. Positive numbers indicate a price increase. Negative numbers mean a price drop.

Stock Quotations

<table>
<thead>
<tr>
<th>Hi</th>
<th>Lo</th>
<th>Stock</th>
<th>Sym</th>
<th>Div</th>
<th>Yld %</th>
<th>PE</th>
<th>Vol 100s</th>
<th>Hi</th>
<th>Lo</th>
<th>Close</th>
<th>Net Chg</th>
</tr>
</thead>
<tbody>
<tr>
<td>86.40</td>
<td>47.87</td>
<td>AppleComp</td>
<td>AAPL</td>
<td>2.22</td>
<td>2.9</td>
<td>34.96</td>
<td>391290</td>
<td>77.78</td>
<td>76.10</td>
<td>77.74</td>
<td>+ 1.86</td>
</tr>
<tr>
<td>475.11</td>
<td>290.69</td>
<td>Google</td>
<td>GOOG</td>
<td>6.82</td>
<td>1.7</td>
<td>59.68</td>
<td>51928</td>
<td>407.68</td>
<td>401.77</td>
<td>406.99</td>
<td>+ 3.01</td>
</tr>
<tr>
<td>27.49</td>
<td>16.75</td>
<td>Intel</td>
<td>INTC</td>
<td>1.10</td>
<td>5.5</td>
<td>18.15</td>
<td>939098</td>
<td>19.98</td>
<td>19.32</td>
<td>19.96</td>
<td>+ 0.55</td>
</tr>
</tbody>
</table>

Practicing the Skill
1. How many shares of Google stock were traded on the day shown?
2. What was the day’s highest price for a share of Apple Computer stock?
3. Which stock had the greatest increase in closing price from the previous day?

Applying the Skill to Economics
If you had purchased 100 shares of Intel stock at its lowest 52-week price and sold it at this day’s closing price, how much money would you have made?
The data and forecasts for the graphs, tables, and charts in the Databank are based on information from Standard & Poor’s.

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**The American People**

**U.S. Population Projections, 2000–2050**

![Population Projections Graph]

*Source: U.S. Bureau of the Census*

**Civilian Labor Force, 1950–2010**

![Labor Force Graph]

*Source: Department of Labor, Bureau of Labor Statistics*

*Estimate*
The American People

Hours and Earnings in Private Industries, 1960–2006

A  Average Weekly Hours of Production Workers

B  Average Weekly Earnings of Production Workers, Current Dollars

C  Average Weekly Earnings, 1982 Dollars

Source: Bureau of Labor Statistics
### The U.S. Economy

#### Gross Domestic Product, 1950–2005

![Graph showing the Gross Domestic Product from 1950 to 2005.](image)

*Source: U.S. Department of Commerce, Bureau of Economic Analysis*

#### A Look at Stock Market History

![Graph showing the S&P 500 Price Index from 1935 to 2005.](image)

*Source: Standard & Poor’s*
**The U.S. Economy**

**Real Personal Consumption Expenditures, 1990–2005**

![Bar chart showing real personal consumption expenditures for goods and services from 1990 to 2005.]

*Source: Department of Commerce, Bureau of Economic Analysis*

**Personal Consumption Expenditures, 1960–2005**

![Line graph showing personal consumption expenditures for various categories from 1960 to 2005.]

*Source: Department of Commerce, Bureau of Economic Analysis*
The U.S. Economy

Average Prices of Selected Goods, 1990–2006

- Electricity per 500 KWH
- Utility natural gas, 40 therms
  (1 therm = 100,000 British thermal units)
- Gasoline, all types, per gallon
- Gasoline, unleaded regular, per gallon
- Ground chuck, 100% beef, per pound
- Eggs, 1 dozen large
- Chicken, per pound
- White bread, per pound
- Tomatoes, per lb.
- Apples, red delicious, per lb.
- Bananas, per lb.

Source: Bureau of Labor Statistics; U.S. city average prices for July
The U.S. Economy


Inflation in Consumer Prices, 1950–2006

Source: Bureau of Labor Statistics
The Government Sector


Total Government Expenditures, 1965–2005

Source: The Federal Budget for Fiscal Year 2007, Historical Tables

*Estimate

Source: Economic Report of the President, 2006
The Government Sector

Federal Government Total Receipts and Total Outlays, 1950–2007

Source: Economic Report of the President, 2006
*2006 and 2007 are estimates

Federal Debt Held by the Public, 1950–2007

Source: Economic Report of the President, 2006
*2006 and 2007 are estimates

Federal Debt Held by the Public Per Capita, 1950–2007

Source: Economic Report of the President, 2006
*Estimate
### Federal Budget Receipts, 1990–2010

#### A. Federal Budget Receipts

#### B. Individual Income Taxes

#### C. Employment Taxes

#### D. Corporate Income Taxes

#### E. Excise Taxes

#### F. Other Receipts

### Percentage of Total Receipts

- **1990**
  - Individual Income Taxes: 36.8%
  - Employment Taxes: 9.1%
  - Corporate Income Taxes: 45.2%
  - Other Receipts: 8.9%

- **2000**
  - Individual Income Taxes: 32.2%
  - Employment Taxes: 10.2%
  - Corporate Income Taxes: 7.9%
  - Other Receipts: 49.6%

- **2010**
  - Individual Income Taxes: 36.0%
  - Employment Taxes: 9.8%
  - Corporate Income Taxes: 6.5%
  - Other Receipts: 47.6%

*Source: Federal Budget for FY 2007, Historical Tables
*Estimates
The Financial Sector

Interest Rates, 1960–2005

Prime rate charged by banks
Treasury Bill Rate

Year


0 5 10 15 20

Percent

Consumer Credit Outstanding, 1985–2005

<table>
<thead>
<tr>
<th>Total Consumer Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
</tr>
<tr>
<td>1995</td>
</tr>
<tr>
<td>2005</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Nonrevolving</th>
<th>Revolving</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>20.8%</td>
<td>79.2%</td>
</tr>
<tr>
<td>1995</td>
<td>38.9%</td>
<td>61.1%</td>
</tr>
<tr>
<td>2005</td>
<td>37.5%</td>
<td>62.5%</td>
</tr>
</tbody>
</table>

Nonrevolving (includes loans for vacations, education, automobiles, etc.)
Revolving (includes credit card, check credit)

Source: Board of Governors of the Federal Reserve System
Money Stock, 1975–2005

In billions of dollars

- **M1** consists of all currency and checkable deposits.
- **M2** consists of M1 plus noncheckable savings accounts, money market deposit accounts, time deposits, and money market mutual funds.

<table>
<thead>
<tr>
<th>Year</th>
<th>M1</th>
<th>M2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>$287.1</td>
<td>$1,016.2</td>
</tr>
<tr>
<td>1985</td>
<td>$619.8</td>
<td>$2,495.7</td>
</tr>
<tr>
<td>1995</td>
<td>$1,126.8</td>
<td>$3,640.6</td>
</tr>
<tr>
<td>2005</td>
<td>$1,368.7</td>
<td>$6,671.8</td>
</tr>
</tbody>
</table>

Source: Board of Governors of the Federal Reserve System

Personal Saving, 1960–2006

Source: U.S. Department of Commerce, Bureau of Economic Analysis
The Global Economy

**Population**

- **Low-income countries**: 54 countries
- **Middle-income countries**: 98 countries
- **High-income countries**: 56 countries

**Population**

<table>
<thead>
<tr>
<th>Population (in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1500</td>
</tr>
<tr>
<td>1000</td>
</tr>
<tr>
<td>500</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

**Population density**

<table>
<thead>
<tr>
<th>Population density (people per sq. km)</th>
</tr>
</thead>
<tbody>
<tr>
<td>105</td>
</tr>
<tr>
<td>90</td>
</tr>
<tr>
<td>75</td>
</tr>
<tr>
<td>60</td>
</tr>
</tbody>
</table>

**Gross National Income**

- **Low-income countries**: 54 countries
- **Middle-income countries**: 98 countries
- **High-income countries**: 56 countries

**Gross National Income**

- **Gross National Income**
- **Gross National Income per Capita**

**Gross Domestic Product**

- **Low-income countries**: 54 countries
- **Middle-income countries**: 98 countries
- **High-income countries**: 56 countries

**Gross Domestic Product**

- **Gross Domestic Product (Percent Growth)**
- **Gross Domestic Product per Capita (Percent Growth)**

**Source**: International Monetary Fund
The Global Economy

World Population by Age, 2000–2050

<table>
<thead>
<tr>
<th>Year</th>
<th>0–19 Years</th>
<th>20–64 Years</th>
<th>65 and Older</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.23 billion</td>
<td>5.46 billion</td>
<td>0.39 billion</td>
</tr>
<tr>
<td>2025*</td>
<td>0.26 billion</td>
<td>5.75 billion</td>
<td>0.40 billion</td>
</tr>
<tr>
<td>2050*</td>
<td>0.29 billion</td>
<td>6.08 billion</td>
<td>0.43 billion</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of the Census
*Estimate

Countries Ranked by Population, 2000 and 2050

<table>
<thead>
<tr>
<th>Country</th>
<th>Year 2000</th>
<th>Year 2050*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Population (in millions)</td>
<td>Rank</td>
</tr>
<tr>
<td>China</td>
<td>1,261</td>
<td>1</td>
</tr>
<tr>
<td>India</td>
<td>1,014</td>
<td>2</td>
</tr>
<tr>
<td>United States</td>
<td>276</td>
<td>3</td>
</tr>
<tr>
<td>Indonesia</td>
<td>224</td>
<td>4</td>
</tr>
<tr>
<td>Brazil</td>
<td>173</td>
<td>5</td>
</tr>
<tr>
<td>Russia</td>
<td>146</td>
<td>6</td>
</tr>
<tr>
<td>Pakistan</td>
<td>142</td>
<td>7</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>129</td>
<td>8</td>
</tr>
<tr>
<td>Japan</td>
<td>127</td>
<td>9</td>
</tr>
<tr>
<td>Nigeria</td>
<td>123</td>
<td>10</td>
</tr>
<tr>
<td>Mexico</td>
<td>100</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of the Census
*Estimate
The Global Economy

Aging Index in Selected Nations of the Americas, 2000 and 2025

The aging index indicates the number of persons aged 60 and over compared to every 100 persons under age 15. An aging index of 100 means that there is an equal number of people over the age of 60 and under the age of 15.

Median Age, World, 1975–2025

Source: U.S. Bureau of the Census
*Estimate
The Global Economy

U.S. Exports and Imports, 1960–2005

[Graph showing U.S. exports and imports from 1960 to 2010 with data points for each year, with exports and imports represented by blue and red lines, respectively.]

Inflation and Unemployment, Selected Economies 1990–2005

[Graphs showing consumer prices and unemployment rates for the United Kingdom, United States, and Japan from 1990 to 2005, with data points for each year, and lines indicating trends over time.]

Source: Economic Report of the President, 2006

Source: International Monetary Fund

*Based on national definitions
<table>
<thead>
<tr>
<th>Career Name</th>
<th>Job Description</th>
<th>Qualifications</th>
<th>Median Salary</th>
<th>Job Outlook</th>
</tr>
</thead>
</table>
| Advertising Manager | • Oversee the development of advertisements  
• Manage the creative services and media services departments | • Bachelor's degree in liberal arts, advertising, or journalism  
• Knowledge of marketing and consumer behavior | $57,130       | Above Average |
| Aerospace Engineer | • Design, develop, and test aircraft, spacecraft, and missiles  
• Specialize in areas such as structural design, guidance, navigation and control, instrumentation and communication, or production methods | • Bachelor's degree in engineering  
• Graduate training is essential for engineering faculty positions and many research and development programs | $50,993       | Below Average |
| Air Traffic Controller | • Coordinate the movement of air traffic  
• Direct planes efficiently to minimize delays | • FAA-approved education program  
• Regular medical exams and drug screenings required | $103,030      | Average      |
| Anesthesiologist   | • Care of surgical patients and pain relief  
• Responsible for maintenance of the patient's vital life functions | • Undergraduate degree  
• 4 years of medical school  
• 3 to 8 years of internship and residency | $259,948      | Above Average |
| Buyer             | • Determine which products a company will sell  
• Buy the finished goods for resale to the public | • 4-year college degree in business  
• Ability to accurately predict demand, or what will appeal to consumers | $40,780       | Below Average |
<table>
<thead>
<tr>
<th>Career Name</th>
<th>Job Description</th>
<th>Qualifications</th>
<th>Median Salary</th>
<th>Job Outlook</th>
</tr>
</thead>
</table>
| Consumer Loan Officer    | • Analyze loan applications  
• Make decisions regarding the extension of credit                               | • Bachelor’s degree in finance, economics, or a related field                    | $43,980       | Average     |
| Dentist                  | • Diagnose, prevent, and treat problems with teeth or mouth tissue  
• Perform corrective surgery on gums and supporting bones  
• Remove decay, fill cavities, examine x rays, straighten and repair teeth | • Minimum 2 years college-level pre-dental education  
• Dental school                                                      | $129,920      | Average     |
| Dispatcher               | • Schedule and dispatch workers, equipment, or service vehicles to carry materials or passengers  
• Keep records, logs, and schedules of all calls and vehicles | • High-school diploma for entry level position  
• Typing, filing, and record-keeping skills                                | $30,920       | Average     |
| Economist                | • Research, collect, and analyze economic data  
• Monitor economic trends and develop forecasts  
• Advise businesses, government, and other organizations on economic policy | • Master’s degree in economics  
• Experience gathering and analyzing data for economic models | $68,550       | Average     |
| Editor                   | • Review, rewrite, and edit the work of writers  
• Decide what material will appeal to readers  
• Offer comments to improve the work                                           | • Undergraduate degree in communications, journalism, or English                | $43,890       | Average     |
<table>
<thead>
<tr>
<th>Career Name</th>
<th>Job Description</th>
<th>Qualifications</th>
<th>Median Salary</th>
<th>Job Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electrician</td>
<td>• Install, connect, test, and maintain electrical systems</td>
<td>• High-school diploma</td>
<td>$40,660</td>
<td>Average</td>
</tr>
<tr>
<td></td>
<td>• Install wiring systems into new homes, businesses, and factories</td>
<td>• Usually a 4-year apprenticeship program</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Emergency Medical Technician/Paramedic</td>
<td>• Respond to patients in emergency situations; determine the nature of their condition and extent of injuries</td>
<td>• High-school diploma</td>
<td>$25,310</td>
<td>Excellent</td>
</tr>
<tr>
<td></td>
<td>• Give appropriate emergency care and, when necessary, transport the patient</td>
<td>• Formal EMT training</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fashion Designer</td>
<td>• Study fashion trends, sketch designs of clothing and accessories, select colors and fabrics, and oversee the final production of designs</td>
<td>• 2- or 4-year degree</td>
<td>$55,840</td>
<td>Below Average</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Experience in textiles, sewing, pattern-making, computer-aided design</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Manager</td>
<td>• Prepare financial reports</td>
<td>• Master's degree in business administration, economics, finance, or risk management</td>
<td>$73,340</td>
<td>Average</td>
</tr>
<tr>
<td></td>
<td>• Assess the risk of transactions, raise capital, and analyze investments</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Communicate with investors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information Technology (IT) Specialist</td>
<td>• Work in areas ranging from complexity theory to hardware to programming-language design</td>
<td>• Bachelor's degree in Computer Science, Information Science, or Management Information Systems</td>
<td>$85,190</td>
<td>Excellent</td>
</tr>
<tr>
<td></td>
<td>• Web page development</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Career Name</td>
<td>Job Description</td>
<td>Qualifications</td>
<td>Median Salary</td>
<td>Job Outlook</td>
</tr>
<tr>
<td>---------------------</td>
<td>--------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------------</td>
<td>---------------</td>
<td>----------------</td>
</tr>
</tbody>
</table>
| Landscape Architect | • Plan the location of buildings, roads, and walkways, and the arrangement of flowers, shrubs, and trees around structures  
  • Design landscaping of residential areas, public parks and playgrounds, college campuses, shopping centers, golf courses, parkways, and industrial parks | • Bachelor's and/or Master's degree in landscape architecture                                           | $53,120       | Above Average  |
| Lawyer              | • Represent parties in criminal and civil cases  
  • Counsel clients concerning legal rights and obligations and suggest particular courses of action | • Undergraduate degree  
  • 3 years of law school  
  • Must pass a written bar examination                                                               | $94,930       | Average        |
| Market Research Analyst | • Analyze data on past sales to predict future sales  
  • Design market surveys  
  • Analyze competitors' prices and methods of marketing                                                | • Graduate degree in economics, business administration, marketing, or statistics  
  • Strong background in mathematics and consumer behavior                                               | $53,810       | Above Average  |
| Meteorologist       | • Study the atmosphere's physical characteristics, motions, and processes, and the way in which these factors affect the rest of the environment  
  • Forecast the weather                                                                                      | • Bachelor's degree in atmospheric science  
  • Master's degree preferred                                                                             | $70,100       | Average        |
| Occupational Therapist | • Help physically challenged people improve their ability to perform day-to-day tasks in their living and working environments  
  • Help clients have independent, productive, and satisfying lives                                          | • Bachelor's degree in occupational therapy  
  • Starting in 2007, Master's degree in occupational therapy                                               | $54,660       | Excellent      |
<table>
<thead>
<tr>
<th>Career Name</th>
<th>Job Description</th>
<th>Qualifications</th>
<th>Median Salary</th>
<th>Job Outlook</th>
</tr>
</thead>
</table>
| **Pharmacist**   | • Distribute drugs prescribed by physicians  
                    • Provide information to patients about medications and their use  
                    • Advise physicians and other health practitioners on the selection, dosages, interactions, and side effects of medications | • Undergraduate degree  
                    • Doctor of Pharmacy Degree  
                    • Pass the North American Pharmacist Licensure Exam | $84,900        | Above Average |
| **Pilot**        | • Fly airplanes or helicopters  
                    • Transport passengers and cargo  
                    • Thoroughly check aircraft to make sure that the engines, controls, instruments, and other systems are functioning properly | • 250 hours of flight experience  
                    • Commercial pilot’s license | $53,870        | Average       |
| **Real Estate Agent** | • Help home buyers find a house to purchase  
                    • Help home sellers find a buyer for their property | • Knowledge of neighborhoods, local zoning and tax laws, and where to obtain financing  
                    • High school graduate, licensed real estate agent | $30,930        | Below Average |
| **Registered Nurse** | • Treat patients and educate them and the public about various medical conditions  
                    • Provide advice and emotional support to patients’ family members | • One or more of the following:  
                    • Bachelor of Science in nursing  
                    • Associate degree in nursing  
                    • Nursing diploma | $52,330        | Excellent     |
| **Stockbroker**  | • Relay investors’ stock orders to the floor of a securities exchange, or process them over the Internet  
                    • Offer financial counseling and advice on the purchase or sale of particular securities | • College degree  
                    • Must pass a state licensing exam and the General Securities Registered Representative Exam | $60,990        | Average       |
<table>
<thead>
<tr>
<th>Country</th>
<th>GDP (in $1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>30,000</td>
</tr>
<tr>
<td>Canada</td>
<td>31,500</td>
</tr>
<tr>
<td>Mexico</td>
<td>9,600</td>
</tr>
<tr>
<td>Cuba</td>
<td>3,000</td>
</tr>
<tr>
<td>Puerto Rico (U.S.)</td>
<td>17,700</td>
</tr>
<tr>
<td>Jamaica</td>
<td>4,100</td>
</tr>
<tr>
<td>Belize</td>
<td>6,500</td>
</tr>
<tr>
<td>Panama</td>
<td>6,900</td>
</tr>
<tr>
<td>Suriname</td>
<td>4,300</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>6,300</td>
</tr>
<tr>
<td>Guatemala</td>
<td>4,200</td>
</tr>
<tr>
<td>El Salvador</td>
<td>4,900</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>2,300</td>
</tr>
<tr>
<td>Honduras</td>
<td>2,800</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>9,600</td>
</tr>
<tr>
<td>Colombia</td>
<td>6,600</td>
</tr>
<tr>
<td>Brazil</td>
<td>8,100</td>
</tr>
<tr>
<td>Venezuela</td>
<td>5,800</td>
</tr>
<tr>
<td>Chile</td>
<td>10,700</td>
</tr>
<tr>
<td>Paraguay</td>
<td>4,800</td>
</tr>
<tr>
<td>Ecuador</td>
<td>3,700</td>
</tr>
<tr>
<td>Peru</td>
<td>5,600</td>
</tr>
<tr>
<td>Argentina</td>
<td>12,400</td>
</tr>
<tr>
<td>Uruguay</td>
<td>14,500</td>
</tr>
<tr>
<td>Germany</td>
<td>28,700</td>
</tr>
<tr>
<td>Switzerland</td>
<td>33,800</td>
</tr>
<tr>
<td>Ireland</td>
<td>31,900</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>29,600</td>
</tr>
<tr>
<td>Iceland</td>
<td>32,200</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>58,900</td>
</tr>
<tr>
<td>Belgium</td>
<td>30,600</td>
</tr>
<tr>
<td>Netherlands</td>
<td>29,500</td>
</tr>
<tr>
<td>Sweden</td>
<td>28,400</td>
</tr>
<tr>
<td>Norway</td>
<td>40,000</td>
</tr>
<tr>
<td>Spain</td>
<td>23,300</td>
</tr>
<tr>
<td>France</td>
<td>28,700</td>
</tr>
<tr>
<td>Portugal</td>
<td>17,900</td>
</tr>
<tr>
<td>Malta</td>
<td>18,200</td>
</tr>
<tr>
<td>Italy</td>
<td>27,700</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>16,800</td>
</tr>
<tr>
<td>Austria</td>
<td>31,300</td>
</tr>
<tr>
<td>Slovenia</td>
<td>19,600</td>
</tr>
<tr>
<td>Croatia</td>
<td>12,000</td>
</tr>
<tr>
<td>North America</td>
<td></td>
</tr>
<tr>
<td>South America</td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td></td>
</tr>
<tr>
<td>Africa</td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td></td>
</tr>
<tr>
<td>Australia &amp; Oceania</td>
<td></td>
</tr>
</tbody>
</table>

Each square represents one million people.


Not all countries shown.
Each square represents one million people.

POPULATION GROWTH RATE
(excluding effects of migration)

- 3% and above
- 2-2.9%
- 1-1.9%
- 0-0.9%
- Population loss


Not all countries shown.
### Content vocabulary terms in this glossary are words that relate to economics content. They are **highlighted** yellow in your text.

### Words below that have an asterisk (*) are academic vocabulary terms. They help you understand your school subjects and are **boldfaced** in your text.

<table>
<thead>
<tr>
<th><strong>ability-to-pay principle</strong>: principle of taxation in which those with higher incomes pay more taxes than those with lower incomes, regardless of the number of government services they use (p. 431)</th>
<th><strong>principio de la capacidad de pago</strong>: principio de tributación que propone que los que tienen más ingresos deben pagar más impuestos que los que tienen menos, sin tomar en cuenta la cantidad de servicios gubernamentales que usan (p. 431)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>absolute advantage</strong>: ability of one country to produce more output per unit of input than can another country (p. 467)</td>
<td><strong>ventaja absoluta</strong>: capacidad de un país de producir más salidas por cada unidad de insumos que otros países (p. 467)</td>
</tr>
<tr>
<td><strong>access</strong>: ability to obtain or make use of (p. 96)</td>
<td><strong>acceso</strong>: habilidad de obtener o usar (p. 96)</td>
</tr>
<tr>
<td><strong>accompany</strong>: go with (p. 290)</td>
<td><strong>acompañar</strong>: ir con otro (p. 290)</td>
</tr>
<tr>
<td><strong>accumulate</strong>: build up (p. 100)</td>
<td><strong>acumular</strong>: juntar y amontonar (p. 100)</td>
</tr>
<tr>
<td><strong>accurate</strong>: exact; free from errors (p. 71)</td>
<td><strong>preciso</strong>: exacto; fiel; libre de errores (p. 71)</td>
</tr>
<tr>
<td><strong>adapt</strong>: adjust; get used to (p. 444)</td>
<td><strong>adaptarse</strong>: ajustarse; acostumbrarse (p. 444)</td>
</tr>
<tr>
<td><strong>adequate</strong>: enough (p. 266)</td>
<td><strong>adecuado</strong>: suficiente (p. 266)</td>
</tr>
<tr>
<td><strong>affect</strong>: influence (p. 473)</td>
<td><strong>afectar</strong>: influir (p. 473)</td>
</tr>
<tr>
<td><strong>agency shop</strong>: company in which employees are not required to join the union, but must pay union dues (p. 318)</td>
<td><strong>fábrica con cuota por agencia sindical</strong>: compañía en que los empleados no tienen que ser miembros del sindicato, pero sí tienen que pagar la misma cuota que los miembros (p. 318)</td>
</tr>
<tr>
<td><strong>aggregate demand</strong>: the total of all planned expenditures in the entire economy (p. 348)</td>
<td><strong>demanda agregada</strong>: el total de todos los gastos planeados de una economía entera (p. 348)</td>
</tr>
<tr>
<td><strong>aggregate demand curve</strong>: a graphed line showing the relationship between the aggregate quantity demanded and the average of all prices as measured by the implicit GDP price deflator (p. 348)</td>
<td><strong>curva de demanda agregada</strong>: línea gráfica que muestra la relación entre la cantidad de demanda agregada y el promedio de todos los precios, medidos por el deflactor de precios del PIB implícito (p. 348)</td>
</tr>
<tr>
<td><strong>aggregates</strong>: summation of all the individual parts in the economy (p. 348)</td>
<td><strong>agregado</strong>: suma de todas las partes individuales de una economía (p. 348)</td>
</tr>
<tr>
<td><strong>aggregate supply</strong>: real domestic output of producers based on the rise and fall of the price level (p. 349)</td>
<td><strong>oferta agregada</strong>: producción doméstica real, tomando en cuenta los aumentos y rebajas de los precios (p. 349)</td>
</tr>
<tr>
<td><strong>aggregate supply curve</strong>: a graphed line showing the relationship between the aggregate quantity supplied and the average of all prices as measured by the implicit GDP price deflator (p. 349)</td>
<td><strong>curva de oferta agregada</strong>: línea gráfica que muestra la relación entre la cantidad de oferta agregada y el promedio de todos los precios, medidos por el deflactor de precios del PIB implícito (p. 349)</td>
</tr>
<tr>
<td><strong>allocate</strong>: assign; give out (p. 427)</td>
<td><strong>asignar</strong>: repartir; adjudicar (p. 427)</td>
</tr>
<tr>
<td>ENGLISH</td>
<td>ESPAÑOL</td>
</tr>
<tr>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>alternate: the other choice in a situation (p. 173)</td>
<td>suplente: otra poción en una situación (p. 173)</td>
</tr>
<tr>
<td>alternative: something else to be chosen (p. 16)</td>
<td>alternativa: otra cosa que se puede escoger (p. 16)</td>
</tr>
<tr>
<td>analysis: examination (p. 171)</td>
<td>análisis: examen (p. 171)</td>
</tr>
<tr>
<td>analyze: examine in detail (p. 20)</td>
<td>analizar: examinar detenidamente (p. 20)</td>
</tr>
<tr>
<td>annual: yearly (p. 221)</td>
<td>anual: que se repite cada año (p. 221)</td>
</tr>
<tr>
<td>annual percentage rate (APR): cost of credit expressed as a yearly percentage (p. 98)</td>
<td>tasa de interés anual: costo del crédito expresado como porcentaje anual (p. 98)</td>
</tr>
<tr>
<td>anticipate: expect (p. 357)</td>
<td>prever: esperar (p. 357)</td>
</tr>
<tr>
<td>antitrust legislation: federal and state laws passed to prevent new monopolies from forming and to break up those that already exist (p. 246)</td>
<td>legislación antimonopolista: leyes federal y estatales aprobadas para evitar que se formen nuevos monopolios o para deshacer los que ya existen (p. 246)</td>
</tr>
<tr>
<td>appropriate: suitable; proper (p. 529)</td>
<td>apropiado: adecuado; indicado; correcto (p. 529)</td>
</tr>
<tr>
<td>arbitration: union and management submit the issues they cannot agree on to a third party for a final decision (p. 321)</td>
<td>arbitraje: el sindicato y los gerentes entregan los asuntos que no pueden resolver a un tercero para que tome una decisión final (p. 321)</td>
</tr>
<tr>
<td>articles of incorporation: document listing basic information about a corporation that is filed with the state where the corporation will be headquartered (p. 220)</td>
<td>escritura de constitución: documento que contiene información básica acerca de una sociedad anónima que se presenta al estado donde tendrá su oficina principal (p. 220)</td>
</tr>
<tr>
<td>assembly line: production system in which the good being produced moves on a conveyor belt past workers who perform individual tasks in assembling it (p. 274)</td>
<td>línea de montaje: sistema de producción en que el artículo producido es trasladado por una correa transportadora a distintos obreros que, por turnos, hacen labores particulares para ensamblarlo (p. 274)</td>
</tr>
<tr>
<td>assets: all items to which a business or household holds legal claim (p. 214)</td>
<td>activos: todos los bienes que son la propiedad legal de un negocio o persona (p. 214)</td>
</tr>
<tr>
<td>assist: help (p. 392)</td>
<td>asistir: ayudar (p. 392)</td>
</tr>
<tr>
<td>assume: to take for granted; suppose (p. 77)</td>
<td>suponer: dar por cierto una cosa (p. 77)</td>
</tr>
<tr>
<td>authoritarian socialism: system that supports revolution as a means to overthrow capitalism and bring about socialist goals; the entire economy is controlled by a central government; also called communism (p. 53)</td>
<td>socialismo autoritario: sistema que apoya la revolución como modo de derrocar el capitalismo y realizar metas socialistas; la economía entera es controlada por el gobierno central; también se llama comunismo (p. 53)</td>
</tr>
<tr>
<td>automated teller machine (ATM): unit that allows consumers to do their banking without the help of a teller (p. 376)</td>
<td>cajero automático: máquina que permite a los consumidores hacer sus transacciones bancarias sin la ayuda de un cajero (p. 376)</td>
</tr>
<tr>
<td>automation: production process in which machines do the work and people oversee them (p. 275)</td>
<td>automatización: proceso de producción en que máquinas hacen el trabajo y personas las supervisan (p. 275)</td>
</tr>
<tr>
<td>available: to be had or used (p. 34)</td>
<td>disponible: fácil de conseguir o usar (p. 34)</td>
</tr>
</tbody>
</table>
### English

<table>
<thead>
<tr>
<th>Term</th>
<th>Glossary/Glosario</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>bait and switch</strong></td>
<td>ad that attracts consumers with a low-priced product, then tries to sell them a higher-priced product (p. 72)</td>
</tr>
<tr>
<td><strong>balance of trade</strong></td>
<td>difference between the value of a nation’s exports and its imports (p. 475)</td>
</tr>
<tr>
<td><strong>bankruptcy</strong></td>
<td>the state of legally having been declared unable to pay off debts owed with available income (p. 106)</td>
</tr>
<tr>
<td><strong>barriers to entry</strong></td>
<td>obstacles to competition that prevent others from entering a market (p. 237)</td>
</tr>
<tr>
<td><strong>barter</strong></td>
<td>exchange of goods and services for other goods and services (p. 368)</td>
</tr>
<tr>
<td><strong>base year</strong></td>
<td>year used as a point of comparison for other years in a series of statistics (p. 343)</td>
</tr>
<tr>
<td><strong>benefit</strong></td>
<td>help (p. 476)</td>
</tr>
<tr>
<td><strong>benefits-received principle</strong></td>
<td>system of taxation in which those who use a particular government service support it with taxes in proportion to the benefit they receive; those who do not use a service do not pay taxes for it (p. 431)</td>
</tr>
<tr>
<td><strong>black market</strong></td>
<td>“underground” or illegal market in which goods are traded at prices above their legal maximum prices or in which illegal goods are sold (p. 199)</td>
</tr>
<tr>
<td><strong>blue-collar workers</strong></td>
<td>category of workers employed in crafts, manufacturing, and nonfarm labor (p. 309)</td>
</tr>
<tr>
<td><strong>boom</strong></td>
<td>same as peak (p. 352)</td>
</tr>
<tr>
<td><strong>boycott</strong></td>
<td>economic pressure exerted by unions urging the public not to purchase the goods or services produced by a company (p. 322)</td>
</tr>
<tr>
<td><strong>brand name</strong></td>
<td>word, picture, or logo on a product that helps consumers distinguish it from similar products (p. 74)</td>
</tr>
<tr>
<td><strong>broker</strong></td>
<td>person who acts as a go-between for buyers and sellers of stocks and bonds (p. 150)</td>
</tr>
<tr>
<td><strong>budget deficit</strong></td>
<td>situation when the amount of government spending exceeds its receipts during the fiscal year (p. 428)</td>
</tr>
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</table>

### Spanish

<table>
<thead>
<tr>
<th>Term</th>
<th>Glossary/Glosario</th>
</tr>
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<tbody>
<tr>
<td><strong>enganchar</strong></td>
<td>anuncio que atrae a los consumidores con un producto a precio bajo para después tratar de venderles otro producto más caro (p. 72)</td>
</tr>
<tr>
<td><strong>balanza comercial</strong></td>
<td>diferencia entre el valor de las exportaciones e importaciones de una nación (p. 475)</td>
</tr>
<tr>
<td><strong>bancarrota</strong></td>
<td>haber sido legalmente declarado incapaz de pagar las deudas con los ingresos que se tienen (p. 106)</td>
</tr>
<tr>
<td><strong>barreras al mercado</strong></td>
<td>obstáculos que impiden que competidores entren en un mercado (p. 237)</td>
</tr>
<tr>
<td><strong>trueque</strong></td>
<td>intercambio de bienes y servicios por otros bienes y servicios (p. 368)</td>
</tr>
<tr>
<td><strong>año base</strong></td>
<td>año que se usa como punto de comparación con otros años en una serie de estudios estadísticos (p. 343)</td>
</tr>
<tr>
<td><strong>beneficiar</strong></td>
<td>ayudar (p. 476)</td>
</tr>
<tr>
<td><strong>principio de beneficio obtenido</strong></td>
<td>sistema de tributación en que los que usan un servicio gubernamental pagan impuestos por él en proporción al beneficio que reciben; los que no usan el servicio no pagan impuestos por él (p. 431)</td>
</tr>
<tr>
<td><strong>mercado negro</strong></td>
<td>mercado ilegal en que se venden bienes a precios más altos de los que permite la ley o en que se venden productos ilegales (p. 199)</td>
</tr>
<tr>
<td><strong>obreros</strong></td>
<td>clasificación de trabajadores empleados en artesanías, manufactura y labores no agrícolas (p. 309)</td>
</tr>
<tr>
<td><strong>auge</strong></td>
<td>véase peak/auge (p. 352)</td>
</tr>
<tr>
<td><strong>boicot</strong></td>
<td>presión económica que ejerce un sindicato, animando al público a que no compre los bienes o servicios producidos por una compañía (p. 322)</td>
</tr>
<tr>
<td><strong>marca de fábrica</strong></td>
<td>palabra, imagen o logotipo que lleva un producto para ayudar a los consumidores a distinguirlo de otros productos similares (p. 74)</td>
</tr>
<tr>
<td><strong>corredor de bolsa</strong></td>
<td>persona que sirve de intermediario entre los vendedores y compradores de acciones y bonos (p. 150)</td>
</tr>
<tr>
<td><strong>déficit presupuestario</strong></td>
<td>situación en que la cantidad de dinero que el gobierno gasta es mayor que sus ingresos durante el año fiscal (p. 428)</td>
</tr>
<tr>
<td>ENGLISH</td>
<td>ESPAÑOL</td>
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<tr>
<td>------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>budget surplus: situation when the amount of government receipts is larger than its expenditures during the fiscal year (p. 429)</td>
<td>superávit presupuestario: situación en que los ingresos del gobierno son mayores que los gastos durante el año fiscal (p. 429)</td>
</tr>
<tr>
<td>bureaucracies: offices and agencies of the government that each deal with a specific area (p. 502)</td>
<td>burocracias: oficinas y agencias del gobierno que se ocupan de asuntos particulares (p. 502)</td>
</tr>
<tr>
<td>business cycle: irregular changes in the level of total output measured by real GDP (p. 352)</td>
<td>ciclo económico: cambios irregulares en el nivel de producción total, medidos por el PIB real (p. 352)</td>
</tr>
<tr>
<td>business fluctuations: ups and downs in an economy (p. 352)</td>
<td>fluctuaciones comerciales: alzas y bajas en una economía (p. 352)</td>
</tr>
<tr>
<td>bylaws: a set of rules describing how stock will be sold and dividends paid (p. 221)</td>
<td>reglamentos: reglas que detallan cómo se van a vender acciones y a pagar dividendos (p. 221)</td>
</tr>
</tbody>
</table>

**capacity:** ability (p. 352)  
(capacidad: habilidad (p. 352))

**capital:** previously manufactured goods used to make other goods and services (p. 9)  
(capital: bienes manufacturados que se usan para producir otros bienes y servicios; el dinero es capital financiero (p. 9))

**capital flight:** the legal or illegal export of currency or money capital from a nation by that nation’s leaders (p. 502)  
fuga de capital al extranjero: exportación legal o ilegal de divisas o del capital financiero de una nación por los líderes del mismo país (p. 502)

**capital gain:** increase in value of an asset from the time it was bought to the time it was sold (p. 147)  
ganancia de capital: aumento en el valor de un activo en el tiempo que transcurre entre su compra y su venta (p. 147)

**capitalism:** economic system in which private individuals own the factors of production (p. 43)  
capitalismo: sistema económico en que individuos son dueños de los factores de producción (p. 43)

**capital loss:** decrease in value of an asset from the time it was bought to the time it was sold (p. 147)  
pérdida de capital: disminución en el valor de un activo entre el momento en que se compra y el momento en que se vende (p. 147)

**cartel:** arrangement among groups of industrial businesses to reduce international competition by controlling the price, production, and distribution of goods (p. 241)  
cártel: arreglos entre grupos de negocios industriales para controlar el precio, producción y distribución de bienes y así reducir la competencia internacional (p. 241)

**category:** group (p. 336)  
(categoría: grupo (p. 336))

**Central American Free Trade Agreement (CAFTA):** trade agreement designed to reduce tariff barriers between Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, the Dominican Republic and the United States (p. 481)  
Tratado de Libre Comercio entre Centroamérica y Estados Unidos: acuerdo comercial diseñado para reducir las barreras arancelarias entre Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, la República Dominicana y Estados Unidos (p. 481)

**certificates of deposit:** time deposits that state the amount of the deposit, maturity, and rate of interest being paid (p. 144)  
certificados de depósito: depósitos a plazos que especifican la cantidad del depósito, la fecha de vencimiento y el tipo de interés que se paga (p. 144)
<table>
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<tr>
<th><strong>ENGLISH</strong></th>
<th><strong>ESPÁÑOL</strong></th>
</tr>
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<tbody>
<tr>
<td><strong>channels of distribution</strong>: routes by which goods are moved from producers to consumers (p. 297)</td>
<td><strong>canales de distribución</strong>: vías por las cuales se mueven los bienes de los fabricantes a los consumidores (p. 297)</td>
</tr>
<tr>
<td><strong>charge account</strong>: credit extended to a consumer allowing the consumer to buy goods or services from a particular company and to pay for them later (p. 95)</td>
<td><strong>cuenta de crédito</strong>: crédito que se le extiende a un consumidor, que le permite comprar bienes y servicios de una compañía en particular y pagar por ellos más adelante (p. 95)</td>
</tr>
<tr>
<td><strong>checkable deposits</strong>: funds deposited in a bank that can be withdrawn at any time by presenting a check (p. 380)</td>
<td><strong>depósitos a la vista</strong>: fondos depositados en un banco que se pueden sacar en cualquier momento con sólo presentar un cheque (p. 380)</td>
</tr>
<tr>
<td><strong>check clearing</strong>: method by which a check that has been deposited in one institution is transferred to the issuer's depository institution (p. 395)</td>
<td><strong>compensación de cheques</strong>: método de pagar y transferir cheques de la institución en que se depositan a la institución depositaria de la persona que los emite (p. 395)</td>
</tr>
<tr>
<td><strong>checking account</strong>: account in which deposited funds can be withdrawn at any time by writing a check (p. 380)</td>
<td><strong>cuenta corriente</strong>: cuenta de la cual se pueden sacar fondos depositados por medio de un cheque (p. 380)</td>
</tr>
<tr>
<td><strong>circular flow of income and output</strong>: economic model that pictures income as flowing continuously between businesses and consumers (pp. 39, 448)</td>
<td><strong>flujo circular de ingresos y producción</strong>: modelo económico que representa a los ingresos circulando continuamente entre negocios y consumidores (pp. 37, 448)</td>
</tr>
<tr>
<td><strong>civilian labor force</strong>: total number of people 16 years old or older who are either employed or actively seeking work (p. 308)</td>
<td><strong>fuerza laboral civil</strong>: número total de personas mayores de 16 años que tienen empleo o lo están buscando (p. 308)</td>
</tr>
<tr>
<td><strong>closed shop</strong>: company in which only union members could be hired (p. 318)</td>
<td><strong>fábrica cerrada</strong>: compañía en que sólo se puede dar empleo a miembros del sindicato (p. 318)</td>
</tr>
<tr>
<td><strong>closing costs</strong>: fees involved in arranging for a mortgage or in transferring ownership of property (p. 128)</td>
<td><strong>costos de cierre</strong>: cuotas que se pagan para obtener una hipoteca o transferir una propiedad a un dueño nuevo (p. 128)</td>
</tr>
<tr>
<td><strong>club warehouse store</strong>: store that carries a limited number of brands and items in large quantities and is less expensive than grocery stores (p. 115)</td>
<td><strong>club almacén</strong>: tienda que tiene un surtido limitado de marcas y artículos que vende en grandes cantidades; es más barato que las tiendas de comestibles (p. 115)</td>
</tr>
<tr>
<td><strong>coincident indicators</strong>: economic indicators that usually change at the same time as changes in overall business activity (p. 359)</td>
<td><strong>indicadores coincidentes</strong>: indicadores económicos que cambian a la misma vez que la actividad comercial en general (p. 359)</td>
</tr>
<tr>
<td><strong>collateral</strong>: something of value that a borrower lets the lender claim if a loan is not repaid (p. 100)</td>
<td><strong>garantía</strong>: algo de valor que el prestatario se compromete a darle al prestamista si no le devuelve el dinero (p. 100)</td>
</tr>
<tr>
<td><strong>collective bargaining</strong>: process by which unions and employers negotiate the conditions of employment (p. 321)</td>
<td><strong>negociación colectiva</strong>: proceso mediante el cual los sindicatos y gerentes acuerdan las condiciones de trabajo (p. 321)</td>
</tr>
<tr>
<td><strong>command economy</strong>: system in which the government controls the factors of production and makes all decisions about their use (p. 37)</td>
<td><strong>economía dirigida</strong>: sistema en que el gobierno controla los factores de producción y toma todas las decisiones sobre su uso (p. 37)</td>
</tr>
</tbody>
</table>
**commercial bank** • **consumer**

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<thead>
<tr>
<th><strong>ENGLISH</strong></th>
<th><strong>ESPAÑOL</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>commercial bank</strong>: bank whose main functions are to accept deposits, lend funds, and transfer funds among banks, individuals, and businesses (p. 93)</td>
<td><strong>banco comercial</strong>: banco cuyas funciones principales son aceptar depósitos, prestar fondos y transferir fondos entre bancos, individuos y negocios (p. 93)</td>
</tr>
<tr>
<td><strong>commodity money</strong>: a medium of exchange such as cattle or gems that has value as a commodity or good aside from its value as money (p. 371)</td>
<td><strong>dinero material</strong>: medios de cambio, como el ganado o las joyas, que tienen valor propio como mercancías además de su valor como dinero (p. 371)</td>
</tr>
<tr>
<td><strong>common stock</strong>: shares of ownership in a corporation that give stockholders voting rights and a portion of future profits (after holders of preferred stock are paid) (p. 221)</td>
<td><strong>acciones ordinarias</strong>: tipo de participaciones en una sociedad anónima que da a los accionistas el derecho al voto y una porción de las futuras ganancias (después de que se haya pagado a los accionistas con acciones preferentes); también se llaman acciones comunes (p. 221)</td>
</tr>
<tr>
<td><strong>communism</strong>: term used by Karl Marx for his idealized society in which no government is necessary (p. 53)</td>
<td><strong>comunismo</strong>: término usado por Carlos Marx para referirse a su sociedad idealizada en que no hace falta gobierno (p. 53)</td>
</tr>
<tr>
<td><strong>comparative advantage</strong>: ability of a country to produce a product at a lower opportunity cost than another country (p. 469)</td>
<td><strong>ventaja comparativa</strong>: capacidad de un país de producir un producto por un costo de oportunidad más bajo que otro país (p. 469)</td>
</tr>
<tr>
<td><strong>comparison shopping</strong>: getting information on the types and prices of products available from different stores and companies (p. 73)</td>
<td><strong>comparar antes de comprar</strong>: obtener información sobre los tipos de productos y los precios de éstos en distintas tiendas y compañías (p. 73)</td>
</tr>
<tr>
<td><strong>competition</strong>: rivalry among producers or sellers of similar goods and services to win more business (p. 45)</td>
<td><strong>competencia</strong>: rivalidad entre los productores o vendedores de bienes y servicios semejantes para tener más clientes (p. 45)</td>
</tr>
<tr>
<td><strong>competitive advertising</strong>: advertising that attempts to persuade consumers that a product is different from and superior to any other (p. 72)</td>
<td><strong>publicidad competitiva</strong>: anuncios que tratan de convencer al consumidor que un producto es distinto o mejor que los demás (p. 72)</td>
</tr>
<tr>
<td><strong>compile</strong>: gather (p. 358)</td>
<td><strong>compilar</strong>: reunir; recopilar (p. 358)</td>
</tr>
<tr>
<td><strong>complementary good</strong>: a product often used with another product (p. 181)</td>
<td><strong>bienes complementarios</strong>: productos que se usan en conjunto (p. 181)</td>
</tr>
<tr>
<td><strong>complex</strong>: complicated (p. 22)</td>
<td><strong>complejo</strong>: complicado (p. 22)</td>
</tr>
<tr>
<td><strong>concentrate</strong>: focus (p. 102)</td>
<td><strong>concentrarse</strong>: enfocarse; fijar la atención (p. 102)</td>
</tr>
<tr>
<td><strong>concept</strong>: an idea or thought (p. 178)</td>
<td><strong>concepto</strong>: una idea o pensamiento (p. 178)</td>
</tr>
<tr>
<td><strong>confiscation</strong>: taking over industries by governments without paying for them (p. 497)</td>
<td><strong>confiscación</strong>: toma de posesión de industrias por un gobierno sin pagar por ellas (p. 497)</td>
</tr>
<tr>
<td><strong>conglomerate</strong>: large corporation made up of smaller corporations dealing in unrelated businesses (p. 247)</td>
<td><strong>conglomerado</strong>: gran corporación compuesta de empresas más pequeñas cuyos negocios no están relacionados (p. 247)</td>
</tr>
<tr>
<td><strong>consist</strong>: to be made of (p. 379)</td>
<td><strong>consistir</strong>: estar compuesto de (p. 379)</td>
</tr>
<tr>
<td><strong>consumer</strong>: any person or group that buys or uses goods and services to satisfy personal needs and wants (p. 66)</td>
<td><strong>consumidor</strong>: cualquier persona o grupo que compra o utiliza bienes y servicios para satisfacer sus necesidades o deseos personales (p. 66)</td>
</tr>
<tr>
<td><strong>consumer goods</strong></td>
<td><strong>bienes de consumo</strong></td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>goods produced for individuals and sold directly to the public to be used as they are (p. 272)</td>
<td>bienes producidos para individuos y vendidos directamente al público para usarse tal y como son (p. 272)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>consumerism</strong></th>
<th><strong>protección al consumidor</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>movement to educate buyers about the purchases they make and to demand better and safer products from manufacturers (p. 77)</td>
<td>movimiento dedicado a informar al consumidor sobre las compras que hace y a exigirles productos mejores y más seguros a los fabricantes (p. 77)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>consumer price index (CPI)</strong></th>
<th><strong>índice de precios al consumidor</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a statistical measure of the average of prices of a specified set of goods and services purchased by typical consumers in city areas (p. 343)</td>
<td>medida estadística de los precios promedios de un grupo de bienes y servicios comprados por consumidores típicos de un área urbana (p. 343)</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th><strong>consumer sovereignty</strong></th>
<th><strong>soberanía del consumidor</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>the role of the consumer as ruler of the market when determining the types of goods and services produced (p. 284)</td>
<td>manera en que el consumidor gobierna el mercado cuando determina los tipos de bienes y servicios que se producen (p. 284)</td>
</tr>
</tbody>
</table>

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<thead>
<tr>
<th><strong>continual</strong></th>
<th><strong>continuo</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>repetitive (p. 52)</td>
<td>repetitivo (p. 52)</td>
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<thead>
<tr>
<th><strong>contract</strong></th>
<th><strong>contraerse</strong></th>
</tr>
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<tbody>
<tr>
<td>grow smaller (p. 405)</td>
<td>hacerse más pequeño (p. 405)</td>
</tr>
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<table>
<thead>
<tr>
<th><strong>contraction</strong></th>
<th><strong>contracción</strong></th>
</tr>
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<tbody>
<tr>
<td>part of the business cycle during which economic activity is slowing down (p. 352)</td>
<td>parte del ciclo económico en que la actividad económica disminuye (p. 352)</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th><strong>contrast</strong></th>
<th><strong>contraste</strong></th>
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<tbody>
<tr>
<td>a striking difference in things being compared (p. 105)</td>
<td>gran diferencia entre dos cosas que se comparan (p. 105)</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th><strong>contribute</strong></th>
<th><strong>contribuir</strong></th>
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<tbody>
<tr>
<td>give (p. 157)</td>
<td>dar (p. 157)</td>
</tr>
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<thead>
<tr>
<th><strong>convenience store</strong></th>
<th><strong>tiendas de artículos de consumo frecuente</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>store open 16 to 24 hours a day, carrying a limited selection of relatively higher-priced items (p. 115)</td>
<td>tienda que se mantiene abierta de 16 a 24 horas al día con un surtido limitado de artículos a precios más altos (p. 115)</td>
</tr>
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<thead>
<tr>
<th><strong>convert</strong></th>
<th><strong>convertir</strong></th>
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<tbody>
<tr>
<td>change; switch (p. 371)</td>
<td>cambiar (p. 371)</td>
</tr>
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<thead>
<tr>
<th><strong>copyright</strong></th>
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</thead>
<tbody>
<tr>
<td>exclusive right to sell, publish, or reproduce creative works for a specified number of years (p. 238)</td>
<td>el derecho exclusivo de vender, publicar o reproducir obras creativas por un determinado número de años; también se llama derechos de autor (p. 238)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>core</strong></th>
<th><strong>corazón</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>center (p. 417)</td>
<td>centro (p. 417)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>corporate charter</strong></th>
<th><strong>licencia para negociar</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>license to operate granted to a corporation by the state where it is established (p. 220)</td>
<td>permiso para operar una sociedad anónima que da el estado en que se establece una compañía (p. 220)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>corporation</strong></th>
<th><strong>sociedad anónima</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>type of business organization owned by many people but treated by law as though it were a person; it can own property, pay taxes, make contracts, and so on (p. 219)</td>
<td>tipo de empresa de la cual muchas personas son dueñas, pero la ley la trata como si fuera una persona; puede tener propiedad, pagar impuestos, entrar en contratos, etc.; también se llama corporación (p. 219)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>cost-benefit analysis</strong></th>
<th><strong>análisis de coste-beneficios</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>a financial process in which a business estimates the cost of any action and compares it with the estimated benefits of that action (p. 261)</td>
<td>proceso financiero en que un negocio calcula el costo de emprender una actividad y los beneficios de ésta para compararlos (p. 261)</td>
</tr>
<tr>
<td><strong>ENGLISH</strong></td>
<td><strong>ESPAÑOL</strong></td>
</tr>
<tr>
<td>----------------</td>
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</tr>
<tr>
<td><strong>cost-of-living adjustment (COLA)</strong>: provision calling for a wage increase each year if the general level of prices rises (p. 321)</td>
<td><strong>ajuste por el costo de la vida</strong>: provisión que requiere un aumento de sueldo anual si el nivel general de los precios sube (p. 321)</td>
</tr>
<tr>
<td><strong>cost-push inflation</strong>: theory that higher wages push up prices (p. 445)</td>
<td><strong>inflación de costes</strong>: teoría que los salarios más altos fuerzan los precios hacia arriba (p. 445)</td>
</tr>
<tr>
<td><strong>craft union</strong>: union made up of skilled workers in a specific trade or industry (p. 317)</td>
<td><strong>sindicato de artesanos</strong>: asociación de trabajadores especializados en un oficio o industria en particular (p. 317)</td>
</tr>
<tr>
<td><strong>create</strong>: make (p. 381)</td>
<td><strong>crear</strong>: hacer (p. 381)</td>
</tr>
<tr>
<td><strong>credit</strong>: receipt of funds either directly or indirectly to buy goods and services in the present with the promise to pay for them in the future (p. 88)</td>
<td><strong>crédito</strong>: recibir fondos directa o indirectamente para comprar bienes y servicios en el presente bajo promesa de pagar por ellos en el futuro (p. 88)</td>
</tr>
<tr>
<td><strong>credit bureau</strong>: private business that investigates a person to determine the risk involved in lending to that person (p. 100)</td>
<td><strong>oficina de crédito</strong>: negocio privado que investiga a individuos para determinar el riesgo de hacerles préstamos (p. 100)</td>
</tr>
<tr>
<td><strong>credit card</strong>: credit device that allows a person to make purchases at many kinds of stores, restaurants, and other businesses without paying cash (p. 96)</td>
<td><strong>tarjeta de crédito</strong>: instrumento de crédito que le permite a una persona hacer compras en muchas clases distintas de tiendas, restaurantes y negocios sin tener que pagar con dinero en efectivo (p. 96)</td>
</tr>
<tr>
<td><strong>credit check</strong>: investigation of a person’s income, current debts, personal life, and past history of borrowing and repaying debts (p. 100)</td>
<td><strong>investigación de crédito</strong>: investigación de los ingresos, deudas actuales, vida privada e historial de préstamos pedidos y deudas pagadas de una persona (p. 100)</td>
</tr>
<tr>
<td><strong>credit rating</strong>: rating of the risk involved in lending to a specific person or business (p. 100)</td>
<td><strong>clasificación de crédito</strong>: evaluación del riesgo de hacer un préstamo a una persona o negocio en particular (p. 100)</td>
</tr>
<tr>
<td><strong>credit union</strong>: depository institution owned and operated by its members to provide savings accounts and low-interest loans only to its members (p. 94)</td>
<td><strong>cooperativa de crédito</strong>: institución de depósitos que es propiedad de sus miembros, que es administrada por ellos y que proporciona cuentas de ahorro y préstamos a intereses bajos exclusivamente a sus miembros; también se llama unión crediticia (p. 94)</td>
</tr>
<tr>
<td><strong>crucial</strong>: important; critical (p. 285)</td>
<td><strong>crucial</strong>: importante; crítico (p. 285)</td>
</tr>
<tr>
<td><strong>debit card</strong>: device used to make cashless purchases; money is electronically withdrawn from the consumer’s checkable account and transferred directly to the store’s bank account (p. 381)</td>
<td><strong>tarjeta de débito</strong>: utensilio que se usa para hacer compras sin dinero en efectivo; el dinero se retira electrónicamente de la cuenta de cheques del comprador y se transfiere directamente a la cuenta de banco de la tienda (p. 381)</td>
</tr>
<tr>
<td><strong>debt financing</strong>: raising funds for a business through borrowing (p. 265)</td>
<td><strong>financiamiento mediante deudas</strong>: recaudar fondos para un negocio por medio de préstamos (p. 265)</td>
</tr>
<tr>
<td><strong>deficit financing</strong>: government policy of spending more money than it is able to bring in through revenues (p. 428)</td>
<td><strong>financiamiento del déficit</strong>: política gubemamental de gastar más dinero de los ingresos que tiene y obtener préstamos para cubrir los gastos adicionales (p. 428)</td>
</tr>
<tr>
<td><strong>deflation</strong></td>
<td>deflación</td>
</tr>
<tr>
<td>---</td>
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</tr>
<tr>
<td>prolonged decline in the general price level of goods and services (p. 342)</td>
<td>caída prolongada en el nivel general de los precios de bienes y servicios (p. 342)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>demand</strong></th>
<th>demanda</th>
</tr>
</thead>
<tbody>
<tr>
<td>the amount of a good or service that consumers are able and willing to buy at various possible prices during a specified time period (p. 170)</td>
<td>cantidad de un producto o servicio que los consumidores pueden o están dispuestos a comprar a varios precios posibles durante un periodo de tiempo determinado (p. 170)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>demand curve</strong></th>
<th>curva de demanda</th>
</tr>
</thead>
<tbody>
<tr>
<td>downward-sloping line that shows in graph form the quantities demanded at each possible price (p. 179)</td>
<td>línea descendente en una gráfica cuya inclinación muestra la cantidad de demanda a cada precio posible (p. 179)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>demand-pull inflation</strong></th>
<th>inflación de demanda</th>
</tr>
</thead>
<tbody>
<tr>
<td>theory that prices rise as the result of excessive business and consumer demand; demand increases faster than total supply, resulting in shortages that lead to higher prices (p. 444)</td>
<td>teoría que los precios suben como consecuencia de la demanda excesiva de los negocios y consumidores; la demanda aumenta más rápido que la oferta total, ocasionando una escasez que conduce a precios más altos (p. 444)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>demand schedule</strong></th>
<th>lista de demanda</th>
</tr>
</thead>
<tbody>
<tr>
<td>table showing quantities demanded at different possible prices (p. 179)</td>
<td>tabla que muestra la cantidad de demandada a distintos precios (p. 179)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>democratic socialism</strong></th>
<th>socialismo democrático</th>
</tr>
</thead>
<tbody>
<tr>
<td>system that works within the constitutional framework of a nation to elect socialists to office; the government usually controls only some areas of the economy (p. 53)</td>
<td>sistema que obra dentro del marco de la constitución de una nación para elegir socialistas a cargos públicos; el gobierno generalmente controla solamente algunos sectores de la economía (p. 53)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>depreciation</strong></th>
<th>depreciación</th>
</tr>
</thead>
<tbody>
<tr>
<td>loss of value because of wear and tear to durable goods and capital goods (p. 338); fall in the price of a currency through the action of supply and demand (p. 474)</td>
<td>pérdida de valor de los bienes duraderos y bienes capitales por causa del uso constante (p. 338); rebaja en el valor de una moneda a través de la acción de la oferta y la demanda (p. 474)</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th><strong>depression</strong></th>
<th>depresión</th>
</tr>
</thead>
<tbody>
<tr>
<td>major slowdown of economic activity (p. 352)</td>
<td>disminución significativa en la actividad económica (p. 352)</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th><strong>deregulation</strong></th>
<th>desregulación</th>
</tr>
</thead>
<tbody>
<tr>
<td>reduction of government regulation and control over business activity (p. 248)</td>
<td>reducción en el número de regulaciones y controles gubernamentales sobre las actividades comerciales (p. 248)</td>
</tr>
</tbody>
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<thead>
<tr>
<th><strong>design</strong></th>
<th>diseño</th>
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<tbody>
<tr>
<td>plan (p. 153)</td>
<td>plan (p. 153)</td>
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<thead>
<tr>
<th><strong>despite</strong></th>
<th>a pesar de</th>
</tr>
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<tbody>
<tr>
<td>even though (p. 526)</td>
<td>contra la voluntad de (p. 526)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>devaluation</strong></th>
<th>devaluación</th>
</tr>
</thead>
<tbody>
<tr>
<td>lowering a currency’s value in relation to other currencies by government order (p. 473)</td>
<td>rebajar el valor de una moneda con relación a otras divisas (monedas extranjeras) por orden gubernamental (p. 473)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>developed nations</strong></th>
<th>naciones desarrolladas</th>
</tr>
</thead>
<tbody>
<tr>
<td>nations with relatively high standards of living and economies based more on industry than on agriculture (p. 490)</td>
<td>naciones con niveles de vida relativamente altos y economías basadas en la industria más que en la agricultura (p. 490)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>developing nations</strong></th>
<th>naciones en vías de desarrollo</th>
</tr>
</thead>
<tbody>
<tr>
<td>nations with little industrial development and relatively low standards of living (p. 490)</td>
<td>naciones con poco desarrollo industrial y niveles de vida relativamente bajos (p. 490)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>devote</strong></th>
<th>dedicar</th>
</tr>
</thead>
<tbody>
<tr>
<td>dedicate (p. 498)</td>
<td>aplicar, destinar (p. 498)</td>
</tr>
<tr>
<td>English</td>
<td>Spanish</td>
</tr>
<tr>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>direct foreign investment (DFI): the purchase by foreigners of real estate and businesses in another country (p. 524)</td>
<td>inversión extranjera directa: compra de bienes inmuebles (terrenos y edificios) y negocios en un país por extranjeros (p. 524)</td>
</tr>
<tr>
<td>direct-mail advertising: type of promotion using a mailer that usually includes a letter describing the product or service and an order blank or application form (p. 293)</td>
<td>publicidad por correo directo: tipo de promoción por correo que generalmente incluye una carta describiendo el producto o servicio y un formulario para encargar o solicitarlo (p. 293)</td>
</tr>
<tr>
<td>discount rate: interest rate that the Fed charges on loans to commercial banks and other depository institutions (p. 404)</td>
<td>tasa de descuento: tipo de interés que el Sistema de Reserva Federal les cobra por préstamos a los bancos comerciales y otras instituciones depositantes (p. 404)</td>
</tr>
<tr>
<td>discretionary income: money income a person has left to spend on extras after necessities have been bought (p. 66)</td>
<td>ingresos discrecionales: dinero que le queda a una persona de sus ingresos después de cubrir lo imprescindible (p. 66)</td>
</tr>
<tr>
<td>*displace: relocate (p. 309)</td>
<td>*desplazar: trasladar (p. 309)</td>
</tr>
<tr>
<td>disposable income: income remaining for a person to spend or save after all taxes have been paid (p. 66)</td>
<td>ingresos disponibles: ingresos que le quedan a una persona para ahorrar o gastar después de pagar los impuestos; también se llama renta disponible (p. 66)</td>
</tr>
<tr>
<td>disposable personal income (DPI): same as disposable income (p. 340)</td>
<td>ingresos personales disponibles: véase disposable income/ingresos disponibles (p. 340)</td>
</tr>
<tr>
<td>*distinct: different (p. 219)</td>
<td>*distinto: bien diferenciado (p. 219)</td>
</tr>
<tr>
<td>*distribute: to give out in shares (p. 35)</td>
<td>*distribuir: repartir en partes (p. 35)</td>
</tr>
<tr>
<td>diversification: spreading of investments among several different types to lower overall risk (p. 159)</td>
<td>diversificación: hacer varios tipos de inversiones distintas para disminuir el riesgo total (p. 159)</td>
</tr>
<tr>
<td>dividend: portion of a corporation’s profits paid to its stockholders (p. 221)</td>
<td>dividendo: porción de las ganancias de una sociedad anónima que se paga a los accionistas (p. 221)</td>
</tr>
<tr>
<td>division of labor: the breaking down of a job into small tasks performed by different workers (p. 275)</td>
<td>división del trabajo: partición un trabajo en pequeñas tareas desempeñadas por distintos obreros (p. 275)</td>
</tr>
<tr>
<td>*document: record (p. 212)</td>
<td>*documento: registro o escritura (p. 212)</td>
</tr>
<tr>
<td>*dominate: control (p. 240)</td>
<td>*dominar: controlar (p. 240)</td>
</tr>
<tr>
<td>durability: ability of an item to last a long time (p. 121)</td>
<td>durabilidad: cualidad de poder aguantar mucho tiempo sin estropearse o romperse (p. 121)</td>
</tr>
<tr>
<td>durable goods: manufactured items that have a life span longer than three years (p. 88)</td>
<td>bienes duraderos: artículos manufacturados con una vida de más de tres años (p. 88)</td>
</tr>
<tr>
<td>*duration: the time that a thing continues or lasts (p. 359)</td>
<td>*duración: el tiempo que algo dura o continúa (p. 359)</td>
</tr>
<tr>
<td>e-commerce: business transactions conducted over the Internet (p. 298)</td>
<td>comercio electrónico: llevar a cabo transacciones de negocio a través de Internet (p. 298)</td>
</tr>
<tr>
<td><strong>ENGLISH</strong></td>
<td><strong>ESPAÑOL</strong></td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-------------------------------------------------</td>
</tr>
<tr>
<td><strong>economic assistance</strong>: loans and outright</td>
<td><strong>asistencia económica</strong>: préstamos y subsidios</td>
</tr>
<tr>
<td>grants of money or equipment to other nations</td>
<td>de dinero o maquinaria a otras naciones</td>
</tr>
<tr>
<td>(p. 497)</td>
<td></td>
</tr>
<tr>
<td><strong>economic efficiency</strong>: wise use of available</td>
<td><strong>eficiencia económica</strong>: buen uso de los</td>
</tr>
<tr>
<td>resources so as to obtain the greatest</td>
<td>recursos disponibles para obtener los mayores</td>
</tr>
<tr>
<td>benefits possible (p. 48)</td>
<td>beneficios posibles (p. 48)</td>
</tr>
<tr>
<td><strong>economic equity</strong>: the attempt to balance an</td>
<td><strong>equidad económica</strong>: una política económica</td>
</tr>
<tr>
<td>economic policy so that everyone benefits</td>
<td>gubernamental que trata de lograr que todos se</td>
</tr>
<tr>
<td>fairly (p. 49)</td>
<td>beneficien de manera justa (p. 49)</td>
</tr>
<tr>
<td><strong>economic growth</strong>: expansion of the economy</td>
<td><strong>crecimiento económico</strong>: expansión de la</td>
</tr>
<tr>
<td>to produce more goods, jobs, and wealth (p.</td>
<td>economía para producir más bienes, trabajos y</td>
</tr>
<tr>
<td>49)</td>
<td>riqueza (p. 49)</td>
</tr>
<tr>
<td><strong>economic indicators</strong>: statistics that</td>
<td><strong>indicadores económicos</strong>: estadísticas que</td>
</tr>
<tr>
<td>measure variables in the economy (p. 358)</td>
<td>miden muchas variables en la economía (p. 358)</td>
</tr>
<tr>
<td><strong>economic model</strong>: a theory or simplified</td>
<td><strong>modelo económico</strong>: teoría o representación</td>
</tr>
<tr>
<td>representation that helps explain and predict</td>
<td>simplificada que ayuda a explicar y prever la</td>
</tr>
<tr>
<td>economic behavior in the real world (p. 21)</td>
<td>conducta económica en el mundo real (p. 21)</td>
</tr>
<tr>
<td><strong>economics</strong>: the study of how people make</td>
<td><strong>economía</strong>: estudio de cómo la gente decide en</td>
</tr>
<tr>
<td>choices about ways to use limited resources to</td>
<td>qué manera va a usar recursos limitados para</td>
</tr>
<tr>
<td>fulfill their wants (p. 6)</td>
<td>satisfacer sus deseos (p. 6)</td>
</tr>
<tr>
<td><strong>economic system</strong>: way in which a nation</td>
<td><strong>sistema económico</strong>: manera en que una nación</td>
</tr>
<tr>
<td>uses its resources to satisfy its people's</td>
<td>usa sus recursos para satisfacer las necesidades</td>
</tr>
<tr>
<td>needs and wants (p. 34)</td>
<td>y deseos de su pueblo (p. 34)</td>
</tr>
<tr>
<td><strong>economies of scale</strong>: low production costs</td>
<td><strong>economías de escala</strong>: bajos costos de</td>
</tr>
<tr>
<td>resulting from the large size of output (p.</td>
<td>producción que resultan de la producción en</td>
</tr>
<tr>
<td>258)</td>
<td>gran cantidad (p. 238)</td>
</tr>
<tr>
<td><strong>economy</strong>: the production and distribution</td>
<td><strong>economía</strong>: producción y distribución de</td>
</tr>
<tr>
<td>of goods and services in a society (p. 21)</td>
<td>bienes y servicios en una sociedad (p. 21)</td>
</tr>
<tr>
<td><strong>elastic demand</strong>: situation in which a given</td>
<td><strong>demanda elástica</strong>: situación en que una rebaja</td>
</tr>
<tr>
<td>rise or fall in a product’s price greatly</td>
<td>o aumento dado en el precio de un producto tiene</td>
</tr>
<tr>
<td>affects the amount that people are willing to</td>
<td>gran efecto en la cantidad de ese producto que</td>
</tr>
<tr>
<td>buy (p. 183)</td>
<td>los consumidores están dispuestos a comprar (p. 183)</td>
</tr>
<tr>
<td><strong>elasticity</strong>: economic concept dealing with</td>
<td><strong>elasticidad</strong>: concepto económico que se refiere</td>
</tr>
<tr>
<td>consumers’ responsiveness to an increase or</td>
<td>a la reacción de los consumidores al aumento o</td>
</tr>
<tr>
<td>decrease in the price of a product (p. 182)</td>
<td>rebaja de precio de un producto (p. 182)</td>
</tr>
<tr>
<td><strong>electronic funds transfer (EFT)</strong>: system of</td>
<td><strong>transferencia electrónica de fondos</strong>: sistema</td>
</tr>
<tr>
<td>transferring funds from one bank account</td>
<td>para transferir fondos de una cuenta bancaria</td>
</tr>
<tr>
<td>directly to another without any paper money</td>
<td>directamente a otra sin traspasar papel moneda</td>
</tr>
<tr>
<td>changing hands (p. 376)</td>
<td>(p. 376)</td>
</tr>
<tr>
<td><strong>element</strong>: basic quality (p. 48)</td>
<td><strong>elemento</strong>: calidad básica (p. 48)</td>
</tr>
<tr>
<td><strong>eliminate</strong>: to get rid of (p. 197)</td>
<td><strong>eliminar</strong>: veshacerse de (p. 197)</td>
</tr>
<tr>
<td><strong>embargo</strong>: complete restriction on the</td>
<td><strong>embargo</strong>: prohibición total de la importación</td>
</tr>
<tr>
<td>import or export of a particular good or goods</td>
<td>o exportación de un producto o de productos que</td>
</tr>
<tr>
<td>going to or coming from a specific country (p.</td>
<td>entran o salen de un país en particular (p. 479)</td>
</tr>
<tr>
<td>479)</td>
<td></td>
</tr>
<tr>
<td><strong>enhance</strong>: improve (p. 500)</td>
<td><strong>realizar</strong>: mejorar, aumentar (p. 500)</td>
</tr>
<tr>
<td><strong>ENGLISH</strong></td>
<td><strong>ESPAÑOL</strong></td>
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<tr>
<td>----------------</td>
<td>----------------</td>
</tr>
<tr>
<td><strong>enormous</strong> • <strong>factor</strong></td>
<td><em>enorme: muy grande</em> (p. 87)</td>
</tr>
<tr>
<td><em>enormous:</em> huge (p. 87)</td>
<td><em>enorme:</em> muy grande (p. 87)</td>
</tr>
<tr>
<td><strong>entrepreneur</strong></td>
<td><strong>empresa:</strong> persona que organiza, administra y acepta los riesgos de un negocio para sacarle ganancias (p. 208)</td>
</tr>
<tr>
<td><strong>entrepreneurship:</strong> when individuals take risks to develop new products and start new businesses in order to make profits (p. 9)</td>
<td><strong>empresa:</strong> cuando individuos toman riesgos al desarrollar nuevos productos y empezar nuevos negocios para sacarles ganancias (p. 9)</td>
</tr>
<tr>
<td><strong>equilibrium price:</strong> the price at which the amount producers are willing to supply is equal to the amount consumers are willing to buy (p. 195)</td>
<td><strong>precio de equilibrio:</strong> precio al que la cantidad de un producto que los fabricantes están dispuestos a ofrecer es igual a la cantidad que los consumidores están dispuestos a comprar (p. 195)</td>
</tr>
<tr>
<td><em>equivalent:</em> equal (p. 122)</td>
<td><em>equivalente:</em> igual (p. 122)</td>
</tr>
<tr>
<td><em>estimate:</em> guess (p. 284)</td>
<td><em>estimación:</em> cálculo aproximado (p. 284)</td>
</tr>
<tr>
<td><strong>ethical behavior:</strong> acting in accordance with moral convictions about right and wrong (p. 79)</td>
<td><strong>comportamiento ético:</strong> actuar de acuerdo con convicciones morales acerca del bien y el mal (p. 79)</td>
</tr>
<tr>
<td><em>ethnic:</em> relating to a grouping of people according to race, region of origin, or other characteristics (p. 528)</td>
<td><em>étnico:</em> relacionado con un grupo de personas de acuerdo con su raza, lugar de origen, u otras características (p. 528)</td>
</tr>
<tr>
<td><strong>European Union (EU):</strong> organization of European nations whose goal is to encourage economic integration as a single market (p. 481)</td>
<td><strong>Unión Europea:</strong> organización de naciones europeas cuyo objetivo es promover su integración económica para formar un solo mercado (p. 481)</td>
</tr>
<tr>
<td><em>exceed:</em> go beyond (p. 416)</td>
<td><em>exceder:</em> sobrepasar (p. 416)</td>
</tr>
<tr>
<td><strong>exchange rate:</strong> the price of one nation’s currency in terms of another nation’s currency (p. 472)</td>
<td><strong>tipo de cambio:</strong> valor de la moneda de una nación comparado con la moneda de otra (p. 472)</td>
</tr>
<tr>
<td><em>expand:</em> extend beyond the prior state (p. 49)</td>
<td><em>expandir:</em> extenderse más allá de su estado anterior (p. 49)</td>
</tr>
<tr>
<td><strong>expansion:</strong> part of the business cycle in which economic activity slowly increases (p. 352)</td>
<td><strong>expansión:</strong> parte del ciclo económico en que la actividad económica aumenta lentamente (p. 352)</td>
</tr>
<tr>
<td><em>expert:</em> specialist (p. 442)</td>
<td><em>experto:</em> especialista (p. 442)</td>
</tr>
<tr>
<td><strong>exports:</strong> goods sold to other countries (p. 466)</td>
<td><strong>exportaciones:</strong> bienes que se venden a otros países (p. 466)</td>
</tr>
<tr>
<td><strong>externalities:</strong> economic side effects or by-products that affect an uninvolved third party; can be negative or positive (p. 422)</td>
<td><strong>factores externos:</strong> consecuencias indirectas de actividades económicas que afectan a terceras personas que no tomaron parte en ellas; pueden ser negativas o positivas (p. 422)</td>
</tr>
<tr>
<td><em>factor:</em> thing to be considered (p. 119)</td>
<td><em>factor:</em> cosa que hay que tomar en cuenta (p. 119)</td>
</tr>
</tbody>
</table>
factors of production • focus

**ENGLISH**

- **factors of production**: resources of land, labor, capital, and entrepreneurship used to produce goods and services (p. 8)
- **Fed**: the Federal Reserve System created by Congress in 1913 as the nation’s central banking organization (p. 392)
- **federal funds rate**: interest rate that banks charge each other on loans (usually overnight) (p. 405)
- **Federal Open Market Committee (FOMC)**: 12-member committee in the Federal Reserve System that meets 8 times a year to decide the course of action that the Fed should take to control the money supply (p. 393)
- **fiat money**: money that has value because a government fiat, or order, has established it as acceptable for payment of debts (p. 371)
- **finance charge**: cost of credit expressed monthly in dollars and cents (p. 97)
- **finance company**: company that takes over contracts for installment debts from stores and adds a fee for collecting the debt; a consumer finance company makes loans directly to consumers at high rates of interest (p. 94)
- **financing**: obtaining funds or money capital for business expansion (p. 260)
- **fiscal policy**: federal government’s use of taxation and spending policies to affect overall business activity (p. 448)
- **fiscal year**: year by which accounts are kept; for the federal government, October 1 to September 30 of the next year (p. 427)
- **five-year plans**: centralized planning system that used to be the basis for China’s economic system; eventually was transformed to a regional planning system leading to limited free enterprise (p. 506)
- **fixed rate of exchange**: system under which a national government sets the value of its currency in relation to a single standard (p. 473)
- **flexible exchange rate**: arrangement in which the forces of supply and demand are allowed to set the price of various currencies (p. 474)

**ESPAÑOL**

- **factores de producción**: recursos de tierra, trabajo, capital y espíritu empresarial que se usan para producir bienes y servicios (p. 8)
- **Sistema de Reserva Federal**: sistema creado por el Congreso en 1913 para servir de organización bancaria central de la nación; conocido como “Fed” (p. 392)
- **tasa federal por fondos prestados**: tipo de interés que se cobran los bancos unos a otros (generalmente por menos de 1 día) (p. 405)
- **Comité Federal del Mercado Libre**: comisión de 12 personas, parte del Sistema de Reserva Federal, que se reúne 8 veces al año para determinar lo que debe hacer la Reserva Federal para controlar la oferta monetaria; también se llama Comité Controlador del Dinero (p. 393)
- **dinero fiduciario**: dinero que tiene valor porque un decreto gubernamental ha establecido que se puede aceptar como pago por deudas (p. 371)
- **cargo de financiamiento**: costo mensual del crédito expresado en dólares y centavos (p. 97)
- **compañía financiera**: compañía que asume los contratos de deudas a plazos de tiendas y les añade una cuota por cobrar la deuda; las compañías de financiamiento directo al consumidor hacen préstamos directamente a los consumidores a intereses altos (p. 94)
- **financiamiento**: obtener fondos o capital financiero para la expansión de un negocio; también se llama financiación (p. 260)
- **política fiscal**: uso por el gobierno federal de tributación (impuestos) y gastos para afectar la actividad comercial general (p. 448)
- **año fiscal**: período de un año en que se llevan las cuentas; para el gobierno federal, empieza octubre 1 y termina septiembre 30 del próximo año (p. 427)
- **planes quinquenales**: sistema de planificación central que formaba la base del sistema económico chino; fue transformado en un sistema de planificación regional que ha conducido a la libre empresa limitada (p. 506)
- **tipo de cambio fijo**: sistema bajo el cual un gobierno nacional establece el valor de su moneda en relación con un patrón único (p. 473)
- **tipo de cambio flexible**: arreglo bajo el cual la oferta y la demanda determinan el valor de varias monedas (p. 474)

*focus: the center of attention (p. 6) *enfoque: centro de atención (p. 6)
**ENGLISH**

<table>
<thead>
<tr>
<th><strong>foreign affiliates</strong></th>
<th>branches of multinational firms (p. 528)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>foreign aid</strong></td>
<td>money, goods, and services given by govern-</td>
</tr>
<tr>
<td></td>
<td>ments and private organizations to help o-</td>
</tr>
<tr>
<td></td>
<td>ther nations and their citizens (p. 497)</td>
</tr>
<tr>
<td><strong>foreign exchange markets</strong></td>
<td>markets dealing in buying and selling foreign currency for businesses that want to import goods from other countries (p. 472)</td>
</tr>
<tr>
<td><strong>fractional reserve banking</strong></td>
<td>system in which only a fraction of the deposits in a bank is kept on hand, or in reserve; the remainder is available to lend (p. 400)</td>
</tr>
<tr>
<td><strong>franchise</strong></td>
<td>contract in which one business (the franchisor) sells to another business (the franchisee) the right to use the franchisor’s name and sell its products (p. 222)</td>
</tr>
<tr>
<td><strong>free-enterprise system</strong></td>
<td>economic system in which individuals own the factors of production and decide how to use them within legal limits; same as capitalism (p. 44)</td>
</tr>
<tr>
<td><strong>full employment</strong></td>
<td>condition of the economy when the unemployment rate is lower than a certain percentage established by economists’ studies (p. 443)</td>
</tr>
<tr>
<td><em>function</em></td>
<td>job; task (p. 398)</td>
</tr>
<tr>
<td><em>fundamental</em></td>
<td>basic (p. 493)</td>
</tr>
</tbody>
</table>

**ESPÁÑOL**

<table>
<thead>
<tr>
<th><strong>sucursales extranjeras</strong></th>
<th>establecimientos que forman parte de empresas multinacionales (p. 528)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ayuda al exterior</strong></td>
<td>dinero, bienes y servicios que gobiernos y organizaciones privadas donan para ayudar a otras naciones y sus ciudadanos (p. 497)</td>
</tr>
<tr>
<td><strong>mercados de divisas</strong></td>
<td>mercados donde negocios que desean importar bienes de otros países compran y venden divisas (monedas extranjeras) (p. 472)</td>
</tr>
<tr>
<td><strong>reserva bancaria parcial</strong></td>
<td>sistema que permite que los bancos tengan sólo un porcentaje de sus depósitos a mano o en reserva; el resto lo pueden usar para hacer préstamos (p. 400)</td>
</tr>
<tr>
<td><strong>franquicia</strong></td>
<td>contrato mediante el cual un negocio (el franquiciante) vende a otro (el franquiciatario) el derecho de usar su nombre y vender sus productos; también se llama licencia (p. 222)</td>
</tr>
<tr>
<td><strong>sistema de libre empresa</strong></td>
<td>sistema económico en que los individuos son dueños de los factores de producción y deciden cómo los van a usar dentro de los límites legales; lo mismo que capitalismo (p. 44)</td>
</tr>
<tr>
<td><strong>pleno empleo</strong></td>
<td>condición económica en que el índice de desempleo está por debajo de un porcentaje establecido por estudios económicos (p. 443)</td>
</tr>
<tr>
<td><em>función</em></td>
<td>labor; tarea (p. 398)</td>
</tr>
<tr>
<td><em>fundamental</em></td>
<td>básico (p. 493)</td>
</tr>
</tbody>
</table>

**GDP** see gross domestic product (GDP)  
**GDP price deflator** price index that removes the effect of inflation from GDP so that the overall economy in one year can be compared to another year (p. 344)  
**generate** make; produce (p. 209)  
**generic brand** general name for a product rather than a specific brand name given by the manufacturer (p. 74)  
**global integration** interdependency among the countries of the world, especially within financial markets and telecommunications (p. 518)  
**goods** tangible objects that can satisfy people’s wants or needs (p. 8)
<table>
<thead>
<tr>
<th>English</th>
<th>Spanish</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross Domestic Product (GDP):</strong> total dollar value of all final goods and services produced in a nation in a single year (p. 337)</td>
<td><strong>Producto Interior Bruto (PIB):</strong> valor total en dólares de todos los bienes y servicios producidos por una nación en un año (p. 337)</td>
</tr>
<tr>
<td><em>guarantee:</em> a promise to replace something if it is not as represented (p. 77)</td>
<td><em>garantía:</em> la promesa de reemplazar algo si no es como se presentó (p. 77)</td>
</tr>
<tr>
<td><em>guideline:</em> pattern (p. 455)</td>
<td><em>directriz:</em> pauta (p. 455)</td>
</tr>
<tr>
<td><strong>Hypothesis:</strong> an assumption involving two or more variables that must be tested for validity (p. 22)</td>
<td><strong>Hipótesis:</strong> suposición que tiene dos o más variables y que se tiene que comprobar para ver si es válida (p. 22)</td>
</tr>
<tr>
<td><em>identical:</em> exactly the same (p. 524)</td>
<td><em>idéntico:</em> exactamente igual (p. 524)</td>
</tr>
<tr>
<td><strong>Import Quota:</strong> restriction imposed on the number of units of a particular good that can be brought into the country (p. 479)</td>
<td><strong>Cuota de Importación:</strong> restricción en el número de unidades de un producto que se puede traer a un país (p. 479)</td>
</tr>
<tr>
<td><strong>Imports:</strong> goods bought from other countries for domestic use (p. 466)</td>
<td><strong>Importaciones:</strong> bienes traídos de otro país para el uso doméstico (p. 466)</td>
</tr>
<tr>
<td><em>impose:</em> to establish or apply by authority (p. 191)</td>
<td><em>imponer:</em> ser establecido o aplicado por una autoridad (p. 191)</td>
</tr>
<tr>
<td><em>incentive:</em> stimulus; motive (p. 37)</td>
<td><em>incentivo:</em> estímulo; aliciente; motivo (p. 37)</td>
</tr>
<tr>
<td><strong>Income Redistribution:</strong> government activity that takes income from some people through taxation and uses it to help citizens in need (p. 420)</td>
<td><strong>Redistribución de Rentas:</strong> actividad gubernamental que toma los ingresos de algunas personas a través de impuestos y los usa para ayudar a otras personas necesitadas (p. 420)</td>
</tr>
<tr>
<td><em>indicate:</em> to be a sign of; signify (p. 369)</td>
<td><em>indicar:</em> señalar; revelar (p. 369)</td>
</tr>
<tr>
<td><em>individual:</em> one person (p. 287)</td>
<td><em>individuo:</em> una persona (p. 287)</td>
</tr>
<tr>
<td><strong>Individual Retirement Account (IRA):</strong> private retirement plan that allows individuals or married couples to save a certain amount of untaxed earnings per year with the interest being tax-deferred (p. 157)</td>
<td><strong>Cuentas de Retiro Individuales:</strong> planes de jubilación privados que permiten que individuos o matrimonios ahorren cierta porción de sus ingresos anuales sin pagar impuestos y que posponen el impuesto sobre los intereses (p. 157)</td>
</tr>
<tr>
<td><strong>Industrial Union:</strong> union made up of all the workers in an industry regardless of job or skill level (p. 317)</td>
<td><strong>Sindicato Industrial:</strong> asociación de todos los obreros de una industria, que no toma en cuenta el tipo de trabajo ni el nivel de especialización (p. 317)</td>
</tr>
<tr>
<td><strong>Inelastic Demand:</strong> situation in which a product’s price change has little impact on the quantity demanded by consumers (p. 183)</td>
<td><strong>Demanda Inelástica:</strong> situación en que el precio de un producto tiene poco efecto en la cantidad demandada por los consumidores (p. 183)</td>
</tr>
<tr>
<td>ENGLISH</td>
<td>ESPAÑOL</td>
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</tr>
<tr>
<td><strong>infant mortality rate</strong>: death rate of infants who die during the first year of life (p. 492)</td>
<td><strong>índice de mortalidad infantil</strong>: porcentaje de muertes de niños en el primer año de vida (p. 492)</td>
</tr>
<tr>
<td><strong>inflation</strong>: prolonged rise in the general price level of final goods and services (p. 342)</td>
<td><strong>inflación</strong>: aumento prolongado en el nivel general de los precios de bienes y servicios finales (p. 342)</td>
</tr>
<tr>
<td><strong>inflation targeting</strong>: a possible central bank policy in which the head of the central bank is given a specified annual rate of inflation as a goal (p. 455)</td>
<td><strong>objetivo inflacionario</strong>: posible política de un banco central que le da al director del banco central una tasa de inflación anual específica como meta (p. 455)</td>
</tr>
<tr>
<td><strong>informative advertising</strong>: advertising that benefits consumers by providing useful information about a product (p. 72)</td>
<td><strong>publicidad informativa</strong>: anuncios que benefician a los consumidores al darles información útil sobre un producto (p. 72)</td>
</tr>
<tr>
<td>*initial: first (p. 233)</td>
<td>*inicial: primero, al principio (p. 233)</td>
</tr>
<tr>
<td>*initiative: ability to originate new ideas (p. 54)</td>
<td>*iniciativa: habilidad de originar ideas nuevas (p. 54)</td>
</tr>
<tr>
<td><strong>injunction</strong>: court order preventing some activity (p. 323)</td>
<td><strong>prohibición judicial</strong>: orden de un juez que impide alguna actividad (p. 323)</td>
</tr>
<tr>
<td><strong>innovation</strong>: transforming an invention into something useful to humans (p. 357)</td>
<td><strong>innovación</strong>: transformar un invento en algo útil para la humanidad (p. 357)</td>
</tr>
<tr>
<td><strong>installment debt</strong>: type of loan repaid with equal payments, or installments, over a specific period of time (p. 88)</td>
<td><strong>deudas pagadas a plazos</strong>: tipo de préstamo que se paga en cantidades iguales durante un período determinado de tiempo (p. 88)</td>
</tr>
<tr>
<td>*instance: case; example (p. 263)</td>
<td>*instancia: caso; ejemplo (p. 263)</td>
</tr>
<tr>
<td>*integral: essential; basic (p. 260)</td>
<td>*integral: esencial; básico (p. 260)</td>
</tr>
<tr>
<td>*intense: strong (p. 479)</td>
<td>*intenso: fuerte; profundo (p. 479)</td>
</tr>
<tr>
<td>*interact: work together (p. 233)</td>
<td>*interactuar: trabajar juntos (p. 233)</td>
</tr>
<tr>
<td><strong>interest</strong>: amount the borrower must pay for the use of someone else’s funds (p. 88)</td>
<td><strong>interés</strong>: cantidad que un prestatario tiene que pagar por usar los fondos de otro (p. 88)</td>
</tr>
<tr>
<td><strong>interlocking directorate</strong>: a board of directors, the majority of whose members also serve as the board of directors of a competing corporation (p. 246)</td>
<td><strong>directorio entrelazado</strong>: junta directiva de una compañía cuya mayoría también sirve en la junta directiva de otra sociedad anónima que compite en el mismo mercado (p. 246)</td>
</tr>
<tr>
<td><strong>intermediate-term financing</strong>: funds borrowed by a business for 1 to 10 years (p. 266)</td>
<td><strong>financiamiento a mediano plazo</strong>: fondos prestados que un negocio tiene entre 1 y 10 años para pagar (p. 266)</td>
</tr>
<tr>
<td><strong>International Monetary Fund (IMF)</strong>: agency whose member governments once were obligated to keep their foreign exchange rates more or less fixed; today it offers monetary advice and provides loans to developing nations (p. 473)</td>
<td><strong>Fondo Monetario Internacional (FMI)</strong>: agencia que antes obligaba a los gobiernos de países miembros a mantener sus tipos de cambio más o menos fijos; hoy ofrece asesoramiento monetario y proporciona préstamos a países en desarrollo (p. 473)</td>
</tr>
<tr>
<td>*interval: period of time (p. 507)</td>
<td>*intervalo: período de tiempo (p. 507)</td>
</tr>
<tr>
<td><strong>inventory</strong>: extra supply of the items used in a business, such as raw materials or goods for sale (p. 210)</td>
<td><strong>inventario</strong>: artículos que un negocio tiene almacenados, como materias primas o mercancía para vender (p. 210)</td>
</tr>
<tr>
<td><strong>ENGLISH</strong></td>
<td><strong>ESPAÑOL</strong></td>
</tr>
<tr>
<td>---------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
</tr>
<tr>
<td><em>involve</em>: concerned with (p. 128)</td>
<td><em>involucrar</em>: comprender; abarcar (p. 128)</td>
</tr>
<tr>
<td><em>issue</em>: give out; distribute (p. 375)</td>
<td><em>emitir</em>: repartir; distribuir (p. 375)</td>
</tr>
<tr>
<td><strong>joint venture</strong>: partnership set up for a specific purpose for a short period of time (p. 216)</td>
<td><strong>negocio en participación</strong>: sociedad establecida por un corto período de tiempo con un propósito determinado (p. 216)</td>
</tr>
<tr>
<td><em>justify</em>: give reason for (p. 431)</td>
<td><em>justificar</em>: dar una razón (p. 431)</td>
</tr>
<tr>
<td><strong>Keogh plan</strong>: retirement plan that allows self-employed individuals to save a maximum of 15 percent of their income up to a specified amount each year, and to deduct that amount from their yearly taxable income (p. 156)</td>
<td><strong>plan Keogh</strong>: plan de jubilación que le permite al que trabaja por su cuenta ahorrar un máximo del 15 por ciento de sus ingresos anuales hasta llegar a una cantidad determinada y descontar la cantidad ahorrada de sus ingresos anuales gravables (p. 156)</td>
</tr>
<tr>
<td><strong>labor</strong>: human effort directed toward producing goods and services (p. 8)</td>
<td><strong>trabajo</strong>: esfuerzo humano dirigido a la producción de bienes y servicios (p. 8)</td>
</tr>
<tr>
<td><strong>labor union</strong>: association of workers organized to improve wages and working conditions for its members (p. 316)</td>
<td><strong>sindicato de obreros</strong>: asociación de trabajadores organizados para mejorar los salarios y condiciones de trabajo de sus miembros; también se llama sindicato laboral y gremio de obreros (p. 316)</td>
</tr>
<tr>
<td><strong>lagging indicators</strong>: indicators that seem to lag behind changes in overall business activity (p. 359)</td>
<td><strong>indicadores de rezaga</strong>: indicadores que ocurren después de los cambios en las actividades comerciales (p. 359)</td>
</tr>
<tr>
<td><strong>laissez-faire</strong>: economic system in which the government minimizes its interference with the economy (p. 43)</td>
<td><strong>dejad hacer</strong>: sistema económico en que el gobierno interfiere lo menos posible en la economía (p. 43)</td>
</tr>
<tr>
<td><strong>land</strong>: natural resources and surface land and water (p. 8)</td>
<td><strong>tierra</strong>: recursos naturales, la superficie terrestre y el agua (p. 8)</td>
</tr>
<tr>
<td><strong>law of demand</strong>: economic rule stating that the quantity demanded and price move in opposite directions (p. 172)</td>
<td><strong>ley de la demanda</strong>: regla económica que dice que al cambiar el precio, la cantidad demandada cambia en sentido contrario (p. 172)</td>
</tr>
<tr>
<td><strong>law of diminishing marginal utility</strong>: rule stating that the additional satisfaction a consumer gets from purchasing one more unit of a product will lessen with each additional unit purchased (p. 174)</td>
<td><strong>ley de utilidad marginal decreciente</strong>: regla que dice que el consumidor recibe menos satisfacción adicional cada vez que compra una unidad más de un producto (p. 174)</td>
</tr>
<tr>
<td><strong>law of diminishing returns</strong>: economic rule that says as more units of a factor of production are added to other factors of production, after some point total output continues to increase but at a diminishing rate (p. 193)</td>
<td><strong>ley de los rendimientos decrecientes</strong>: regla económica que dice que al añadir más unidades de un solo factor económico a los otros factores económicos, después de cierto punto el aumento en la producción será menos y menos significativo (p. 193)</td>
</tr>
<tr>
<td><strong>ENGLISH</strong></td>
<td><strong>ESPANOL</strong></td>
</tr>
<tr>
<td>-----------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td><strong>law of supply</strong>: economic rule stating that price and quantity supplied move in the same direction (p. 187)</td>
<td><strong>ley de la oferta</strong>: regla económica que dice que al cambiar el precio, la cantidad ofrecida cambia en el mismo sentido (p. 187)</td>
</tr>
<tr>
<td><strong>leading indicators</strong>: statistics that point to what will happen in the economy (p. 358)</td>
<td><strong>indicadores anticipados</strong>: estadísticas que pronostican lo que va a suceder en la economía (p. 358)</td>
</tr>
<tr>
<td><strong>lease</strong>: long-term agreement describing the terms under which property is rented (p. 126)</td>
<td><strong>contrato de alquiler</strong>: acuerdo a largo plazo que describe los términos bajo los cuales se alquila o arrienda una propiedad (p. 126)</td>
</tr>
<tr>
<td><strong>legal tender</strong>: money that by law must be accepted for payment of public and private debts (p. 371)</td>
<td><strong>medios de curso legal</strong>: moneda que, por ley, se tiene que aceptar en pago de deudas públicas y privadas (p. 371)</td>
</tr>
<tr>
<td><strong>liability insurance</strong>: insurance that pays for bodily injury and property damage (p. 133)</td>
<td><strong>seguro de responsabilidad civil</strong>: seguro que paga por lesiones corporales y daños a propiedad (p. 133)</td>
</tr>
<tr>
<td><strong>license</strong>: a permit (p. 45)</td>
<td><strong>licencia</strong>: un permiso (p. 45)</td>
</tr>
<tr>
<td><strong>limited liability</strong>: requirement in which an owner’s responsibility for a company’s debts is limited to the size of the owner’s investment in the firm (p. 220)</td>
<td><strong>responsabilidad limitada</strong>: requisito que limita la responsabilidad de cada dueño por las deudas de una compañía al tamaño de su inversión en la firma (p. 220)</td>
</tr>
<tr>
<td><strong>limited liability company</strong>: type of business enterprise that protects members against losing all of their personal wealth; members are taxed as if they were in a partnership (p. 216)</td>
<td><strong>compañía de responsabilidad limitada</strong>: tipo de negocio que protege a sus miembros contra la pérdida de toda su riqueza personal; los miembros pagan impuestos como si estuviesen en una sociedad (p. 216)</td>
</tr>
<tr>
<td><strong>limited partnership</strong>: special form of partnership in which one or more partners have limited liability but no voice in management (p. 216)</td>
<td><strong>sociedad limitada</strong>: tipo de sociedad en que uno o más socios tienen responsabilidad limitada, pero no pueden participar en la administración del negocio (p. 216)</td>
</tr>
<tr>
<td><strong>local union</strong>: members of a union in a particular factory, company, or geographic area (p. 318)</td>
<td><strong>sección sindical</strong>: miembros de un sindicato en una fábrica, compañía o área geográfica en particular (p. 318)</td>
</tr>
<tr>
<td><strong>location</strong>: site; place (p. 272)</td>
<td><strong>ubicación</strong>: sitio; lugar (p. 272)</td>
</tr>
<tr>
<td><strong>lockout</strong>: situation that occurs when management prevents workers from returning to work until they agree to a new contract (p. 323)</td>
<td><strong>cierre patronal</strong>: situación en que los gerentes impiden que los trabajadores regresen al trabajo hasta que acepten un nuevo contrato; también se llama paro forzoso o paro patronal (p. 323)</td>
</tr>
<tr>
<td><strong>long-term financing</strong>: funds borrowed by a business for a period of more than 10 years or funds raised by issuing stock (p. 267)</td>
<td><strong>financiamiento a largo plazo</strong>: préstamo de fondos que un negocio tiene por más de 10 años o fondos que recauda por medio de la venta de acciones (p. 267)</td>
</tr>
<tr>
<td><strong>loose money policy</strong>: monetary policy that makes credit inexpensive and abundant, possibly leading to inflation (p. 399)</td>
<td><strong>política monetaria expansiva</strong>: política monetaria que resulta en crédito barato y abundante; puede conducir a la inflación (p. 399)</td>
</tr>
<tr>
<td>English</td>
<td>Spanish</td>
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<tr>
<td>---------------------------------------------</td>
<td>----------------------------------------------</td>
</tr>
<tr>
<td><strong>M1</strong>: narrowest definition of the money supply; consists of moneys that can be spent immediately and against which checks can be written (p. 383)</td>
<td><strong>M1</strong>: definición más estricta de la oferta monetaria; comprende el dinero que se puede gastar inmediatamente y contra el cual se pueden emitir cheques (p. 383)</td>
</tr>
<tr>
<td><strong>M2</strong>: broader definition of the money supply; includes all of M1, plus such near moneys as savings deposits, small-denomination time deposits, money market deposit accounts, and retail money market mutual fund balances (p. 383)</td>
<td><strong>M2</strong>: definición más general de la oferta monetaria; incluye la M1 más cuasi-dinero como depósitos de ahorro, depósitos a plazo de pequeña denominación, cuentas de depósito de mercado monetario y balances de fondos mutualistas del mercado monetario al por menor (p. 383)</td>
</tr>
<tr>
<td><strong>macroeconomics</strong>: the branch of economic theory dealing with the economy as a whole and decision making by large units such as governments (p. 6)</td>
<td><strong>macroeconomía</strong>: rama de la teoría económica que trata de la economía en su totalidad y de los modos en que grandes organismos, como los gobiernos, toman decisiones (p. 6)</td>
</tr>
<tr>
<td><em>maintain</em>: keep (p. 420)</td>
<td><em>mantener</em>: preservar; continuar (p. 420)</td>
</tr>
<tr>
<td><em>major</em>: main (p. 430)</td>
<td><em>importante</em>: principal (p. 430)</td>
</tr>
<tr>
<td><em>manipulate</em>: influence; control (p. 527)</td>
<td><em>manipular</em>: influir; controlar (p. 527)</td>
</tr>
<tr>
<td><strong>marginal utility</strong>: an additional amount of satisfaction (p. 174)</td>
<td><strong>utilidad marginal</strong>: una cantidad adicional de satisfacción o provecho (p. 174)</td>
</tr>
<tr>
<td><strong>market</strong>: the process of freely exchanging goods and services between buyers and sellers (pp. 38, 170)</td>
<td><strong>mercado</strong>: el proceso de intercambio libre de bienes y servicios entre compradores y vendedores (pp. 38, 170)</td>
</tr>
<tr>
<td><strong>market basket</strong>: representative group of goods and services used to compile the consumer price index (p. 343)</td>
<td><strong>canasta de compras</strong>: grupo representativo de bienes y servicios usado para calcular el índice de precios al consumidor (p. 343)</td>
</tr>
<tr>
<td><strong>market economy</strong>: system in which individuals own the factors of production and make economic decisions through free interaction while looking out for their own and their families’ best interests (p. 38)</td>
<td><strong>economía de mercado</strong>: sistema en que particulares son los dueños de los factores de producción y toman decisiones económicas, relacionándose libremente con otros, para el mayor beneficio de sus familias y sí mismos (p. 38)</td>
</tr>
<tr>
<td><strong>marketing</strong>: all the activities needed to generate consumer demand and to move goods and services from the producer to the consumer (p. 284)</td>
<td><strong>mercadotecnia</strong>: todas las actividades necesarias para generar demanda y mover bienes y servicios de los productores a los consumidores; también se llama marketing (p. 284)</td>
</tr>
<tr>
<td><strong>market research</strong>: gathering, recording, and analyzing data about the types of goods and services that people want (p. 285)</td>
<td><strong>investigación de mercados</strong>: reunir, anotar y analizar datos acerca de los tipos de bienes y servicios que desea el público (p. 285)</td>
</tr>
<tr>
<td><strong>market structure</strong>: the extent to which competition prevails in particular markets (p. 232)</td>
<td><strong>estructura del mercado</strong>: punto hasta el cual la competencia predomina en un mercado (p. 232)</td>
</tr>
<tr>
<td><strong>market survey</strong>: information gathered by researchers about possible users of a product based on such characteristics as age, sex, income, education, and geographic location (p. 287)</td>
<td><strong>estudio del mercado</strong>: información obtenida por investigadores sobre los posibles usuarios de un producto, como su edad, sexo, ingresos, estudios y ubicación geográfica (p. 287)</td>
</tr>
<tr>
<td>English</td>
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<td>-----------------------------------------------------------------------</td>
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<tr>
<td><strong>maturity</strong>: period of time at the end of which time deposits will pay a stated rate of interest (p. 144)</td>
<td></td>
</tr>
<tr>
<td><strong>mechanization</strong>: combined labor of people and machines (p. 274)</td>
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</tr>
<tr>
<td><strong>mediation</strong>: a neutral person tries to get both sides to reach an agreement during negotiations (p. 321)</td>
<td></td>
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<tr>
<td><strong>Medicaid</strong>: state and federal public-assistance program that helps pay health care costs for low-income and disabled persons (p. 421)</td>
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</tr>
<tr>
<td><strong>Medicare</strong>: government program that provides health care for the aged (p. 417)</td>
<td></td>
</tr>
<tr>
<td><strong>medium of exchange</strong>: use of money for exchange for goods or services (p. 368)</td>
<td></td>
</tr>
<tr>
<td><strong>merger</strong>: the legal combination of two or more companies that become one corporation (p. 247)</td>
<td></td>
</tr>
<tr>
<td>*<strong>method</strong>: system; mode (p. 298)</td>
<td></td>
</tr>
<tr>
<td><strong>microeconomics</strong>: the branch of economic theory that deals with behavior and decision making by small units such as individuals and firms (p. 6)</td>
<td></td>
</tr>
<tr>
<td><strong>military assistance</strong>: aid given to a nation’s armed forces (p. 497)</td>
<td></td>
</tr>
<tr>
<td>*<strong>minimum</strong>: smallest possible amount (p. 142)</td>
<td></td>
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<tr>
<td><strong>minimum wage law</strong>: federal law that sets the lowest legal hourly wage rate that may be paid to certain types of workers (p. 313)</td>
<td></td>
</tr>
<tr>
<td><strong>mixed economy</strong>: system combining characteristics of more than one type of economy (p. 40)</td>
<td></td>
</tr>
<tr>
<td><strong>monetarism</strong>: theory that deals with the relationship between the amount of money the Fed places in circulation and the level of activity in the economy (p. 453)</td>
<td></td>
</tr>
<tr>
<td><strong>monetarists</strong>: supporters of the theory of monetarism, often linked with Milton Friedman (p. 453)</td>
<td></td>
</tr>
<tr>
<td><strong>monetary policy</strong>: policy that involves changing the rate of growth of the supply of money in circulation in order to affect the cost and availability of credit (p. 392)</td>
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<table>
<thead>
<tr>
<th>Spanish</th>
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<tbody>
<tr>
<td><strong>plazo de vencimiento</strong>: período de tiempo al final del cual los depósitos a plazos pagan una tasa de interés establecida (p. 144)</td>
</tr>
<tr>
<td><strong>mecanización</strong>: esfuerzo combinado de personas y máquinas (p. 274)</td>
</tr>
<tr>
<td><strong>mediación</strong>: una persona neutral trata de hacer que ambas partes lleguen a un acuerdo durante una negociación (p. 321)</td>
</tr>
<tr>
<td><strong>Medicaid</strong>: programa de asistencia público estatal y federal que provee apoyo financiero para los gastos médicos de personas de bajos ingresos y personas incapacitadas (p. 421)</td>
</tr>
<tr>
<td><strong>Medicare</strong>: programa gubernamental que proporciona cuidado de la salud para personas de la tercera edad (p. 417)</td>
</tr>
<tr>
<td><strong>medio de cambio</strong>: uso del dinero a cambio de bienes y servicios (p. 368)</td>
</tr>
<tr>
<td><strong>corporación</strong>: combinación legal de compañías en una sola sociedad anónima (p. 247)</td>
</tr>
<tr>
<td><strong>método</strong>: sistema; modo (p. 298)</td>
</tr>
<tr>
<td><strong>microeconomía</strong>: rama de la teoría económica que estudia la conducta y modos de tomar decisiones de unidades pequeñas, como individuos y empresas (p. 6)</td>
</tr>
<tr>
<td><strong>asistencia militar</strong>: ayuda dada a las fuerzas armadas de una nación (p. 497)</td>
</tr>
<tr>
<td><strong>cambio</strong>: cantidad menor posible (p. 142)</td>
</tr>
<tr>
<td><strong>ley del salario mínimo</strong>: ley federal que establece el sueldo por hora más bajo que se puede pagar legalmente a ciertos tipos de trabajadores (p. 313)</td>
</tr>
<tr>
<td><strong>economía mixta</strong>: sistema que combina las características de más de un tipo de economía (p. 40)</td>
</tr>
<tr>
<td><strong>monetarismo</strong>: teoría que relaciona la cantidad de dinero que el Sistema de Reserva Federal pone en circulación con el nivel de actividad en la economía (p. 453)</td>
</tr>
<tr>
<td><strong>monetaristas</strong>: partidarios de la teoría del monetarismo, a menudo conectada con Milton Friedman (p. 453)</td>
</tr>
<tr>
<td><strong>política monetaria</strong>: política que controla el crecimiento de la cantidad de dinero en circulación para afectar el costo y la facilidad de obtener crédito (p. 392)</td>
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</table>
### monetary rule • near moneys

<table>
<thead>
<tr>
<th>English</th>
<th>Spanish</th>
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<tbody>
<tr>
<td><strong>monetary rule</strong>: monetarists’ belief that</td>
<td><strong>norma monetaria</strong>: creencia de los</td>
</tr>
<tr>
<td>the Fed should allow the money supply to</td>
<td>monetaristas que el Sistema de Reserva</td>
</tr>
<tr>
<td>grow at a smooth, consistent rate per year</td>
<td>Federal debe permitir que la oferta monetaria</td>
</tr>
<tr>
<td>and not use monetary policy to stimulate</td>
<td>crezca a un ritmo anual constante y no usar</td>
</tr>
<tr>
<td>or slow the economy (p. 455)</td>
<td>la política monetaria para estimular o</td>
</tr>
<tr>
<td></td>
<td>reducir la actividad económica (p. 455)</td>
</tr>
<tr>
<td><strong>money</strong>: anything customarily used as a</td>
<td><strong>moneda</strong>: cualquier cosa que se acostumba</td>
</tr>
<tr>
<td>medium of exchange, a unit of accounting,</td>
<td>usar como medio de cambio, unidad de</td>
</tr>
<tr>
<td>and a store of value (p. 368)</td>
<td>contabilidad y reserva de valor; también se</td>
</tr>
<tr>
<td></td>
<td>llama dinero (p. 368)</td>
</tr>
<tr>
<td><strong>money market deposit account</strong>: account</td>
<td><strong>cuenta de depósito de mercado monetario</strong>:</td>
</tr>
<tr>
<td>that pays relatively high rates of interest,</td>
<td>cuenta que paga intereses relativamente alto,</td>
</tr>
<tr>
<td>requires a minimum balance, and allows</td>
<td>requiere un saldo mínimo y mantiene los</td>
</tr>
<tr>
<td>immediate access to funds (p. 143)</td>
<td>fondos disponibles en cualquier momento</td>
</tr>
<tr>
<td><strong>money market fund</strong>: type of mutual fund</td>
<td><strong>fondo de mercado monetario</strong>: tipo de fondo</td>
</tr>
<tr>
<td>that uses investors’ funds to make short-</td>
<td>mutualista que utiliza los fondos de los</td>
</tr>
<tr>
<td>term loans to businesses and banks (p. 152)</td>
<td>inversionistas para hacer préstamos a corto</td>
</tr>
<tr>
<td></td>
<td>plazo a empresas y bancos (p. 152)</td>
</tr>
<tr>
<td><strong>monopolistic competition</strong>: market situation in which a large number of sellers offer similar but slightly different products and in which each has some control over price (p. 242)</td>
<td><strong>competencia monopolística</strong>: mercado en que un gran número de vendedores ofrecen productos parecidos aunque algo distintos y en que cada vendedor tiene algún control sobre el precio (p. 242)</td>
</tr>
<tr>
<td><strong>monopoly</strong>: market situation in which a</td>
<td><strong>monopolio</strong>: mercado en que hay sólo un</td>
</tr>
<tr>
<td>single supplier makes up an entire industry</td>
<td>proveedor que comprende la industria entera</td>
</tr>
<tr>
<td>for a good or service with no close</td>
<td>de un producto o servicio sin verdaderos</td>
</tr>
<tr>
<td>substitutes (p. 237)</td>
<td>sustitutos (p. 237)</td>
</tr>
<tr>
<td><strong>mortgage</strong>: installment debt owed on</td>
<td><strong>hipoteca</strong>: tipo de deuda pagada a plazos</td>
</tr>
<tr>
<td>houses, buildings, or land (p. 89)</td>
<td>por casas, edificios o terrenos (p. 89)</td>
</tr>
<tr>
<td><strong>multinationals</strong>: firms that do business</td>
<td><strong>corporaciones multinacionales</strong>: firmas que</td>
</tr>
<tr>
<td>and have offices or factories in many</td>
<td>hacen negocio y tienen oficinas y fábricas</td>
</tr>
<tr>
<td>countries (p. 528)</td>
<td>en muchos países; también se llaman empresas</td>
</tr>
<tr>
<td></td>
<td>transnacionales o internacionales (p. 528)</td>
</tr>
<tr>
<td><strong>mutual fund</strong>: investment company that</td>
<td><strong>fondo mutualista</strong>: compañía inversionista</td>
</tr>
<tr>
<td>pools the funds of many individuals to</td>
<td>que reúne los fondos de muchos individuos</td>
</tr>
<tr>
<td>buy stocks, bonds, or other investments (p.</td>
<td>para comprar acciones, bonos y otros tipos</td>
</tr>
<tr>
<td>152)</td>
<td>de inversiones (p. 152)</td>
</tr>
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<table>
<thead>
<tr>
<th>English</th>
<th>Spanish</th>
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<tbody>
<tr>
<td><strong>national debt</strong>: total amount of</td>
<td><strong>deuda pública</strong>: cantidad de deuda que</td>
</tr>
<tr>
<td>outstanding debt for the federal government</td>
<td>tiene el gobierno federal (p. 428)</td>
</tr>
<tr>
<td>(p. 428)</td>
<td></td>
</tr>
<tr>
<td><strong>national income (NI)</strong>: total income</td>
<td><strong>renta nacional</strong>: ingresos totales de</td>
</tr>
<tr>
<td>earned by everyone in the economy (p. 339)</td>
<td>todas las personas que forman parte de una</td>
</tr>
<tr>
<td></td>
<td>economía (p. 339)</td>
</tr>
<tr>
<td><strong>national income accounting</strong>: measurement</td>
<td><strong>cálculo de la renta nacional</strong>: medida del</td>
</tr>
<tr>
<td>of the national economy’s performance,</td>
<td>rendimiento económico de una nación, tomando</td>
</tr>
<tr>
<td>dealing with the overall economy’s output</td>
<td>en cuenta la producción y los ingresos</td>
</tr>
<tr>
<td>and income (p. 336)</td>
<td>totales (p. 336)</td>
</tr>
<tr>
<td><strong>near moneys</strong>: assets, such as savings</td>
<td><strong>cuasi-dinero</strong>: activos, como las cuentas</td>
</tr>
<tr>
<td>accounts, that can be turned into money</td>
<td>de ahorro, que se pueden convertir en</td>
</tr>
<tr>
<td>relatively easily and without the risk of</td>
<td>dinero con bastante facilidad sin</td>
</tr>
<tr>
<td>loss of value (p. 382)</td>
<td>correr el riesgo de que pierdan valor (p. 382)</td>
</tr>
</tbody>
</table>
**net domestic product (NDP)**: value of the nation’s total output (GDP) minus the total value lost through depreciation on equipment (p. 338)

**producto interior neto**: valor de la producción total de un país (PIB) menos el valor total perdido por la depreciación de equipos (p. 338)

**net exports**: difference between what the nation sells to other countries and what it buys from other countries (p. 338)

**exportaciones netas**: diferencia entre lo que una nación le vende a otros países y lo que compra de ellos (p. 338)

**network**: system (p. 392)

**red**: sistema (p. 392)

**neutral**: unbiased; not taking sides (p. 321)

**neutral**: imparcial; que no se adhiere a un partido (p. 321)

**North American Free Trade Agreement (NAFTA)**: trade agreement designed to reduce and gradually eliminate tariff barriers between Mexico, Canada, and the United States (p. 481)

**Tratado de Libre Comercio Norteamericano**: acuerdo comercial diseñado para disminuir y eliminar gradualmente las barreras arancelarias entre México, Canadá y Estados Unidos (p. 481)

**notion**: idea (p. 508)

**noción**: idea (p. 508)

**obtain**: get (p. 128)

**obtener**: conseguir (p. 128)

**obvious**: clear; apparent (p. 292)

**obvio**: claro, evidente (p. 292)

**offset**: counteract; make up for (p. 449)

**contrarrestar**: resistir; compensar (p. 449)

**oligopoly**: industry dominated by a few suppliers who exercise some control over price (p. 240)

**oligopolio**: industria dominada por pocos proveedores que ejercen algún control sobre los precios (p. 240)

**open-market operations**: buying and selling of United States securities by the Fed to affect the money supply (p. 406)

**operaciones del mercado abierto**: compra y venta de valores de los Estados Unidos por el Sistema de Reserva Federal para afectar la oferta monetaria (p. 406)

**opportunity cost**: value of the next best alternative given up for the alternative that was chosen (p. 16)

**costo de oportunidad**: valor de la mejor opción a la que se renuncia al escoger otra opción (p. 16)

**output**: production; yield (p. 348)

**rendimiento**: producción; provecho (p. 348)

**overall**: total (p. 159)

**total**: general; en su totalidad (p. 159)

**overdraft checking**: checking account that allows a customer to write a check for more money than exists in his or her account (p. 376)

**cuenta corriente con descubierto**: cuenta corriente que le permite al cliente escribir cheques por más dinero del que tiene en la cuenta; también se llama cuenta corriente con sobregiro (p. 376)

**overseas**: abroad; out of the country (p. 466)

**extranjero**: fuera del país (p. 466)

**over-the-counter market**: electronic purchase and sale of stocks and bonds, often of smaller companies, which often takes place outside the organized stock exchanges (p. 151)

**mercado extrabursátil**: compra y venta electrónica de acciones y bonos, a menudo de compañías pequeñas, que a menudo se realiza fuera de las bolsas de valores organizadas (p. 151)
partnership: business that two or more individuals own and operate (p. 215)

patent: exclusive right to make, use, or sell an invention for a specified number of years (p. 238)

peak: period of prosperity in a business cycle in which economic activity is at its highest point (p. 352)

penetration pricing: selling a new product at a low price to attract customers away from an established product (p. 291)

pension plans: company plans that provide retirement income for their workers (p. 156)

perceived: apparent or obvious (p. 69)

perfect competition: market situation in which there are numerous buyers and sellers, and no single buyer or seller can affect price (p. 232)

period: a portion of time (p. 88)

personal income (PI): total income that individuals receive before personal taxes are paid (p. 339)

physical: material (p. 342)

picketing: action of strikers who walk in front of a workplace carrying signs that state their disagreement with the company (p. 322)

points: fees paid to a lender and computed as a percentage of a loan (p. 129)

portion: a part (pp. 156, 401)

potential: possible (p. 115)

precede: come before (p. 352)

precise: accurate (p. 403)

preferred stock: shares of ownership in a corporation that give stockholders a portion of future profits (before any profits go to holders of common stock), but no voting rights (p. 221)

previous: occurring before; prior (p. 95)
**price ceiling** • **productivity**

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<tr>
<th><strong>ENGLISH</strong></th>
<th><strong>ESPAÑOL</strong></th>
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<tr>
<td><strong>price ceiling</strong>: a legal maximum price that may be charged for a particular good or service (p. 198)</td>
<td><strong>precio máximo</strong>: precio más alto que la ley permite que se cobre por un producto o servicio en particular (p. 198)</td>
</tr>
<tr>
<td><strong>price elasticity of demand</strong>: economic concept that deals with how much demand varies according to changes in price (p. 182)</td>
<td><strong>efecto del precio en la elasticidad de la demanda</strong>: concepto económico que trata de cómo la demanda varía de acuerdo con los cambios en el precio (p. 182)</td>
</tr>
<tr>
<td><strong>price floor</strong>: a legal minimum price below which a good or service may not be sold (p. 199)</td>
<td><strong>precio mínimo</strong>: precio más bajo que la ley permite que se cobre por un producto o servicio (p. 199)</td>
</tr>
<tr>
<td><strong>price leadership</strong>: a practice in some industries in which the largest firm publishes its price list ahead of its competitors, who then match those announced prices (p. 291)</td>
<td><strong>liderazgo en la fijación de precios</strong>: práctica en algunas industrias en que la compañía más grande publica sus precios antes de sus competidores que entonces tratan de igualarlos (p. 291)</td>
</tr>
<tr>
<td><strong>prime rate</strong>: rate of interest that banks charge on loans to their best business customers (p. 404)</td>
<td><strong>tasa preferencial</strong>: tipo de interés que los bancos cobran por préstamos a sus mejores clientes comerciales (p. 404)</td>
</tr>
<tr>
<td><strong>principal</strong>: amount originally borrowed in a loan (p. 88)</td>
<td><strong>principal</strong>: cantidad original de un préstamo; también se llama capital (p. 88)</td>
</tr>
<tr>
<td>*<strong>principle</strong>: a rule of conduct (p. 70)</td>
<td>*<strong>principio</strong>: regla de comportamiento (p. 70)</td>
</tr>
<tr>
<td><strong>private-labeled products</strong>: lower-priced store-brand products carried by some supermarket chains and club warehouse chains (p. 116)</td>
<td><strong>productos de marca privada</strong>: productos a precios más bajos que llevan la marca de la tienda en que se venden y son vendidos por cadenas de supermercados y de clubes almacenes (p. 116)</td>
</tr>
<tr>
<td><strong>private property</strong>: whatever is owned by individuals rather than by government (p. 46)</td>
<td><strong>propiedad privada</strong>: todo lo que pertenece a particulares y no al gobierno (p. 46)</td>
</tr>
<tr>
<td>*<strong>process</strong>: method; procedure (p. 271)</td>
<td>*<strong>proceso</strong>: método; procedimiento (p. 271)</td>
</tr>
<tr>
<td><strong>producer price index (PPI)</strong>: measure of the change in price over time that U.S. producers charge for their goods and services (p. 344)</td>
<td><strong>índice de precios de productores</strong>: medida, a través del tiempo, de los cambios en los precios que los productores estadounidenses cobran por sus bienes y servicios (p. 344)</td>
</tr>
<tr>
<td><strong>product differentiation</strong>: manufacturers’ use of minor differences in quality and features to try to differentiate between similar goods and services (p. 241)</td>
<td><strong>diferenciación de productos</strong>: uso de pequeñas diferencias en calidad y características por parte de los fabricantes para tratar de diferenciar bienes y servicios parecidos (p. 241)</td>
</tr>
<tr>
<td><strong>production</strong>: process of changing resources into goods that satisfy the needs and wants of individuals and businesses (p. 272)</td>
<td><strong>producción</strong>: proceso de convertir recursos en bienes que satisfacen las necesidades y deseos de individuos y negocios (p. 272)</td>
</tr>
<tr>
<td><strong>production possibilities curve</strong>: graph showing the maximum combinations of goods and services that can be produced from a fixed amount of resources in a given period of time (p. 17)</td>
<td><strong>curva de posibilidades de producción</strong>: gráfica que muestra la mayor combinación de bienes y servicios que se pueden producir con una cantidad fija de recursos en un periodo de tiempo determinado (p. 17)</td>
</tr>
<tr>
<td><strong>productivity</strong>: the amount of output (goods and services) that results from a given level of inputs (land, labor, capital, and entrepreneurship) (p. 9)</td>
<td><strong>productividad</strong>: producción final (cantidad de bienes y servicios) que rinde una cantidad determinada de insumos (tierra, trabajo, capital y empresa) (p. 9)</td>
</tr>
<tr>
<td>ENGLISH</td>
<td>ESPAÑOL</td>
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</tr>
<tr>
<td><strong>product life cycle</strong>: series of stages that a product goes through from first introduction to complete withdrawal from the market (p. 294)</td>
<td><strong>ciclo de vida de un producto</strong>: etapas por las que pasa un producto desde que se introduce hasta que se retira del mercado (p. 294)</td>
</tr>
<tr>
<td><strong>professionals</strong>: highly educated individuals with college degrees and usually additional education or training (p. 310)</td>
<td><strong>profesionales</strong>: personas muy preparadas, que han cursado por lo menos cuatro años al nivel universitario y generalmente tienen educación o preparación adicional (p. 310)</td>
</tr>
<tr>
<td><strong>profit</strong>: amount earned after a business subtracts its costs from its revenues (pp. 45, 261)</td>
<td><strong>ganancias</strong>: dinero que le queda a un negocio después de restar los costos de las entradas; también se llama lucro, beneficios y utilidad (pp. 45, 261)</td>
</tr>
<tr>
<td><strong>profit incentive</strong>: desire to make money that motivates people to produce and sell goods and services (p. 45)</td>
<td><strong>afán de lucro</strong>: deseo de ganar dinero que alienta a las personas a producir y vender bienes y servicios (p. 45)</td>
</tr>
<tr>
<td><strong>progressive tax</strong>: tax that takes a larger percentage of higher incomes than of lower incomes; justified on the basis of the ability-to-pay principle (p. 433)</td>
<td><strong>impuesto progresivo</strong>: impuesto que grava un porcentaje mayor a los que tienen más ingresos y menor a los que tienen menos; se justifica con el principio de la capacidad de pago (p. 433)</td>
</tr>
<tr>
<td><em>prohibit</em>: forbid; disallow (p. 246)</td>
<td><em>prohibir</em>: vedar; desautorizar (p. 246)</td>
</tr>
<tr>
<td><strong>proletariat</strong>: term Karl Marx used to refer to workers (p. 52)</td>
<td><strong>proletariado</strong>: término que Carlos Marx usó para referirse a los obreros (p. 52)</td>
</tr>
<tr>
<td><em>promote</em>: endorse; help (p. 248)</td>
<td><em>promover</em>: apoyar; impulsar; ayudar (p. 248)</td>
</tr>
<tr>
<td><strong>promotion</strong>: use of advertising to inform consumers that a new or improved product or service is available and to persuade them to purchase it (p. 293)</td>
<td><strong>promoción</strong>: uso de la publicidad para informar a los consumidores que un producto o servicio nuevo o mejorado está en venta y para convencerlos a que lo compren (p. 293)</td>
</tr>
<tr>
<td><strong>proportional tax</strong>: tax that takes the same percentage of all incomes; as income rises, the amount of tax paid also rises (p. 433)</td>
<td><strong>impuesto proporcional</strong>: impuesto que grava el mismo porcentaje a todos los ingresos; al subir los ingresos, la cantidad de impuestos que hay que pagar también sube (p. 433)</td>
</tr>
<tr>
<td><strong>proprietor</strong>: owner of a business (p. 214)</td>
<td><strong>propietario</strong>: dueño de un negocio (p. 214)</td>
</tr>
<tr>
<td><strong>protectionists</strong>: people who argue for trade restrictions to protect domestic industries (p. 479)</td>
<td><strong>proteccionistas</strong>: personas que abogan en favor de restricciones comerciales para proteger las industrias domésticas (p. 479)</td>
</tr>
<tr>
<td><strong>protective tariff</strong>: tax on imports used to raise the cost of imported goods and thereby protect domestic producers (p. 478)</td>
<td><strong>aranceles proteccionistas</strong>: impuestos sobre las importaciones usados para subir el precio de bienes importados y proteger a los productores domésticos (p. 478)</td>
</tr>
<tr>
<td><strong>public-assistance programs</strong>: government programs that make payments to citizens based on need (p. 421)</td>
<td><strong>programas de asistencia pública</strong>: programas gubernamentales que hacen pagos a personas necesitadas (p. 421)</td>
</tr>
<tr>
<td><strong>public goods</strong>: goods or services that can be used by many individuals at the same time without reducing the benefit each person receives (p. 419)</td>
<td><strong>bienes públicos</strong>: bienes y servicios que pueden ser usados por muchas personas a la misma vez sin reducir el beneficio que obtiene cada una (p. 419)</td>
</tr>
<tr>
<td>English</td>
<td>Spanish</td>
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<tr>
<td><strong>public-works projects</strong>: publicly used facilities, such as schools and highways, built by federal, state, or local governments with public money (p. 415)</td>
<td><strong>proyectos de obras públicas</strong>: edificaciones e instalaciones para el uso público, como escuelas y carreteras, construidas por el gobierno federal, estatal o local con dinero público (p. 415)</td>
</tr>
<tr>
<td><strong>purchasing power</strong>: the real goods and services that money can buy; determines the value of money (p. 342)</td>
<td><strong>poder adquisitivo</strong>: cantidad real de bienes y servicios que se pueden comprar con el dinero; determina el valor del dinero (p. 342)</td>
</tr>
<tr>
<td><strong>quantity demanded</strong>: the amount of a good or service that a consumer is willing and able to purchase at a specific price (p. 172)</td>
<td><strong>cantidad demandada</strong>: cantidad de un producto o servicio que los consumidores están dispuestos y pueden comprar a un precio dado (p. 172)</td>
</tr>
<tr>
<td><strong>quantity supplied</strong>: the amount of a good or service that a producer is willing and able to supply at a specific price (p. 187)</td>
<td><strong>cantidad ofrecida</strong>: cantidad de un producto o servicio que un productor está dispuesto y puede ofrecer a un precio dado (p. 187)</td>
</tr>
<tr>
<td><strong>rational choice</strong>: choosing the alternative that has the greatest value from among comparable-quality products (p. 69)</td>
<td><strong>selección racional</strong>: escoger la alternativa de mayor valor entre productos de la misma calidad (p. 69)</td>
</tr>
<tr>
<td><strong>rationing</strong>: the distribution of goods and services based on something other than price (p. 199)</td>
<td><strong>raciocinamiento</strong>: basar la distribución de bienes y servicios en razones que no incluyen el precio (p. 199)</td>
</tr>
<tr>
<td><strong>real GDP</strong>: GDP that has been adjusted for inflation by applying the price deflator (p. 344)</td>
<td><strong>PIB real</strong>: PIB al que se le ha aplicado el deflactor de precios para corregir los efectos de la inflación (p. 344)</td>
</tr>
<tr>
<td><strong>real income effect</strong>: economic rule stating that individuals cannot keep buying the same quantity of a product if its price rises while their income stays the same (p. 173)</td>
<td><strong>efecto de ingresos reales</strong>: regla económica que dice que los consumidores no pueden continuar comprando la misma cantidad de un producto si el precio de éste sube mientras que sus ingresos se mantienen iguales (p. 173)</td>
</tr>
<tr>
<td><strong>receipts</strong>: income received from the sale of goods and/or services; also, slips of paper documenting a purchase (p. 211)</td>
<td><strong>entradas</strong>: ingresos recibidos de la venta de bienes o servicios; recibos escritos que comprueban que se han hecho ciertas compras (p. 211)</td>
</tr>
<tr>
<td><strong>recession</strong>: part of the business cycle in which the nation’s output (real GDP) declines for at least six months (p. 352)</td>
<td><strong>recesión</strong>: parte del ciclo económico en que el rendimiento nacional (PIB real) baja por seis meses al menos (p. 352)</td>
</tr>
<tr>
<td>*recover: to regain strength, get better (p. 521)</td>
<td>*recuperar: recobrar fuerzas; mejorarse (p. 521)</td>
</tr>
<tr>
<td><strong>recovery</strong>: same as expansion (p. 352)</td>
<td><strong>recuperación</strong>: lo mismo que expansion/expansión (p. 352)</td>
</tr>
<tr>
<td>*regime: political system (p. 502)</td>
<td>*régimen: sistema político (p. 502)</td>
</tr>
<tr>
<td>*region: any division or part of a geographical area (p. 66)</td>
<td>*región: cualquier división o parte de un área geográfica (p. 66)</td>
</tr>
</tbody>
</table>
regional • right-to-work laws

*regional: local (p. 116)

registration fee: licensing fee, usually annual, paid to a state for the right to use a car (p. 131)

regressive tax: tax that takes a larger percentage of lower incomes than of higher incomes (p. 433)

*regulate: to control according to a rule or principle (p. 43)

*relevant: important (p. 208)

*remove: take away (p. 449)

representative money: money that is backed by an item of value, such as gold or silver (p. 371)

*require: need (p. 142)

reserve requirements: regulations set by the Fed requiring banks to keep a certain percentage of their checkable deposits as cash in their own vaults or as deposits in their Federal Reserve district bank (p. 400)

*resolve: decide; solve (p. 321)

*resource: supply (p. 307)

*restrict: limit (p. 477)

retailers: businesses that sell consumer goods directly to the public (p. 298)

*reveal: make known (p. 17)

revenues: total income from sales of output (p. 261)

revenue tariff: tax on imports used primarily to raise government revenue without restricting imports (p. 478)

*reverse: opposite (p. 349)

*revolution: uprising (p. 239)

right-to-work laws: state laws forbidding unions from forcing workers to join and pay union dues (p. 318)

*contrario: opuesto (p. 349)

*derechos aduaneros: impuesto sobre las importaciones usado principalmente para recaudar ingresos gubernamentales sin restringir las importaciones; también se llaman impuestos aduaneros o derechos arancelarios (p. 478)

*reglamentar: controlar de acuerdo con una regla o principio (p. 43)

*relevante: pertinente; importante (p. 208)

*quitar: sacar; eliminar (p. 449)

*dinero crediticio: dinero que está respaldado por algo de valor, como el oro o la plata (p. 371)

*requiere: necesita (p. 142)

*resolver: decidir; arreglar (p. 321)

*recurso: suministro disponible de algo (p. 307)

*restringir: limitar (p. 477)

*tiendas al por menor: negocios que venden bienes directamente al consumidor (p. 298)

*derechos a pagar: hacer que se sepa algo (p. 17)

*ingresos: total de las ganancias provenientes de la venta de la producción de una compañía (p. 261)

*leyes de derecho al trabajo: leyes estatales que prohíben que los sindicatos fueren a los trabajadores a afiliarse y a pagar cuotas sindicales (p. 318)
### English

<table>
<thead>
<tr>
<th>Robotics/Robótica</th>
<th><strong>Robotic</strong>s: sophisticated computer-controlled machinery that operates an assembly line (p. 275)</th>
<th>Robótica: maquinaria compleja, controlada por computadoras, que opera una línea de montaje (p. 275)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roth IRA/Roth IRA: private retirement plan that taxes income before it is saved, but which does not tax interest on that income when funds are used upon retirement (p. 157)</td>
<td>Cuenta de retiro individual Roth: plan de jubilación privado en que se gravan los ingresos antes de ser ahorrados, pero no se gravan los intereses por los ahorros cuando se usan esos fondos después de jubilarse (p. 157)</td>
<td></td>
</tr>
<tr>
<td>Saving/Saving: setting aside income for a period of time so that it can be used later (p. 142)</td>
<td>Ahorrar: guardar ingresos por un período de tiempo para poder usarlos más adelante (p. 142)</td>
<td></td>
</tr>
<tr>
<td>Savings account/Savings account: account that pays interest, has no maturity date, and from which funds can be withdrawn at any time without penalty (p. 143)</td>
<td>Cuenta de ahorro: cuenta que paga interés, no tiene fecha de vencimiento y de la cual se pueden sacar fondos en cualquier momento sin tarifas (p. 143)</td>
<td></td>
</tr>
<tr>
<td>Savings and Loan association (S&amp;L)/Savings and loan association (S&amp;L): depository institution that accepts deposits and lends funds (p. 93)</td>
<td>Sociedad de ahorro y préstamos: institución que acepta depósitos y presta fondos (p. 93)</td>
<td></td>
</tr>
<tr>
<td>Savings bank/Savings bank: depository institution originally set up to serve small savers overlooked by commercial banks (p. 93)</td>
<td>Banco de ahorro: tipo de institución depositaria establecida originalmente para servir a personas que ahorraban pequeñas cantidades y eran ignorados por los bancos comerciales (p. 93)</td>
<td></td>
</tr>
<tr>
<td>Savings bonds/Savings bonds: bonds issued by the federal government as a way of borrowing money; they are purchased at half the face value and increase every 6 months until full face value is reached (p. 149)</td>
<td>Bonos de ahorro: bonos emitidos por el gobierno federal para obtener dinero prestado; se compran a la mitad de su valor nominal, y cada 6 meses aumentan en valor hasta llegar al valor nominal completo (p. 149)</td>
<td></td>
</tr>
<tr>
<td>Scarcity/Scarcity: basic economic problem that results from a combination of limited resources and unlimited wants (p. 7)</td>
<td>Escasez: problema que resulta de la combinación de recursos limitados y deseos sin límite (p. 7)</td>
<td></td>
</tr>
<tr>
<td>*Scheme/Scheme: a secret plan (p. 153)</td>
<td>*Confabulación: un plan secreto (p. 153)</td>
<td></td>
</tr>
<tr>
<td>Secured loan/Secured loan: loan that is backed up by collateral (p. 101)</td>
<td>Préstamo garantizado: préstamo que está asegurado por propiedad (p. 101)</td>
<td></td>
</tr>
<tr>
<td>Security deposit/Security deposit: funds a renter lets an owner hold in case the rent is not paid or the apartment is damaged (p. 126)</td>
<td>Depósito de garantía: fondos que un inquilino pone en manos del dueño en caso de que no pague el alquiler o deje el apartamento dañado (p. 126)</td>
<td></td>
</tr>
<tr>
<td>Semiskilled workers/Semiskilled workers: people whose jobs require some training, often using modern technology (p. 310)</td>
<td>Obreros semicalificados: personas cuyos trabajos requieren un poco de preparación, a menudo en el uso de la tecnología moderna; también se llaman obreros semiespecializados (p. 310)</td>
<td></td>
</tr>
<tr>
<td>*Series/Series: a number of things coming one after another (p. 105)</td>
<td>*Serie: un número de cosas que suceden una después de la otra (p. 105)</td>
<td></td>
</tr>
<tr>
<td>Service flow/Service flow: amount of use a person gets from an item over time and the value a person places on this use (p. 121)</td>
<td>Servicio útil: cantidad de uso que una persona le saca a un artículo a través del tiempo y el valor que le da a su uso (p. 121)</td>
<td></td>
</tr>
<tr>
<td><strong>services</strong></td>
<td><strong>servicios</strong></td>
<td></td>
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<tr>
<td>actions that can satisfy people’s wants or needs (p. 8)</td>
<td>actividades económicas que pueden satisfacer los deseos o necesidades del público (p. 8)</td>
<td></td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th><strong>service workers</strong></th>
<th><strong>trabajadores en el área de servicio</strong></th>
</tr>
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<tbody>
<tr>
<td>people who provide services directly to individuals (p. 309)</td>
<td>personas que proporcionan servicios directamente al público (p. 309)</td>
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<thead>
<tr>
<th><strong>shortage</strong></th>
<th><strong>escasez</strong></th>
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<tbody>
<tr>
<td>situation in which the quantity demanded is greater than the quantity supplied at the current price (p. 197)</td>
<td>situación en que la cantidad demandada al precio actual es mayor que la cantidad ofrecida; falta de un producto (p. 197)</td>
</tr>
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<table>
<thead>
<tr>
<th><strong>short-term financing</strong></th>
<th><strong>financiamiento a corto plazo</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>funds borrowed by a business for any period of time less than a year (p. 265)</td>
<td>préstamo de fondos que un negocio tiene que pagar en menos de un año (p. 265)</td>
</tr>
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<thead>
<tr>
<th><strong>significant</strong></th>
<th><strong>significativo</strong></th>
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<tbody>
<tr>
<td>noteworthy (p. 317)</td>
<td>notable (p. 317)</td>
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<thead>
<tr>
<th><strong>socialism</strong></th>
<th><strong>socialismo</strong></th>
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<tbody>
<tr>
<td>a system in which the government owns the major factors of production and attempts to manage output and the distribution of goods (p. 52)</td>
<td>sistema en que el gobierno es dueño de todos los factores de producción importantes y trata de dirigir la producción y distribución de bienes (p. 52)</td>
</tr>
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<table>
<thead>
<tr>
<th><strong>sole proprietorship</strong></th>
<th><strong>propiedad individual</strong></th>
</tr>
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<tbody>
<tr>
<td>business owned and operated by one person (p. 214)</td>
<td>negocio operado por un solo dueño, el propietario único (p. 214)</td>
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</tbody>
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<table>
<thead>
<tr>
<th><strong>source</strong></th>
<th><strong>fuente</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>place from which something comes (p. 466)</td>
<td>sitio de donde proviene algo (p. 466)</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th><strong>specialization</strong></th>
<th><strong>especialización</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>concept that a nation should produce and export a limited assortment of goods for which it is particularly suited in order to use its resources most efficiently (p. 468)</td>
<td>concepto de que una nación debe limitarse a producir y exportar una selección de aquellos bienes que son más apropiados para ser producidos en ella, para usar sus recursos lo más eficientemente posible (p. 468)</td>
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<tr>
<th><strong>specific</strong></th>
<th><strong>específico</strong></th>
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<tr>
<td>particular (p. 180)</td>
<td>particular (p. 180)</td>
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<thead>
<tr>
<th><strong>stabilization policies</strong></th>
<th><strong>políticas de estabilización</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>attempts by the federal government to keep the economy healthy; includes monetary and fiscal policies (p. 442)</td>
<td>intentos por parte del gobierno federal de mantener sana la economía; incluyen las políticas monetaria y fiscal (p. 442)</td>
</tr>
<tr>
<td>English</td>
<td>Spanish</td>
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<td>-------------------------</td>
<td>--------------------------</td>
</tr>
<tr>
<td><strong>stagflation</strong></td>
<td><strong>estagflación</strong></td>
</tr>
<tr>
<td>combination of inflation and stagnation (low economic activity)</td>
<td>combinación de inflación con estancamiento (poca actividad económica); también se llama estanflación (p. 445)</td>
</tr>
<tr>
<td><strong>standard of living</strong></td>
<td><strong>nivel de vida</strong></td>
</tr>
<tr>
<td>the material well-being of an individual, group, or nation, measured by how well their necessities and luxuries are satisfied</td>
<td>bienestar material de un individuo, grupo o nación, en forma de cálculo de lo bien que puede satisfacer sus necesidades y obtener lujos (p. 49)</td>
</tr>
<tr>
<td><strong>startup</strong></td>
<td><strong>negocio nuevo</strong></td>
</tr>
<tr>
<td>a beginning business enterprise</td>
<td>empresa nueva (p. 209)</td>
</tr>
<tr>
<td><strong>statistic</strong></td>
<td><strong>estadística</strong></td>
</tr>
<tr>
<td>numerical data collected to show information</td>
<td>datos numéricos recolectados para mostrar información (p. 336)</td>
</tr>
<tr>
<td><strong>status</strong></td>
<td><strong>condición jurídica</strong></td>
</tr>
<tr>
<td>legal condition</td>
<td>situación legal (p. 133)</td>
</tr>
<tr>
<td><strong>stock</strong></td>
<td><strong>acciones</strong></td>
</tr>
<tr>
<td>share of ownership in a corporation that entitles the buyer to a certain part of the future profits and assets of the corporation</td>
<td>participaciones en una sociedad anónima que hacen al comprador uno de sus propietarios con derecho a recibir parte de las ganancias y activos de la sociedad (p. 219)</td>
</tr>
<tr>
<td><strong>stockholders</strong></td>
<td><strong>accionistas</strong></td>
</tr>
<tr>
<td>people who have invested in a corporation and own some of its shares of stock</td>
<td>personas que han invertido en una sociedad anónima y son dueños de un número de acciones (p. 147)</td>
</tr>
<tr>
<td><strong>stock market indexes</strong></td>
<td><strong>índices del mercado de acciones</strong></td>
</tr>
<tr>
<td>measures of what is happening to a given set of stock prices for a specified list of companies; the most well known is the Dow Jones Industrial Average</td>
<td>medidas de lo que está sucediendo a los precios de un grupo determinado de acciones de una lista de compañías en particular; el mejor conocido es el Dow Jones Industrial Average (p. 151)</td>
</tr>
<tr>
<td><strong>store of value</strong></td>
<td><strong>reserva de valor</strong></td>
</tr>
<tr>
<td>use of money to store purchasing power for later use</td>
<td>uso del dinero como almacén del poder adquisitivo que una persona recibe como pago, a cambio de su trabajo o de un artículo vendido, y que puede usar en el futuro (p. 369)</td>
</tr>
<tr>
<td><strong>strategy</strong></td>
<td><strong>estrategia</strong></td>
</tr>
<tr>
<td>plan (p. 289)</td>
<td>plan (p. 289)</td>
</tr>
<tr>
<td><strong>strike</strong></td>
<td><strong>huelga</strong></td>
</tr>
<tr>
<td>deliberate work stoppage by workers to force an employer to give in to their demands</td>
<td>paro de trabajo intencional por parte de los trabajadores para forzar a los patronos a que ceden a sus demandas (p. 317)</td>
</tr>
<tr>
<td><strong>submit</strong></td>
<td><strong>someter</strong></td>
</tr>
<tr>
<td>present (p. 427)</td>
<td>presentar (p. 427)</td>
</tr>
<tr>
<td><strong>subsequent</strong></td>
<td><strong>subsiguiente</strong></td>
</tr>
<tr>
<td>coming after; following</td>
<td>posterior; que sigue</td>
</tr>
<tr>
<td>(p. 503)</td>
<td>(p. 503)</td>
</tr>
<tr>
<td><strong>subsistence agriculture</strong></td>
<td><strong>agricultura de subsistencia</strong></td>
</tr>
<tr>
<td>growing of just enough food by a family to take care of its own needs; no crops are available for export or to feed an industrial workforce</td>
<td>cultivar alimentos suficientes para satisfacer las necesidades de una familia solamente; la cosecha no alcanza para exportar o alimentar a la fuerza laboral industrial (p. 492)</td>
</tr>
<tr>
<td><strong>substitute</strong></td>
<td><strong>sustituto</strong></td>
</tr>
<tr>
<td>replacement</td>
<td>reemplazo; suplente</td>
</tr>
<tr>
<td>(p. 502)</td>
<td>(p. 502)</td>
</tr>
<tr>
<td><strong>substitution effect</strong></td>
<td><strong>efecto de sustitución</strong></td>
</tr>
<tr>
<td>economic rule stating that if two items satisfy the same need and the price of one rises, people will buy more of the other</td>
<td>regla económica que dice que si dos artículos satisfacen la misma necesidad y el precio de uno sube, el público comprará más del otro (p. 173)</td>
</tr>
<tr>
<td><strong>sufficient</strong></td>
<td><strong>suficiente</strong></td>
</tr>
<tr>
<td>enough</td>
<td>bastante</td>
</tr>
<tr>
<td>(p. 259)</td>
<td>(p. 259)</td>
</tr>
</tbody>
</table>
### Supplemental Security Income • Temporary Assistance for Needy Families

<table>
<thead>
<tr>
<th><strong>ENGLISH</strong></th>
<th><strong>ESPÀÑOL</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Supplemental Security Income</strong>: federal programs that</td>
<td>**Ingresos Suplementarios de</td>
</tr>
<tr>
<td>include food stamps and payments to the disabled and</td>
<td>Seguridad**: programa federal que</td>
</tr>
<tr>
<td>aged (p. 421)</td>
<td>provee beneficios que incluyen</td>
</tr>
<tr>
<td></td>
<td>cupones de alimentos y apoyo</td>
</tr>
<tr>
<td></td>
<td>financiero a personas ancianas y</td>
</tr>
<tr>
<td></td>
<td>personas incapacitadas (p. 421)</td>
</tr>
<tr>
<td><strong>supply</strong>: the amount of a good or service that producers</td>
<td><strong>oferta</strong>: cantidad de un producto</td>
</tr>
<tr>
<td>are able and willing to sell at various prices during a</td>
<td>o servicio que los productores</td>
</tr>
<tr>
<td>specified time period (p. 170)</td>
<td>pueden y están dispuestos a vender</td>
</tr>
<tr>
<td></td>
<td>a varios precios durante un</td>
</tr>
<tr>
<td></td>
<td>periodo de tiempo determinado</td>
</tr>
<tr>
<td><strong>supply curve</strong>: upward-sloping line that shows in graph</td>
<td><strong>curva de oferta</strong>: línea</td>
</tr>
<tr>
<td>form the quantities supplied at each possible price</td>
<td>ascendiente en una gráfica cuya</td>
</tr>
<tr>
<td>(p. 189)</td>
<td>inclinación muestra la cantidad</td>
</tr>
<tr>
<td></td>
<td>ofrecida a cada precio posible</td>
</tr>
<tr>
<td><strong>supply schedule</strong>: table showing quantities supplied at</td>
<td><strong>lista de oferta</strong>: tabla que</td>
</tr>
<tr>
<td>different possible prices (p. 188)</td>
<td>muestra las cantidades que se</td>
</tr>
<tr>
<td></td>
<td>ofrecen a distintos precios</td>
</tr>
<tr>
<td><strong>surplus</strong>: situation in which quantity supplied is</td>
<td><strong>superávit</strong>: situación en que</td>
</tr>
<tr>
<td>greater than quantity demanded at the current price (p. 197)</td>
<td>la cantidad ofrecida es mayor que</td>
</tr>
<tr>
<td></td>
<td>la cantidad demandada al precio</td>
</tr>
<tr>
<td></td>
<td>actual (p. 197)</td>
</tr>
<tr>
<td><strong>survey</strong>: a detailed study, as by gathering and analyzing</td>
<td><strong>encuesta</strong>: estudio detallado,</td>
</tr>
<tr>
<td>information (p. 443)</td>
<td>por medio de recoger y analizar</td>
</tr>
<tr>
<td></td>
<td>información (p. 443)</td>
</tr>
<tr>
<td><strong>target</strong>: a goal (p. 455)</td>
<td><strong>blanco</strong>: meta; objetivo (p. 455)</td>
</tr>
<tr>
<td><strong>tariff</strong>: tax placed on an imported product (p. 478)</td>
<td><strong>arancel</strong>: impuesto que grava un</td>
</tr>
<tr>
<td></td>
<td>producto importado (p. 478)</td>
</tr>
<tr>
<td><strong>tax-exempt bonds</strong>: bonds sold by local and state</td>
<td><strong>bonos exentos de impuestos</strong>:</td>
</tr>
<tr>
<td>governments; interest paid on the bond is not taxed by the</td>
<td>bonos emitidos por los gobiernos</td>
</tr>
<tr>
<td>federal government (p. 148)</td>
<td>locales y estatales; los intereses</td>
</tr>
<tr>
<td></td>
<td>que pagan no son gravados por el</td>
</tr>
<tr>
<td></td>
<td>gobierno federal (p. 148)</td>
</tr>
<tr>
<td><strong>technical</strong>: of a specific science, art, or craft (p. 492)</td>
<td><strong>técnico</strong>: que tiene que ver con</td>
</tr>
<tr>
<td></td>
<td>una ciencia, arte, o artesanía en</td>
</tr>
<tr>
<td></td>
<td>particular (p. 492)</td>
</tr>
<tr>
<td><strong>technical assistance</strong>: aid in the form of engineers,</td>
<td><strong>asistencia técnica</strong>: ayuda</td>
</tr>
<tr>
<td>teachers, and technicians to teach skills to individuals in</td>
<td>proporcionada por ingenieros,</td>
</tr>
<tr>
<td>other nations (p. 497)</td>
<td>maestros y técnicos para enseñar</td>
</tr>
<tr>
<td></td>
<td>técnicas a personas de otros</td>
</tr>
<tr>
<td></td>
<td>países (p. 497)</td>
</tr>
<tr>
<td><strong>technology</strong>: the use of science to develop new products</td>
<td><strong>tecnología</strong>: el uso de la</td>
</tr>
<tr>
<td>and new methods for producing and distributing goods and</td>
<td>ciencia para desarrollar nuevos</td>
</tr>
<tr>
<td>services (pp. 10, 191)</td>
<td>productos y nuevos métodos de</td>
</tr>
<tr>
<td></td>
<td>producción y distribución de</td>
</tr>
<tr>
<td></td>
<td>bienes y servicios (pp. 10, 191)</td>
</tr>
<tr>
<td><strong>telecommunications</strong>: long-distance communication,</td>
<td><strong>telecomunicaciones</strong>:</td>
</tr>
<tr>
<td>usually electronic, using communications satellites and</td>
<td>generalmente electrónicas, que</td>
</tr>
<tr>
<td>fiber-optic cables (p. 518)</td>
<td>usan satélites de comunicación y</td>
</tr>
<tr>
<td></td>
<td>cables de fibra óptica (p. 518)</td>
</tr>
<tr>
<td><strong>temporary</strong>: impermanent; not lasting (p. 216)</td>
<td><strong>temporario</strong>: temporal; pasajero;</td>
</tr>
<tr>
<td></td>
<td>no duradero (p. 216)</td>
</tr>
<tr>
<td><strong>Temporary Assistance for Needy Families</strong>: state-run</td>
<td>**Asistencia Temporal para Familias</td>
</tr>
<tr>
<td>program that provides assistance and work opportu-</td>
<td>Necesitadas**: programa administrado</td>
</tr>
<tr>
<td>nities to needy families (p. 421)</td>
<td>por los estados que ofrece servicios</td>
</tr>
<tr>
<td></td>
<td>de apoyo y oportunidades de empleo</td>
</tr>
<tr>
<td></td>
<td>a familias necesitadas (p. 421)</td>
</tr>
<tr>
<td>English</td>
<td>Spanish</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td><strong>test-marketing</strong></td>
<td><strong>hacer una prueba de mercado</strong></td>
</tr>
<tr>
<td>offering a product for sale in a small area for a limited period of time to see how well it sells before offering it nationally (p. 287)</td>
<td>poner un producto en venta en un área pequeña por un periodo de tiempo limitado para ver lo bien que se vende antes de ofrecerlo en todo el país (p. 287)</td>
</tr>
<tr>
<td><em>theory</em></td>
<td><em>teoría</em></td>
</tr>
<tr>
<td>a model that explains observations (p. 22)</td>
<td>un modelo que explica observaciones (p. 22)</td>
</tr>
<tr>
<td><strong>thrift institutions</strong></td>
<td><strong>instituciones de ahorro</strong></td>
</tr>
<tr>
<td>mutual savings banks, S&amp;Ls, and credit unions that offer many of the same services as commercial banks (p. 380)</td>
<td>bancos de ahorro mutuos, sociedades de ahorro y préstamos y cooperativas de crédito que ofrecen los mismos servicios que los bancos comerciales (p. 380)</td>
</tr>
<tr>
<td><strong>tight money policy</strong></td>
<td><strong>política monetaria restrictiva</strong></td>
</tr>
<tr>
<td>monetary policy that makes credit expensive and in short supply in an effort to slow the economy (p. 399)</td>
<td>política monetaria que hace que el crédito sea caro y difícil de obtener para tratar de reducir la actividad económica (p. 399)</td>
</tr>
<tr>
<td><strong>time deposits</strong></td>
<td><strong>depositos a plazos</strong></td>
</tr>
<tr>
<td>savings plans that require savers to leave their funds on deposit for certain periods of time (p. 144)</td>
<td>planes de ahorro que obligan al ahorrador a dejar sus fondos en depósito por períodos de tiempo determinados (p. 144)</td>
</tr>
<tr>
<td><strong>time lags</strong></td>
<td><strong>demoras</strong></td>
</tr>
<tr>
<td>periods between the time fiscal policy is enacted and the time it becomes effective (p. 457)</td>
<td>período entre el momento en que se aprueba una política fiscal y el momento en que entra en vigor (p. 457)</td>
</tr>
<tr>
<td><strong>trade-off</strong></td>
<td><strong>compensación</strong></td>
</tr>
<tr>
<td>sacrificing one good or service to purchase or produce another (p. 15)</td>
<td>renunciar a un producto o servicio para comprar o producir otro (p. 15)</td>
</tr>
<tr>
<td><strong>traditional economy</strong></td>
<td><strong>economía tradicional</strong></td>
</tr>
<tr>
<td>system in which economic decisions are based on customs and beliefs that have been handed down from generation to generation (p. 36)</td>
<td>sistema en que las decisiones económicas se basan en las costumbres y creencias que se han pasado de generación en generación (p. 36)</td>
</tr>
<tr>
<td><strong>transfer payments</strong></td>
<td><strong>transferencias</strong></td>
</tr>
<tr>
<td>welfare and other supplementary payments that a state or the federal government makes to individuals (p. 340)</td>
<td>pagos de asistencia social y otros pagos suplementarios que el gobierno estatal o federal le hace a individuos (p. 340)</td>
</tr>
<tr>
<td><em>transform</em></td>
<td><em>transformar</em></td>
</tr>
<tr>
<td>change (p. 519)</td>
<td>cambiar (p. 519)</td>
</tr>
<tr>
<td><em>transmit</em></td>
<td><em>transmitir</em></td>
</tr>
<tr>
<td>broadcast (p. 519)</td>
<td>emitir (p. 519)</td>
</tr>
<tr>
<td><em>transport</em></td>
<td><em>transportar</em></td>
</tr>
<tr>
<td>move; transfer (p. 370)</td>
<td>mover; transferir (p. 370)</td>
</tr>
<tr>
<td><strong>Treasury bills</strong></td>
<td><strong>letras del Tesoro</strong></td>
</tr>
<tr>
<td>certificates issued by the U.S. Treasury in exchange for a minimum amount of $1,000 and maturing in a few days up to 26 weeks (p. 149)</td>
<td>certificados emitidos por el Tesoro de los EE.UU. que requieren una inversión mínima de $1,000 y se vencen entre varios días y 26 semanas después (p. 149)</td>
</tr>
<tr>
<td><strong>Treasury bonds</strong></td>
<td><strong>bonos del Tesoro</strong></td>
</tr>
<tr>
<td>certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 30 years (p. 149)</td>
<td>certificados emitidos por el Tesoro de los EE.UU. a cambio de inversiones mínimas de $1,000 con fechas de vencimiento de 30 años en el futuro (p. 149)</td>
</tr>
<tr>
<td><strong>Treasury notes</strong></td>
<td><strong>pagarés del Tesoro</strong></td>
</tr>
<tr>
<td>certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 2 to 10 years (p. 149)</td>
<td>certificados emitidos por el Tesoro de los EE.UU. a cambio de inversiones mínimas de $1,000 con fechas de vencimiento de 2 a 10 años después (p. 149)</td>
</tr>
</tbody>
</table>
**trough** • **vary**

<table>
<thead>
<tr>
<th>ENGLISH</th>
<th>ESPAÑOL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>trough</strong>: lowest part of the business cycle in which the downward spiral of the economy levels off (p. 352)</td>
<td><strong>punto bajo</strong>: parte del ciclo económico en que la actividad económica en disminución se nivela; también se llama depresión (p. 352)</td>
</tr>
</tbody>
</table>

| **undergo**: go through (p. 264) | ***experimentar**: pasar por (p. 264) |
| **underground economy**: transactions by people who do not follow federal and state laws with respect to reporting earnings (p. 443) | **economía sumergida**: transacciones hechas por personas que no obedecen las leyes federales y estatales que requieren que se de parte al gobierno sobre los ingresos (p. 443) |
| **unemployment rate**: percentage of the civilian labor force that is unemployed but is actively looking for work (p. 442) | **índice de desempleo**: porcentaje de la fuerza laboral civil que no tiene empleo pero está buscando trabajo (p. 442) |
| **union**: see labor union | **sindicato**: véase labor union/sindicato de obreros |
| **union shop**: company that requires new employees to join a union after a specific period of time (p. 318) | **fábrica sindical**: compañía que obliga a nuevos empleados a hacerse miembros del sindicato después de un período de tiempo determinado (p. 318) |
| **unique**: only one of its kind (p. 234) | ***único**: que no hay otro de su tipo (p. 234) |
| **unit of accounting**: use of money as a yardstick for comparing the values of goods and services in relation to one another (p. 369) | **unidad de contabilidad**: uso del dinero como medida del valor de distintos bienes y servicios que se puede usar de criterio para compararlos (p. 369) |
| **unlimited liability**: requirement that an owner is personally and fully responsible for all losses and debts of a business (p. 214) | **responsabilidad sin límite**: requisito que hace a un dueño total y personalmente responsable de todas las pérdidas y deudas de su negocio (p. 214) |
| **unsecured loan**: loan guaranteed only by a promise to repay it (p. 101) | **préstamo no garantizado**: préstamo hecho sin obtener una garantía, sólo la promesa de devolver el dinero (p. 101) |
| **unskilled workers**: people whose jobs require no specialized training (p. 310) | **trabajadores no calificados**: personas cuyos trabajos no requieren preparación especial (p. 310) |
| **usury law**: law restricting the amount of interest that can be charged for credit (p. 105) | **ley contra la usura**: ley que limita la cantidad de interés que se puede cobrar por el crédito (p. 105) |
| **utility**: the ability of any good or service to satisfy consumer wants (p. 174) | **utilidad**: capacidad de un producto o servicio de satisfacer los deseos de los consumidores (p. 174) |
| **utilize**: to make use of (p. 6) | **utilizar**: hacer uso de (p. 6) |
| **valid**: legitimate (p. 299) | ***válido**: legítimo (p. 299) |
| **vary**: differ (p. 376) | ***variar**: ser diferente (p. 376) |
**visible • World Trade Organization (WTO)**

<table>
<thead>
<tr>
<th>ENGLISH</th>
<th>ESPAÑOL</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>visible</strong>: able to be seen (p. 219)</td>
<td><strong>visible</strong>: que se puede ver (p. 219)</td>
</tr>
<tr>
<td><strong>visible</strong>: that can be seen (p. 178)</td>
<td><strong>visual</strong>: que tiene que ver con lo que se puede ver (p. 178)</td>
</tr>
<tr>
<td>voluntary exchange: a transaction in which a buyer and a seller exercise their economic freedom by working out their own terms of exchange (p. 171)</td>
<td>intercambio voluntario: transacción en que el comprador y el vendedor ejercen su libertad económica al llegar a un acuerdo sobre las condiciones del intercambio (p. 171)</td>
</tr>
<tr>
<td>warranty: promise made by a manufacturer or a seller to repair or replace a product within a certain time period if it is found to be faulty (p. 74)</td>
<td>garantía: promesa de un fabricante o vendedor de reparar o reemplazar un producto defectuoso dentro de un plazo de tiempo determinado (p. 74)</td>
</tr>
<tr>
<td>welfare: same as public-assistance programs (p. 421)</td>
<td>bienestar social: lo mismo que public-assistance programs/programas de asistencia pública (p. 421)</td>
</tr>
<tr>
<td>white-collar workers: category of workers employed in offices, sales, or professional positions (p. 309)</td>
<td>empleados en trabajos no manuales: categoría de trabajadores empleados en oficinas, ventas o puestos profesionales (p. 309)</td>
</tr>
<tr>
<td>wholesalers: businesses that purchase large quantities of goods from producers for resale to other businesses (p. 297)</td>
<td>mayoristas: negocios que compran grandes cantidades de bienes de los fabricantes para vendérselas a otros negocios (p. 297)</td>
</tr>
<tr>
<td>workers’ compensation: government program that extends payments for medical care to workers injured on the job (p. 421)</td>
<td>compensación a trabajadores accidentados: programas gubernamentales que hacen pagos para asistencia médica a trabajadores que se lesionan en el trabajo (p. 421)</td>
</tr>
<tr>
<td>World Trade Organization (WTO): world’s largest trade agreement currently with more than 140 nations (p. 480)</td>
<td>Organización Mundial del Comercio: acuerdo comercial más extenso del mundo, actualmente entre más que 140 naciones (p. 480)</td>
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Graphic elements for unit and chapter openers and People & Perspectives pages, icon images for section openers, figure and summary numbers, Case Studies, Global Economy, Careers, Technology Activity and Skills features, and icons for Critical Thinking, Technology, and Study & Writing Skills: PhotoDisc, Inc.

Type design element for Study & Writing Skills pages: Tony Cordoa/Photonica.

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